THE INSTITUTE OF CHARTERED ACCOUNTANTS
OF NIGERIA

PATHFINDER

MAY 2015 SKILLS LEVEL EXAMINATIONS

Question Papers

Suggested Solutions

Plus

Examiners' Reports

FOREWORD

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

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

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

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

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

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

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

NOTES

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

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THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATIONS - MAY 2015

FINANCIAL REPORTING

Time Allowed: 3 hours

ATTEMPT FIVE QUESTIONS IN ALL

SECTION A: COMPULSORY QUESTION (30 Marks)

QUESTION 1

UNITARISATON PLC

Unitarisation Plc is a successful Nigerian Company which recently amended its objects clause in the Memorandum of Association to include "programmes and activities that will promote National unity and encourage anti-terrorism compliance" as part of its social responsibilities. The company, therefore, acquired 60% of the equity share capital of Famous Plc a widely known and successful advertising company to propagate this mission.

The summarised draft financial statements of the two companies are as follows:

Statement of Profit or Loss and Other Comprehensive Income for the year ended 31 October, 2014.

	Unitarisation Plc.	Famous Plc.
	₦'m	₦'m
Revenue	51,000	25,200
Cost of sales	(37,800)	(19,200)
Gross profit	13,200	6,000
Distribution costs	(1,200)	(1,200)
Administrative expenses	(3,600)	(1,920)
Finance costs	(180)	(240)
Profit before tax	8,220	2,640
Income tax Expense	(2,820)	(840)
Profit for the year	5,400	1,800

Statement of Financial Position as at 31 October, 2014

	Unitarisation Plc.	Famous Plc.
Assets:	₦'m	₦'m
Non-current assets:		
Property, plant & equipment	24,360	7,560
Current assets	9,600	3,960
Total assets	33,960	11,520
Equity & Liabilities:		
Equity shares of ₦1 each	6,000	2,400
Retained earnings	21,240	3,900
	27,240	6,300
Non-current liabilities:		
12% loan notes	1,800	2,400
Current liabilities	4,920	2,820
Total equity & liabilities	33,960	11,520

Relevant additional information are presented below:

(i) The shares of Famous Plc. was acquired on 1 May, 2014 and the issue of shares was not recorded by Unitarisation Plc.

(ii) There is cash in transit of ₦120,000,000 due from Unitarisation Plc. to Famous Plc. arising from intra-group trading.

(iii) The non-controlling interests are valued at full fair value by the parent company. The fair value of the non-controlling interests in Famous Plc. at the date of acquisition was ₦3,540,000,000. There is no goodwill impairment at the end of the accounting year.

(iv) The fair value of Famous Plc. assets were equal to the carrying amounts at the acquisition date except for one equipment with a fair-value of ₦1,200,000,000 over its carrying amount which has a five-year remaining life. Straight line depreciation is adopted. Famous Plc. has not effected the adjustment in the records.

(v) The 60% of share capital of Famous Plc. acquired was settled through share exchange of two shares in Unitarisation Plc. for three shares in Famous Plc. The market value of Unitarisation Plc. at the date of acquisition was ₦6 per share.

(vi) In the post-acquisition period, Unitarisation Plc. bought goods from Famous Plc. amounting to ₦4,800,000,000. Famous Plc. had made a mark-up on cost of 40% on the transaction. As at the year end, Unitarisation Plc. had sold part of these goods worth ₦3,120,000,000.

(vii) Famous Plc's trade receivables at 31 October, 2014 include ₦360,000,000 due from Unitarisation Plc. However, the amount did not agree with the corresponding balance in Unitarisation Plc's trade payable ledger.

(viii) Assume that profits or losses accrue evenly over the period except otherwise stated.

Required:

a. Prepare Unitarisation Plc. Consolidated Profit or Loss and Other Comprehensive Income for the year ended 31 October, 2014. (10 Marks)

b. Unitarisation Plc. Consolidated Statement of Financial Position as at 31 October, 2014. (10 Marks)

c. Consolidated Statement of Changes in Equity for the year ended 31 October, 2014. (6 Marks)

d. In accordance with IFRS 3 on Business Combinations, what is Gain On Bargain Purchase? (4 Marks)

(Total 30 Marks)

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

QUESTION 2

a. When a parent Company elects not to prepare consolidated financial statements and instead prepares separate financial statements; what are the disclosure requirements stipulated in IAS 27 on Separate Financial Statements? (6 Marks)

b. Kerewanta Plc. acquired 60% of the equity shares of Orijinmi Plc. by means of share exchange of three shares in Kerewanta Plc. for four shares in Orijinmi Plc. The market value of the shares of Kerewanta Plc. at the date of acquisition which is 1 April, 2013 was ₦10 per share.

Kerewanta Plc. would make a deferred cash payment of 70k per acquired share on 1 April, 2014. Kerewanta Plc. cost of capital is 12% per annum. None of the consideration has been recorded in the books of Kerewanta Plc. The following information was extracted from the financial statements of the two companies as at 31 March, 2014.

	Kerewanta Plc.	Orijinmi Plc.
	₦'m	₦'m
Equity shares of ₦1 each	60,000	20,000
Share premium	15,000	NIL
Retained earnings 1 April, 2013	20,500	11,600
Retained earnings for the year ended 31 March, 2014	9,800	6,700
Property, plant and equipment	50,400	22,900

The following is the additional relevant information:

(i) An equipment had a fair value of ₦360,000,000 above its carrying amount. At the date of acquisition of Orijinmi Plc. the asset had a remaining life of four years. It is the group's policy to depreciate such asset using the straight line method.

(ii) Orijinmi Plc. had deferred tax liability of ₦10,000,000 as at 31 March, 2014 which had not been recorded. The company's goodwill is not impaired.

(iii) Non-controlling interests are to be valued at fair value at the date of acquisition of Orijinmi Plc. The fair value of the shares of Orijinmi Plc. held by non-controlling interests at the date of acquisition is ₦6 per share.

Required:

Calculate the following as at 31 March, 2014:

i. Equity

ii. Non-controlling interests

iii. Consolidated goodwill

iv. Property, plant and equipment (14 Marks)

(Total 20 Marks)

QUESTION 3

Galadanci Plc. is a telecommunications company operating in Nigeria. The management of the company presented the following summarised financial statements for the years ended 31 December, 2013 and 2014.

Statements of Profit or Loss and Other Comprehensive Income for the year ended:

	2014	2013
	₦'billion	₦'billion
Revenue	2,430	1,638
Cost of sales	(1,701)	(983)
Gross profit	729	655
Administrative costs	(311)	(180)
Distribution costs	(207)	(117)
Finance costs	(36)	(6)
Profit before taxation	175	352
Income tax expense	(54)	(102)
Profit for the year	121	250

Statements of financial position as at 31 December:

	2014		2013	
	₦'billion	₦'billion	₦'billion	₦'billion
Assets:				
Non-current assets:				
Property, plant & equipment		612		369
Intangible assets		270		180
Investment in shares of Papanga Plc. at cost		207		Nil
		1,089		549
Current assets:				
Inventory	120		100	
Trade receivables	150		70	
Other receivables	Nil	270	110	280
Total assets		1,359		829
Equity & liabilities:				
Equity shares of ₦1 each		390		225
Retained earnings		340		270
		730		495

Non-current liabilities:				
10% secured loan notes	80		80	
12% secured loan notes	260	340	Nil	80
Current liabilities:				
Bank short term loan	49		10	
Trade payables	190		140	
Income tax payable	50	289	104	254
Total equity & liabilities		1,359		829

The following additional information is relevant for the year ended 31 December, 2014:

(i) Galadanci Plc. acquired 60% interests in the equity shares of Papanga Plc. which is into commercial rice production in order to diversify its business portfolio and take advantage of the favourable incentives in agriculture recently announced by the Federal Government of Nigeria.

(ii) Galadanci Plc. increased its mobile telephone subscriber based and average revenue per user.

(iii) No dividends were received from Papanga Plc. and the value of its shares had not increased during the year ended 31 December, 2014.

Required:

a. Calculate the following ratios and use them to analyse Galadanci Plc's operating performance during the year ended 31 December, 2014 and comment on any relevant qualitative factors that may impact on the company's performance.

   i. Gross profit percentage
   ii. Return on capital employed (where capital employed = Total Asset less current liabilities)
   iii. Net profit (PBIT) percentage
   iv. Asset turnover
   v. Gearing ratio
   vi. Debt/Equity ratio (16 Marks)

b. Prepare Galadanci Plc's Cash Flows from operating activities using the indirect method in accordance with 1AS 7 on Statement of Cash Flows. (4 Marks)

(Total 20 Marks)

QUESTION 4

a. The following information is extracted from the financial statements of Kubua Plc. for the year ended 30 September, 2014.

	₦'000
Ordinary Share Capital (fully paid at 1.25 kobo each)	20,000
Operating profit before tax	4,000

Other relevant information:

(i) The companies income tax rate is 30%

(ii) The average fair value of one ordinary share during the year was ₦5.00.

(iii) During the year, the company issued share options of 2.5million ordinary shares to existing shareholders at an exercise price of ₦4.00.

Required:

Calculate the basic and diluted Earnings Per Share for the year ended 30 September, 2014. Show all workings (5 Marks)

b. Extract from the Statements of Profit or Loss and Other Comprehensive Income of Bajulaye Plc. for the years ended:

	30/09/2014	30/09/2013
	₦'000	₦'000
Revenue	5,000	2,800
Profit Before Interest and Taxes (PBIT)	2,500	1,200

Extract from the Statements of Financial Position as at

	30/9/2014	30/9/2013
Issued Share Capital:	₦'000	₦'000
Ordinary Shares at 50k each	3,000	3,000
12% Redeemable Preference Shares	1,500	1,500
Total Equity	4,500	4,500

Other relevant information:

- On 1 January, 2013 the entity issued convertible loan notes of ₦2,000,000 with effective interest rate of 10% per annum.
- The loan notes are convertible at nominal values of ₦100 each into the following number of ordinary shares:

30 September, 2018	130 shares
30 September, 2019	125 shares
30 September, 2020	114 shares
30 September, 2021	105 shares

- Companies Income tax rate is 30%.

Required:

i. Calculate the basic and diluted Earnings Per Share for the year ended 30 September, 2014. (8 Marks)

ii. Write a short memo to the Board of Directors of Bajulaiye Plc. explaining FOUR advantages and THREE limitations of Earnings Per Share as a performance indicator to users of financial statements. (7 Marks)

(Total 20 Marks)

SECTION C: ATTEMPT TWO QUESTIONS IN THIS SECTION (30 Marks)

QUESTION 5

IAS 38 - Intangible Assets, specifies the criteria that must be met before an intangible asset can be recognised by an entity in its Financial Statements. Intangible assets are identifiable non-monetary assets without physical substance and include goodwill, brands, copyright and research and development expenditure. They could be purchased and/or internally generated.

Required:

a. Identify any TWO characteristics of goodwill which distinguish it from other intangible assets? (2 Marks)

b. Explain THREE differences between purchased goodwill and non-purchased goodwill. (3 Marks)

c. Identify any THREE conditions that must be met under IAS 38 for development expenditure to be recognised as an intangible asset. (3 Marks)

d. State any FOUR factors to be considered when determining the useful life of an intangible asset. (4 Marks)

e. Calculate the goodwill on consolidation from the information below:

	₦'000
Parent's cost of investment in subsidiary	299,700
Net asset at acquisition date (parent)	986,600
Net asset at acquisition date (subsidiary)	345,800
Fair value of non-controlling interest at acquisition date	169,500
Net asset at reporting date (subsidiary)	316,400
Impairment of goodwill	62,200

Parent has 80% interests in subsidiary (3 Marks)

(Total 15 Marks)

QUESTION 6

a. IAS 28 - Investments in Associates and Joint Ventures permits, the application of equity method when accounting for investments in associates and joint ventures.

Required:

Explain briefly the Equity Method and state the circumstances under which an entity can discontinue the use of equity method under IAS 28. (5 Marks)

b. Agbantara Plc. acquired equity shares from Odinma Plc. and Dangari Limited. The following are the Statements of Profit or Loss and Other Comprehensive Income for the year ended 31 December, 2014 for the three companies:

	Agbantara Plc.	Odinma Plc.	Dangari Ltd
	₦'m	₦'m	₦'m
Revenue	4,500	1,350	630
Cost of sales	(2,430)	(720)	(270)
Gross profit	2,070	630	360
Admin expenses	(1,350)	(180)	(135)
Finance income	135	90	-
Finance costs	(180)	-	(90)
Profit before tax	675	540	135
Income tax expenses	(225)	(135)	(45)
Profit for the year	450	405	90

Other comprehensive income:			
Gains on property revaluation, net of tax	180	90	45
Total comprehensive income for the year	630	495	135

The following information is also relevant:

(i) Agbantara Plc. acquired 72 million ordinary shares in Odinma Plc. out of its 120,000,000 ordinary shares of ₦1 each par value for ₦160,000,000. The shares were acquired four years ago when it had ₦15,000,000 credit balance on its retained earnings. During the year, Odinma Plc. sold goods costing ₦38,000,000 to Agbantara Plc. for ₦45,000,000. These goods were yet to be sold as at 31 December, 2014.

(ii) Agbantara Plc. acquired 35,000,000 ordinary shares in Dangari Limited out of 100,000,000 ordinary shares. The shares were acquired three years ago when the company had a credit balance on its retained earnings of ₦10,000,000.

(iii) Agbantara Plc's group policy is to measure non-controlling interests (NCI) at fair value. NCI at acquisition date in Odinma Plc. at fair value was ₦48,000,000. Impairment test carried out on the goodwill relating to Odinma Plc. and investment in Dangari Limited at year end resulted in ₦10,000,000 and ₦15,000,000 losses respectively.

You are required to:

Prepare Agbantara Plc. Consolidated Statement of Profit or Loss and Other Comprehensive Income for the year ended 31 December, 2014.

(10 Marks)
(Total 15 Marks)

QUESTION 7

a. There is usually a lead time between the end of an entity's accounting year and when the financial statements are approved and signed off by the directors. In between this period, there are two types of events according to IAS 10-Events After The Reporting Period, which may require consideration when preparing financial statements.

You are required to:

Identify and explain these events and state how they are treated in the financial statements. (4 Marks)

b. Company A is indebted to company B to the tune of ₦50,000,000. The financial year-end of company B is 30 June, 2014. On 30 July 2014, company B received a letter from a liquidator advising it that company A has gone into insolvency. The letter revealed that company A ceased operations a month ago and that company B is only likely to receive a liquidation dividend of 20k for every naira owed by company A. It is the normal practice of company B's board to approve the audited financial statements three months after the financial year end.

Required:

i. Explain how the above transactions should be treated in the financial statements of company B in accordance with IAS 10-Events After The Reporting Period. (2 Marks)

ii. Prepare journal entries that are required to adjust company B's financial statements to account for the above event. (2 Marks)

iii. State what would have been the treatment in the financial statements assuming it was fire that destroyed company B's factory building on 30 July, 2014. (3 Marks)

c. The directors of XYZ Plc declared that a dividend of ₦1 per ordinary share be paid to shareholders on the company's register as at 15 April, 2014. The financial statements were approved by the company's board on 30 May, 2014. The shareholders, at the company's annual general meeting held on 15 June, 2014, approved the payment of the dividend to eligible shareholders on 1 July, 2014.

Required:

Explain how the dividend proposed by the Directors should be treated in the financial statements of XYZ Plc in accordance with IAS 10. (4 Marks)

(Total 15 Marks)

SECTION A

SOLUTION 1

(a)

UNITARISATION PLC.
CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 OCTOBER, 2014

	₦'m
Revenue (51,000 + (25,200 x $\frac{6}{12}$) – 4,800 (Wk 3)	58,800
	4,800
Cost of sales (Wk 2)	(43,200)
Gross profit	15,600
Distribution costs (1,200 + (1,200 x $\frac{6}{12}$)	(1,800)
Admin. Costs (3,600 + (1,920 x $\frac{6}{12}$)	(4,560)
Finance costs (180 +(240 x $\frac{6}{12}$)	(300)
Profit before tax	8,940
Income tax (2,820 + (840 x $\frac{6}{12}$)	(3,240)
Profit for the year	5,700
Other comprehensive income	Nil
Total comprehensive income	5,700
Profit attributable to:	
Owners of the parent	5,580
Non-controlling interest (wk 1)	120
	5,700

Workings:

	₦'m
Wk 1 Non-controlling interests:	
Statement of profit or loss	
Post acquisition profit (Famous) (1,800 x $\frac{6}{12}$)	900
Unrealised profit	(480)
Fair value adjustment movement	(120)
	300
NCI post acquisition share (40% x 300)	120

Wk 2 Cost of sales

	₦'m
Unitarisation Plc	37,800
Famous Plc ($19{,}200 \times \frac{6}{12}$)	9,600
Movement of fair value adjustment (Wk 1)	120
Intragroup purchases (Wk 3)	(4,800)
Unrealised profit (Wk 3)	480
	43,200

Wk 3 Intragroup Trading:

	DR	CR
	₦'m	₦'m
Revenue	4,800	
Purchases		4,800
Being removal of intragroup sales and purchases		
Retained earnings/cost of sales (4,800 – 3,120) x 40/140	480	
Inventories		480
Being elimination of unrealised profit		

(b)

UNITARISATION PLC.

CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 OCTOBER, 2014

	₦'m
ASSETS	
Non-current assets	
Property, plant & equipment (24,360 + 7,560 + 1,080) (Wk 5)	33,000
Goodwill (Wk 3)	2,700
	35,700
Current assets (Wk 8)	12,840
	48,540
EQUITY AND LIABILITIES	
Equity attributable to owners of parent company:	
Share capital (6,000 + 960) (wk 6)	6,960
Share premium (Wk 6)	4,800
Retained earnings (Wk 2)	21,420
Shareholders fund	33,180
Non-controlling interest (Wk 4)	3,660
	36,840
Non-current liabilities	

12% loan notes (1,800 + 2,400)	4,200
Current liabilities	
(4,920 + 2,820 – 240) (Wk 7)	7,500
	48,540

Workings

Wk 1 Group structure

Unitarisation Plc.

↓ 60% (1/5/2015)

Famous Plc

The subsidiary was acquired during the year (middle of the accounting Year)

Wk 2 Retained earnings:

	Unitarisation Plc.	Famous Plc.
	₦'m	₦'m
As in the question	21,240	3,900
Fair value adjustment movement (Wk 5)		(120)
Unrealised profit (Wk 3)		(480)
Pre-acquisition profit		(3,000)
Retained earnings of subsidiary		300
Group share of subsidiary (60% x 300)	180	
Consolidated retained earnings	21,420	

Wk 3 Goodwill:

	₦'m	₦'m
Consideration transferred		5,760
Fair value of non-controlling interest		3,540
Less: Net asset fair value at acquisition:		
Share capital	2,400	
Retained earnings	3,000	
Fair value adjustment	1,200	(6,600)
Goodwill		2,700

Wk 4 Statement of Financial Position:

	₦'m
NCI at acquisition	3,540
Share of post acquisition retained earnings (40% x 300)	120
	3,660

Wk 5 Fair Value Adjustments:

	Acquisition 1/5/14 ₦'m	Movement (6/12) ₦'m	Year end 31/10/14 ₦'m
Movement in equipment $\left(\frac{1,200}{5} x \frac{6}{12}\right)$	1,200	(120)	1,080

Wk 6 Share exchange:

	DR ₦'m	CR ₦'m
No of share issued (2,400 x 60% x 2/3) = 960		
Consideration transferred (960 x ₦6)	5,760	
Unitarisation share capital (960 x ₦1)		960
Unitarisation share premium (960 x ₦5)		4,800

Wk 7 Cash in transit:

	DR ₦'m	CR ₦'m
Receivables		360
Payables	240	
Group cash	120	

Wk 8 Current asset:

	₦'m
Unitarisation Plc.	9,600
Famous Plc.	3,960
Unrealised profit	(480)
Intercompany receivables (State in the question)	(360)
Cash in transit (WK 8)	120
	2,840

c)

UNITARISATION PLC.
CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 OCTOBER, 2014

	Share Capital	Share Premium	Retained Earnings	Equity Unitarisation	NCI	Total Equity
	₦'m	₦'m	₦'m	₦'m	₦'m	₦'m
As at 1 November, 2013	6,000		15,840	21,840		21,840
Profit for the year			5,580	5,580	120	5,700
Other comprehensive income:						
Transactions with owner's equity:						
Addition paid-in capital	960	4,800		5,760		5,760
Addition on acquisition of Famous Plc.					3,540	3,540
As at 31 October, 2014	6,960	4,800	21,420	33,180	3,660	36,840

d) Gain on Bargain purchase arises when the aggregate of the consideration transferred (which is usually measured at fair value), the non-controlling interest and the fair value of the previously held equity interest is less than the acquisition date amount of the identifiable assets acquired and the liabilities assumed.

EXAMINER'S REPORT

The question tests candidates' knowledge of Preparation of Consolidated Statement of Profit or Loss and other Comprehensive Income Statement of Financial Position, Statement of Changes in Equity and explanation of Gain on Bargain Purchase.

About 98% of the candidates attempted the question and performance was below average.

Most of the candidates could not correctly explain the Gain on Bargain Purchase in accordance with IFRS 3 on Business Combination, while candidates who were unable to correctly prepare the consolidated final accounts properly lost some marks, because ₦'m symbol in their solutions. (For example recording ₦5m as ₦51,000). Also majority of the candidates could not correctly prepare Statement of Changes in Equity.

Candidates are advised to note that future Chartered Accountants should pay special attention to denominations and should correctly reflect this in their solution to questions.

Similarly, they should pay attention to relevant International Financial Reporting Standards (IFRS) that affect preparation of consolidated and separate financial statement for better performance in future examinations of the Institute.

SOLUTION 2

a)

DISCLOSURE REQUIREMENTS STIPULATED IN IAS 27 WHERE A COMPANY ELECTS NOT TO PREPARE CONSOLIDATED FINANCIAL STATEMENTS

When a parent company elects not to prepare consolidated financial statements and instead prepares separate financial statements, IAS 27 on Consolidated and Separate Financial Statements states that it shall disclose in those separate financials.

(i) The fact that financial statements are separate financial statements.

(ii) A list of significant investment in subsidiaries, joint venture and associates including:

- The name of those investees
- The principal place of business (and country of incorporation, if different) of those investees
- Its proportion of ownership interest (and its proportion of the voting rights, if different) held in those investees.

(iii) A description of the method used to account for the investment listed under (ii).

b)

(i) Equity as at 31 March, 2014

	₦'m
Share capital of Kerewanta Plc.	69,000
Share premium	96,000
Retained earnings (Wk 1)	33,360
	198,360

(ii) Non-controlling interests as at 31 March, 2014

	₦'m
Added on acquisition at 1 April, 2013	48,000
40% post acquisition on profit (40% x ₦6,700)	2,680
Deferred tax expenses (₦10million x 40%)	(4)
Additional depreciation (1/4 year x ₦360 x 40%)	(36)
	50,640

(iii) Consolidated Goodwill as at 31 March, 2014

Purchase consideration of Kerewanta Plc.		₦'m
Share consideration		90,000
Deferred consideration		7,500
		97,500
Non- controlling interest		48,000
Cost of business combination		145,500
Fair value of identifiable net asset at 1 April, 2013		
	₦'m	
Share capital	20,000	
Pre-acquisition reserves	11,600	
Fair value adjustments	360	(31,976)
Full goodwill		113,540

(iv) Property, plant and equipment as at 31 March, 2014

	₦'m
Kerewanta Plc.	50,400
Orijinmi Plc.	22,900
Fair value Adjustment	360
Less: Additional depreciation (1/4 years x ₦360million)	(90)
	73,570

Workings:

Wk 1 Retained earnings as at 31 March, 2014

	₦'m
Kerewanta Plc. retained earnings (₦20,500 + ₦9,800)	30,300
60% post-acquisition profit (60% x ₦6,700)	4,020
Finance cost (12% x ₦7,500million)	(900)
Deferred tax expense (₦10million x 60%)	(6)
Additional depreciation (1/4 years x ₦360million x 60%)	(54)
	33,360

EXAMINER'S REPORT

The question tests the disclosure requirement necessary for the computation of items in the Consolidated Statement of Financial Position, such as equity, property, plant and equipment.

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

The commonest pitfalls observed include the following:

- Inadequate knowledge of the disclosure requirement required for calculating some of the basic Consolidated Statement of Financial Position (CSFP) items highlighted above.
- Failure to show necessary workings as to how the figures were arrived at.
- Omission of ₦'m configuration in their solution thus, reducing the figures that are expected in million naira to thousand naira.
- Failure to recognize deferred tax liability in their solution as required by the examiner.
- It is apparent that most candidates lack the requisite knowledge of IFRS, hence they could not correctly calculate the relevant items of SFP as required by the examiner.

They are therefore advised to pay more attention to this section of the syllabus as it could feature regularly at this level of the Institute's examinations.

SOLUTION 3

(a)

	Ratio Analysis	2014	2013
(i)	Gross profit %		
	$\frac{Gross profit}{Revenue / sales} x100\%$	$\frac{729}{2,430} x100\%$	$\frac{655}{1,638} x100\%$
		= <u>30%</u>	= <u>39.98%</u> <u>(40%)</u>
(ii)	Return on capital employed (ROCE)	$\frac{175+36}{1,359-289} x100\%$	$\frac{352+6}{829-254} x100\%$
	[illegible] / [illegible] 100%	$= \frac{211}{1,070} x100\%$	$= \frac{358}{575} x100\%$
		=19.72%	= 62.26%
		=<u>20%</u>	= <u>62%</u>

		2014	2013
(iii)	Net profit (PBIT) percentage $\frac{PBIT}{\text{Reveue / sales}} x100\%$	$= \frac{211}{2,430} x100\%$ =8.68% = 9%	$= \frac{358}{1,638} x100\%$ =21.86% = 22
(iv)	Asset Turnover $\frac{\text{[illegible] ([illegible])}}{\text{[illegible]}}$	$\frac{2,430}{1,359}$ = 1.79 times	$\frac{1,638}{829}$ = 1.98 times
(v)	Gearing Ratio $= \frac{Debt}{Debt + Equity} x100\%$	$\frac{80+260}{730+340} x100\%$ $\frac{340}{1,070} x100\%$ =31.78% =32%	$\frac{80}{495+80} x100\%$ $\frac{80}{575} x100\%$ =13.91% = 14%
(vi)	Debit/Equity Ratio $\frac{Debit}{Equity} x100\%$	$= \frac{389}{730} x100\%$ =53.29%	$\frac{90}{495} x100\%$ =18.18%

ii. ANALYSIS OF OPERATING PERFORMANCE OF GALADANCI

- There is increase in revenue from ₦1,638bn to ₦2,430bn (2014) with a rising cost of sales from ₦983bn (2013) to ₦1,701bn (2014) which leads to decrease in gross profit % from 40% to 30%.
- Profit before interest and tax dropped from ₦358bn to ₦211bn, while capital employed increased from ₦575bn to ₦1,070bn as a result of the increase in the level of production and non-current asset to meet the level of increase in demand.
- The capital expended on non-current asset is long-term in nature and can only be recouped on a spread over a number of years, hence the reduction in Net Profit percentage of 22% (2013) to 9% (2014). Therefore, it will take some time for the profit to rise synergistically.
- The immediate effect of the increase in non-current asset also led to the decrease in asset turnover of 1.98 times (2013) to 1.79 times (2014).
- The financing effect is reflected in increase in the gearing ratio from 14% (2013) to 32% (2014) as a result of the increase in the long-term debt

from ₦80bn (2013) to ₦340bn (2014) and capital employed from ₦575bn to ₦1,070bn. This is also reflected in increase in the Debt/Equity ratio from 18.18% (2013) to 53.29% (2014) which is a very high level of difference/increase.

- The company, in a bid to increase revenue, might have incurred excessive cost which is higher in proportion to the increase in the revenue generated through increase in customers' base.

- The company's investment in the subsidiary (Papanga Plc.) might have been financed by debt which has equally contributed to significant increase in finance cost and high gearing ratio, without any commensurate return from the same investment.

- Other inefficiencies that may be attributed to the company's business model and strategy.

Comment on Qualitative Analysis

(i) The measure in non-current asset and capital employed may lead to synergistic effect in the next few years because it works like the cyclical movement in the company's performance at the peak and if the level of activities are not increased by injecting more capital funds, it may lead to serious problem that may lead the company exiting the market if it gets to saturated point, because telecommunication is a dynamic and complex industry.

(ii) Investment in shares of Papanga Plc. is futuristic in terms of yielding profit because the industry is at the infant stage which will yield high level of profit in the very near future.

It could be a very good product in the investment portfolio of the company.

b)

GALADANCI PLC.
STATEMENT OF CASHFLOWS FOR
THE YEAR ENDED 31 DECEMBER, 2014 (INDIRECT METHOD)

	₦'bn	₦'bn
OPERATING ACTIVITIES:		
Profit before taxes		175
Adjustment for non-cash and non-operating items		
Depreciation of property, plant & equipment	-	
Amortisation of intangible assets	-	
Finance cost	36	36
Movement in working capital:		
Increase in inventory ₦ (120 – 100)	(20)	
Increase in trade receivables ₦(150 – 70)	(80)	
Decrease in other receivables ₦(110 – 0)	110	
Increase in trade payables ₦(190 – 140)	50	60
Cash flows from operating activities		271
Interest paid		(36)
Tax paid (Wk 1)		(108)
		127

(Wk 1) Working

	₦'bn
Tax b/f	104
Income tax expenses (P or L)	54
Less payable bal c/f	(50)
	108

EXAMINER'S REPORT

The question tests the candidates' ability to calculate financial ratios and the use of those ratios to analyse the operational performance of a company, while preparation of operating activities of cash flow using indirect method is also examined in part 'b' of the question.

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

The commonest pitfalls were the inability of candidates to calculate the financial ratios correctly and failure to give correct interpretations for ratios calculated.

Candidates are advised to pay more attention to the Interpretation of financial ratios being a financial report paper, as failure to do so may leads to loss of marks.

SOLUTION 4

a.(i) <u>Calculation of Basic Earnings Per Share (EPS)</u>

	₦'000
Operating Profit Before Tax	4,000
Taxation @ 30% of ₦4,000,000	(1,200)
Profit for the period	2,800

No. of shares = ₦20,000,000 ÷ ₦1.25k = 16,000,000 shares

$\therefore$ Basic EPS = $\dfrac{₦2{,}800{,}000}{16{,}000{,}000 \text{ shares}}$

= <u>17.5k</u>

a.(ii) <u>Calculation of Diluted EPS</u>

Diluted EPS = $\dfrac{\text{[illegible]}}{\text{[illegible]}}$ =

= 2,800,000/(16,000,000 + 278,000)

= $\dfrac{2{,}800}{16{,}278}$ = ₦0.17 kobo or <u>17 kobo</u>

Test for Dilution

Since the average market price of (₦4.50 per share) is higher than the exercise/strike price (of ₦4.00 per share), the potential shares are DILUTIVE.

Step I - Proceed on Deemed Exercise of Share Option

= ₦4 share x 2.5 million shares

= ₦10 million

Step 2 - Deemed Re-purchased own shares for delivery to the Option Holders

Shares Re-Purchased = ₦10 million ÷ ₦4.5 per share

= 2,222,222 shares

Step 3 - Potential Ordinary Shares

(i.e. The shortfall to be issue as bonus)

= (2,500,000 – 2,222,222 shares)

= 277,778 shares

≈ 278,000 shares

Step 4 - Weighted average Potential Ordinary Shares

$$= \frac{12}{12} \times 277,778 \text{ shares}$$

= 277,778 shares

≈ 278,000 shares

Average Market Price ₦(5 + 4) = ₦9 ÷ 2 = ₦4.5

b. (i) BASIC EPS

	₦'000
Profit Before Interest and Tax (PBIT)	2,500
Less: Interest on convertible loan notes:	
10% of ₦2million	(200)
PBT	2,300
Taxation @ 30%	(690)
Pref. Dividend	(180)
	1,430
No of shares	6,000

□□□ = $\frac{1,430}{6,000}$ = 24 □□□□

Diluted EPS

Earnings	1,430
Add: Interest on Convertible Loan	200
Income Tax on Conv. Loan @ 30%	(60)
	1,570

No of shares	6,000
Loan notes converted to Ordinary shares =- $\frac{2,000,000}{100}$ x 130	2,600
	8,600

[illegible] = 18 kobo

b. Date: 19 May 2015

From: Mr. XYZ

To: Chairman, Board of Directors

<u>MEMORANDUM TO BOARD OF DIRECTORS ON ADVANTAGES AND LIMITATIONS OF EARNINGS PER SHARE (EPS)</u>

The above subject matter refers.

The following are some of the advantages:

- It is a medium through which the EPS of different entities are compared.
- It can also be used to evaluate and compare the EPS of the same entity in different years. Thus, it is useful in trend analysis of an entity's EPS.
- It measures performance from the perspective of investors and potential investors.
- It points out earnings distributable to the ordinary sharesholders
- It is a measure of returns to entity holders.

<u>Limitations of EPS include the following:</u>

- Inflation is not considered
- Historical cost information from the financial statements is used, so the productive value is low.
- The choice of accounting policies affects EPS of an entity.
- Window dressing of financial statements raises earnings unnecessarily to deceive shareholders.

Yours faithfully,

Mr. XYZ
Signed

EXAMINER'S REPORT

The question tests the principles and application of IAS 33 on Earnings Per Share (EPS). Candidates are required to compute both 'basic' and 'diluted' Earnings Per Share (EPS).

About 60% of the candidates attempted the question and performance was average.

Most candidates could not correctly calculate the number of shares as well as relevant earnings particularly for the purpose of calculating diluted Earnings Per Share (EPS).

Candidates are advised to pay more attention to the provision of IAS 33 and other relevant standards for better performance in future examinations of the Institute.

SOLUTION 5

a. <u>Characteristics of Goodwill which distinguished it from other intangible assets</u>

i. It is a balancing figure: Goodwill itself is between the fair value of the whole business and the fair value of the separatable net assets of the business. It cannot be valued on its own.

ii. Goodwill cannot be disposed off as a separate asset.

iii. The factors contributing to goodwill cannot be quantified.

iv. The value of goodwill is volatile, i.e. it can only be given a numerical value at the time of acquisition of the whole business.

v. Goodwill exists in perpetuity unless impaired.

b. <u>Differences between purchased and non-purchased goodwill</u>

	Purchased	Non – purchased
i.	Arises when one business acquires another as a going concern.	It's inherent in the business.
ii.	It arises from purchase and consolidation of a subsidiary.	Has no identifiable value.

iii.	Will be recognized in the financial statements as its value at a particular point in time is certain.	It is not recognized in the financial statements.

c. Conditions for recognizing development expenditure as an intangible asset exists where the entity demonstrates the following

i. The technical feasibility of completing the intangible asset so that it will be available for use or for sales;

ii. Its intention is to complete the intangible asset and use or sell it;

iii. Its ability to use or sell the intangible assets;

iv. How the intangible asset will generate probable future economic benefits. Among other things, the entity can demonstrate the existence of a market for the output of the intangible cost or the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset;

v. The availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset;

vi. Its ability to measure reliably, the expenditure attributable to the intangible asset during its development.

d. Factors to consider in the determination of the useful life of Intangible Asset include the following

i. The expected usage of the asset by the entity and whether the asset could be managed efficiently by another management team;

ii. Typical product life cycles for the asset and public information estimates of useful lives of similar assets that are used in a similar way;

iii. Technical, technological, commercial or other types of obsolescence;

iv. The stability of the industry in which the asset operates and changes in the market demand for the products of services output from the asset and the entity's ability and intention to reach such a level;

v. The period of control over the asset and legal or similar limits on the use of the asset, such as the expiry dates of related leases;

vi. Whether the useful life of the asset is dependent on the useful life of other assets of the entity.

e. Calculation of goodwill on consolidation

	₦'000
Cost of investment in Subsidiary	299,700
Fair value of non-controlling interest	169,500
	469,200
Net Asset at acquisition date (Subsidiary)	(345,800)
Goodwill on consolidation	123,400
Impairment	(62,200)
	61,200

EXAMINER'S REPORT

The question tests the principles and application of IAS 38 on Intangible Assets. Candidates are required to differentiate between purchase and non-purchase goodwill, state the conditions required for development cost to be recognized as an intangible asset, factors that must be considered in determining the useful life of an intangible asset and characteristic of goodwill.

About 80% of the candidates attempted the question and performance was above average.

Some of the pitfall of the candidates was their lack of indept knowledge of the provisions of IAS 38.

Candidates are required to pay attention to the provisions of IFRS for better performance in future.

SOLUTION 6

a. (i) The Equity Method is a method of accounting whereby the investment is initially recognized at cost and adjusted thereafter for the post-acquisition change in the investor's share of the investee's net assets.

The investor's profit or loss includes its share of the investee's profit or loss and the investor's other comprehensive income includes its share of the investee's other comprehensive income.

(ii) Discontinuing the Use of Equity Method

An entity shall discontinue the use of Equity Method from the date when its investment ceases to be an associate or joint venture as follows:

- If the investment becomes a subsidiary, the entity shall account for its investment in accordance with IFRS 3 on Business combination and IFRS 10.
- If the retained interest in the former associate or joint venture is a financial asset, the entity shall measure the retained interest at fair value. The fair value of the retained interest shall be regarded as its fair value on initial recognition as its financial asset in accordance IFRS 9. The entity shall recognize in profit or loss any difference between:

    - The fair value of any retained interest and any proceeds from disposing of a part interest in the associate or joint venture;
    - The carrying amount of the investment at the date the equity method was discontinued.
    - When an entity discontinues the use of the equity method, the entity shall account for all amounts previously recognized in other comprehensive income in relation to that investment on the same basis as would have been recognized if the investee had directly disposed of the related assets or liabilities.

b.

AGBANTARA GROUP
CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER, 2014

		₦'million
Revenue ₦(4,500 + 1,350 - 45)		5,805.00
Cost of sales ₦(2,430 + 720) - 38 (Wk 4)		(3,112.00)
Gross profit		2,693.00
Administrative expenses ₦(1,350 + 180 + 10)		1,540.00
Operating profit		1,153.00
Finance income ₦(135 + 90)		225.00
Share of Associate Profit [(35% x ₦90) – ₦15]		16.50
Finance costs (₦180)		(180)
Profit before taxes		1,214.50
Income taxes ₦(225 + 135)		360.00
Profit for the year		854.50
Other comprehensive Income:		
Items that may not be reclassified to Profit or Loss;		
Gains on property valuation ₦(180 + 90)	270.00	
Gains on property valuation of Associate (35% x ₦45)	15.75	285.75
Total Comprehensive Income		1,140.25
Profit for the year attributable to:		
- Owners'of Agbantara Plc.		699.30
- Non Controlling Interest		155.20
		854.50
Total Comprehensive Income attributable to:		
- Owners'of Agbantara Plc.	Wk 5	949.05
- Non-Controlling Interest	Wk 5	191.20
		1,140.25

Workings:

Wk 1 - % Holding in Odinma Plc. by Agbantara Plc.

$$= \frac{\text{72 million on shares}}{\text{120 million on shares}}$$

= 60% (Subsidiary)

Wk 2 - %Holding in Dangari Ltd by Agbantara Plc.

$$= \frac{\text{35 million on shares}}{\text{100 million on shares}}$$

= 35% (Associate)

Wk 3 - Unrealised Profit on Sales of Goods

= 100% x (₦45 million – ₦38 million)

= ₦7 million

Wk 4 - Inter Company Cost of Sales

= Inter-company Revenue – Unrealised Profit

= (₦45 million – ₦7 million)

= ₦38 million

Wk 5 - Profit/Total Comprehensive Income Attributable to:

	Agbantara Plc.	NCI
	₦'million	₦'million
Agbantara Plc for the year	450.00	–
Share of Post-acquisition Profit for the Year ₦405 million in the ratio 60:40	243.00	162.00
Unrealized Profit on Inventory		
₦7 million in the ratio 60:40	(4.20)	(2.80)
Share of Dangari Profit (35% x ₦90)	31.50	–
Impairment Loss on Goodwill		
₦10 million in the ratio 60:40	(6.00)	(4.00)
Impairment loss on Investment of Dangari	(15.00)	–
	699.30	155.20
Other Comprehensive Income:		
- Gain on Revaluation – Agbantara Plc.	180.00	–
- Gain on Revaluation – Odunma Plc. ₦90 million in the ratio 60:40	54.00	36.00
- Gain on Revaluation – Dangari Ltd (35% x ₦45 million)	15.75	–
	949.05	191.20

Alternative Solution to Working 5

<u>Calculation of NCI</u>	N'm
Total comprehensive income	1,140.25
Attributable to:	
Owners of the parent (balancing figure)	949.05
Non-controlling interests	191.20
	1,140.25

Working 5

Calculation of NCI - ODINMA	₦'m
On profit for the period ₦405m x 40%	162
On gains on revaluation of property ₦405 x ₦90	36
Unrealised profit on intercompany sales ₦7 x 40%	(2.8)
Impairment of goodwill ₦10 x 40%	(4.0)
	191.2

EXAMINER'S REPORT

The question tests the provisions and application of IAS 28 on Investment in Associates. Candidates are required to explain Equity Method of Accounting for Associates and joint venture.

They are also required to prepare a Consolidated Statement of Profit or Loss and Other Comprehensive Income disclosing the treatment of Associates in the statement.

About 70% of the candidates attempted the question and performance was poor.

Although majority of the candidates were able to explain Equity Method of accounting correctly, some could not prepare Statement of Profit or Loss and Other Comprehensive Income correctly, while others that prepared it correctly were unable to disclose the transactions relating to Associates properly in the statement.

Similarly, most candidates failed to show the ₦'m sign in the solution and this led to loss of marks.

Candidates are advised to pay special attention to all relevant IFRS at this level of this Institute examination as Section C of the Financial Reporting paper is meant to test candidate's knowledge and application of International Financial Reporting Standard (IFRS).

SOLUTION 7

Events after the reporting period are those events favourable and unfavourable, that occur between the end of the reporting period and the date when the financial statements are authorized for use.

Types of events

i. Adjusting events

These are events that provide evidence of conditions that existed at the end of the reporting period.

ii. Non-Adjusting events

These are events that indicate conditions that arose after the reporting period.

Treatment of Events

i. Adjusting events - require adjustment in the financial statement.

Examples are:

- Evidence of permanent diminution of property before the year-end;
- Insolvency of a customer with balance owing at the year end;
- Amount received or paid in respect of legal or insurance.

ii. Non-Adjusting events - do not require adjustment in the financial statement.

Examples are:

- Acquisition or disposal of a subsidiary after the year-end;
- Announcement of a plan to discontinue an operation;
- Major purchase and disposal of assets.

b. (i) IAS 10 provision confirms that the receipt of information after the reporting period indicating that an asset was impaired at the end of the reporting period or that the amount of a previously recognized impairment loss for that asset needs to be adjusted. In this scenario, the bankruptcy of a customer that occurs after the reporting period usually confirms that the customer was credit – impaired at the end of the reporting period.

Hence, company should adjust its financial statements for the year ended 30 June, 2014 for the probable loss (bad debts) of ₦40 million (i.e. 80% of ₦50 million) suffered as a result of Company A insolvency as confirmed by the appointed liquidation on 30 July, 2014.

(ii) General Journal

	DR	CR
	₦'000	₦'000
Bad debt (written off)	40,000	
Trade receivable (Company A)		40,000
Being bad debt written off of ₦40 million (i.e. 80% of ₦50 million) suffered as a result of Company A insolvency as confirmed by the liquidator on 30 July, 2014		

(iii) A fire incident occurring on 30 July, 2014 is a "Non-Adjusting Event" as the event occurred subsequent to (or after) the reporting date (30 June, 2014).

The requirement of IAS 10 requires only a disclosure of the incident with respect to its occurrence (i.e. the nature), the circumstances and the financial effects, unless if it is so material that it may affect the going concern status of Company B.

c. If an entity declares dividend to equity shareholders (as defined in IAS 32 – Financial Instruments Presentation) after the reporting period, the entity shall not recognize those dividends as a liability at the end of the reporting period. If dividends are declared after the reporting period but before the financial statements are authorized for issue, the dividends are not recognized as a liability at the end of the reporting period because no obligation exists at that time. Such dividends are disclosed in the notes in accordance with IAS 1 - Presentation of Financial Statements.

EXAMINER'S REPORT

The question tests the principles and application of provisions of IAS 10 on Event After Reporting Date, IAS 37 on Provision and IAS 1 on Presentation of Financial Statement.

Only about 40% of the candidates attempted the question and performance was below average.

The common pitfalls include:

- **Difficulty in differentiating between adjusting and non-adjusting events**
- **Inability to raise current journal entries to reflect the appropriate adjusting entries.**

- Failure to realize that dividend not yet approved at the Annual General Meeting should be disclosed by way of notes and should not be recognized as liability in the Statement of Financial Position as required by IAS 37 on Provisions.

Candidates are required to be more familiar with all relevant IFRS at this level of the Institute's examinations for better performance in future examinations.

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION - MAY 2015

TAXATION

Time Allowed: 3 hours

ATTEMPT FIVE QUESTIONS IN ALL

SECTION A COMPULSORY QUESTION (30 MARKS)

QUESTION 1

You have been invited to make a presentation to the Board of Directors of BICCI Nigeria Limited.

Your performance at the presentation will determine your appointment as the Tax Consultant to the company.

BICCI Nigeria Limited, a trading company, was incorporated on 2 March 2009. It commenced business on 2 October of the same year, making accounts up to 30 September annually. The shareholders invested ₦18million in Non current assets before the company commenced business in 2009.

Other information provided are:

(i) Authorised, Issued and Fully Paid-Up Capital – ₦10million.
(ii) Value Added Tax and Withholding Tax Returns filed: 2010 – 2013, were carried out 2 months after each month of the transaction.
(iii) Companies Income Tax and Tertiary Education Tax returns were filed on 30 June for 2011 to 2014 Assessment Years.
(iv) Extracts from the accounts:

	30/9/13	30/9/12	30/9/11	30/9/10
	₦	₦	₦	₦
Revenue	25,320,000	21,522,000	13,989,000	7,964,000
Cost of revenue	(10,128,000)	(8,609,000)	(5,596,000)	(3,078,000)
Gross profit	15,192,000	12,913,000	8,393,000	4,886,000)
Depreciation	(2,675,000)	(2,006,250)	(1,504,688)	(1,125,516)
Selling & Distr. exp.	(8,250,000)	(6,600,000)	(5,610,000)	(5,329,500)
Admin exp.	(4,185,164)	(3,138,873)	(2,354,155)	(1,765,616)
Net Profit/(Loss)	81,836	1,167,877	(1,075,843)	(3,334,632)

	30/9/13	30/9/12	30/9/11	30/9/10
	₦	₦	₦	₦
Remittances				
VAT	443,100	376,650	244,800	173,100
CIT	2,430,399	1,885,488	1,210,936	143,887
TET	244,421	184,377	94,214	27,675
	3,117,920	2,446,515	1,549,950	344,662

On 15 July 2014, the tax inspectors visited the company and had a meeting with the Management. At the end of the meeting, the FIRS team informed the management of an impending tax audit which will take place in the company's premises on 25 August 2014. A list of items to be made available in August 2014, which was given to the management is as shown below:

(i) Audited Accounts: 2010 – 2013;

(ii) Bank Statements: 2010 – 2013;

(iii) Trial Balance for each year involved;

(iv) Evidence of Tax Returns filed during the years under review for Companies Income Tax/Value Added Tax/Withholding Tax/Tertiary Education Tax;

(v) General Ledger print out;

(vi) Proof of payments for (iv) above;

(vii) Evidence of registration with the relevant tax authorities;

(viii) Tax Clearance Certificate for each year; and

(ix) WHT Credit Notes, if any.

The team of Tax Inspectors visited the company on 25 and 26 August 2014 to carry out the audit.

Below are the extracts from the Interim Tax Audit Report of the FIRS:

(i)	30/09/13	30/09/12	30/09/11	30/09/10
	₦'000	₦'000	₦'000	₦'000
Revenue	25,320	21,522	13,989	7,694
VAT on revenue	8,862	7,533	4,896	3,462
Undisclosed revenue	16,458	13,989	9,093	4,232
Directors' Current Account	19,578	21,228	19,250	18,000
Payments under WHT:				
Directors' fees	1,625	2,125	1,145	960
Rent	3,500	3,500	2,625	2,625
Professional fees	1,200	1,200	950	950
Commission	2,825	1,875	970	376

(ii) Cost of sales written back - 60%
(iii) Selling and Distribution expenses written back - 60%
(iv) Admin. expenses written back - 60%

You are required to:

a. List the documents to be provided by BICCI Nigeria Limited in order to respond to Federal Inland Revenue Service (FIRS) Interim Tax Audit Report. (3 Marks)

b. Compute the possible tax liabilities of BICCI Nigeria Limited in order to respond to Federal Inland Revenue Service (FIRS) Interim Tax Audit Report. (12 Marks)

c. Prepare a schedule of Revenue's receipts collected by the company on Value Added Tax (VAT) and Withholding Tax (WHT). (7 Marks)

d. Advise the management on possible tax liabilities that may arise from non-response of BICCI Nigeria Limited to the Federal Inland Revenue Service (FIRS) Interim Tax Audit Report. (8 Marks)

(Total 30 Marks)

SECTION B: ATTEMPT ANY TWO QUESTIONS IN THIS SECTION (40 Marks)

QUESTION 2

You have been approached by Mr. Sola Abijah, a political science graduate who did his compulsory National Youth Service in a media organisation in 2009. On completion of National Youth Service in January 2010, he was offered a part-time job as a freelance writer in two international newspapers. He receives an income (net of Withholding tax) based on the articles he writes that are published by the newspapers. In March 2010, he joined a popular political party and served as the party's temporary Public Relations Officer, also on part-time income basis.

On 2 January 2012, he secured employment on full-time basis as Senior Manager, Corporate Affairs, in Jola Investment Enterprises on a salary of ₦12,000,000 per annum.

He was ignorant of the requirements for filing Tax Returns and paying tax to Government. He has been served a warning by the State Board of Internal Revenue (SBIR) to desist from non-disclosure of his other incomes, failing which, a Best of Judgement assessment may be raised on him by the tax inspector.

Mr. Abijah has approached you to provide tax advisory services in respect of his income tax compliance requirements and the likely tax liability that may be imposed on him by the SBIR.

The following additional information has been presented to you:

	Notes	2012	2011	2010
		₦	₦	₦
Emolument		8,250,000.00	-	-
Benefits-in-kind	1	3,750,000.00	-	-
Other Incomes:	2			
Part -time writing		3,875,000.00	3,293,750.00	2,140,938.00
Public relations		2,575,450.00	2,189,133.35	1,641,849.55
Other Deductions				
Withholding tax suffered at source:				
Part -time writing		193,750.00	164,687.50	107,046.90
Public relations		128,772.50	109,456.65	82,092.45
Other Deductions				
Pension contribution		660,000.00	-	-
National Housing Fund Contribution		206,250.00	-	-

In January 2012, Mr. Abijah took a Life Assurance Policy on his life with a capital sum assured of ₦5million and paid an annual premium of ₦375,000.

Note 1: Benefits-in-kind	2012	2011	2010
	₦	₦	₦
Official Car cost	2,500,000.00	-	-
Drivers allowances	1,250,000.00	-	-

Note 2: Other Incomes:			
Freelance Income (Gross)	4,068,750.00	3,458,437.50	2,247,985.00
Public Relations Income (Gross)	2,704,222.50	2,298,590.00	1,723,941.00

You are required to:

a. State the difference between employment income and part-time income. (3 Marks)

b. Explain why, when and to whom tax payers are expected to file income tax returns. (5 Marks)

c. Explain the circumstances that may arise to cause a tax authority to raise a Best of Judgment Assessment. (4 Marks)

d. Compute the tax liability on Mr. Abijah's Total income. (8 Marks)

(Total 20 Marks)

QUESTION 3

Hopeful Limited, a manufacturing company has been having declining profits and liquidity problems since 2010. The company changed its accounting year-end in 2010 from 31 May to 31 December.

The shareholders injected ₦10million into the company in January 2011, which boosted its profits in 2011 and 2012.

Even with the increase in profits in 2011 and 2012, the Managing Director was of the opinion that it is better to cut the company's losses, once and for all, by winding-up the company. However, the Finance Director disagreed and argued that since the company's performance was now improving, it should continue to operate.

The Company's Accountant has prepared the financial statements and the following are extracts:

Profits for:	₦
Year ended 31 May 2009	540,000
Year ended 31 May 2010	300,000
Seven months to 31 December 2010	645,000
Year ended 31 December 2011	1,575,000
Year ended 31 December 2012	1,876,500

The Chairman of Hopeful Limited invited you to his office on 12 June 2013, to educate him on the two concepts of change of accounting date and cessation of business as well as their tax implications.

Required:

a. Identify the steps involved in the event that HOPEFUL Limited adopts the change of accounting date. (6 Marks)

b. Compute the Assessable profits for 2011 – 2013, if the option to change accounting date is accepted, using both the old and the new dates. (7 Marks)

c. Compute the Assessable profits for the relevant years if the cessation option is accepted using the normal basis and the revised basis of assessment.

(7 Marks)

(Total 20 Marks)

QUESTION 4

The Managing Partner of Aarinola Sunkanmi & Co., a firm of Estate Surveyors and Valuers based in Lagos, has invited you to calculate the Chargeable income of each of the firm's partners after the admission of Mariam in 2014.

The information relating to the Partnership are as follows:

(a) The firm makes up its accounts up to 31 December of each year

(b) Extracts from the books of account for the year ended 31 December 2014, are listed below:

	₦
Net profit for the year	1,380,000
Depreciation	450,000
Capital Allowances for the year	366,300
Balancing Allowance	72,500
Balancing Charge	75,480
Profit on sale of fixed assets	77,500
Legal expenses for successfully defending one of the Partners for professional misconduct	14,000

(c) Other information:

(i) The THREE partners are Aarinola, Olasunkanmi and Murphiefe:

(ii) Profit sharing ratio is as follows:

Aarinola	2
Olasunkanmi	1
Murphiefe	1

(iii) Aarinola and Murphiefe received ₦15,000 each as interest on loan per annum.

(iv) Salaries paid to each partner are as follows:

Aarinola	-	₦140,000 per annum
Olasunkanmi	-	₦60,000 per annum
Murphiefe	-	₦60,000 per annum

(v) Olasunkanmi ceased to be a partner on 30 June 2014. Mariam was admitted on 1 July 2014. Mariam's salary was fixed at ₦60,000 per annum. She also received interest on Capital of ₦10,000 per annum.

(vi) Included in travelling expenses is the sum of ₦12,000 paid towards the annual vacation of Aarinola, the Principal Partner.

(vii) On Mariam's admission in July 2014, the profit sharing ratio was changed to:

Aarinola	10
Murphiefe	7
Mariam	3

Required:

a. Compute the Chargeable Income of each partner:

   i. Prior to admission of Mariam (9 Marks)

   ii. Post-admission of Mariam (9 Marks)

b. State the basis period for the existing partners. (2 Marks)

(Total 20 Marks)

SECTION C: ATTEMPT ANY TWO QUESTIONS IN THIS SECTION (30 Marks)

QUESTION 5

Covenant Construction Limited commenced business on 3 August 2011, making up accounts to 31 July annually. The schedule of assets acquired prior to commencement of the business is as shown below:

Description	₦
Tractors and Grader	7,500,000
Motor vehicles for field operations	13,500,000
Construction site -(Factory building)	11,250,000
Furniture, Fixtures and Fittings	778,250

Covenant Construction Limited won another contract and additional assets were purchased as stated below:

Date of Purchase	Description	Number of Items	Cost ₦
Nov. 2011	Plant & Machinery	3	580,000
April 2012	Motor vehicle	1	1,375,000
Aug. 2012	Building	3	1,350,000
Jan. 2013	Generator	1	450,000
June 2013	Factory extension	1	575,000
Nov. 2013	Pick-up van	2	1,050,000

At the last Board meeting, the Directors argued on what benefits will accrue to Covenant Construction Limited on Capital Expenditure incurred before and after commencement of business.

They were also interested in knowing the years that will be affected and the impact it will have on the company's Total Profit.

You have been invited by the Finance Director of the company who asked you to look into these matters. The Finance Director has asked you to specifically address the following:

Required:

a. Prepare the schedule of Capital Expenditure Allocation and identify the Qualifying Expenditure based on which Capital Allowances are claimable:
   i. Normal basis of assessment (5 Marks)
   ii. Revised basis of assessment (based on tax payer's right of election). (5 Marks)

b. Explain the treatment of Capital Expenditure acquired by Covenant Construction Limited before it commenced business on 3 August 2011. (2 Marks)

c. State the relevant tax years and corresponding basis period covered by the data above. (3 Marks)

(Total 15 Marks)

QUESTION 6

HIDDEN TREASURES Limited is an agro-allied and trading organisation which specialises in Crop and Grain production, Animal husbandry, Sale and distribution of Grains (i.e. cowpeas, guinea corn, millet, rice, beans and groundnuts).

The company has been in business for many years and it has been filing annual Income Tax returns regularly except VAT returns. On 16 March 2015, the Federal Inland Revenue Service (FIRS) served a notice of Tax Audit covering 2010 - 2014 financial years.

The management believed erroneously that since it deals in VAT exempt goods, it did not need to file VAT returns on monthly basis.

In preparation for the visit of the FIRS, the company's management invited you on 23 March 2015, to their office and gave you the following extracts from the company's Statement of Comprehensive Income and agreed Capital Allowances:

Year ended		Agric Production	Grain Distribution
		₦	₦
Year ended 30/09/2010	Loss	(770,000)	(225,000)
Year ended 30/09/2011	Profit	630,000	280,000
Year ended 30/09/2012	Loss	(600,000)	(150,000)
Year ended 30/09/2013	Profit	990,000	140,000
Year ended 30/09/2014	Profit	30,000	120,000

Agreed Capital Allowances are as follows:

Tax Year	Capital Allowance
	₦
2011	70,000
2012	65,000
2013	125,000
2014	115,750
2015	85,000

You are required to:

a. State the provisions of the VAT law with regard to rendition of returns by Vatable persons. (2 Marks)

b. Show by analysis the amount of losses carried forward under each income head shown above. (8 Marks)

c. Compute the tax liabilities for each year. (5 Marks)

(Total 15 Marks)

QUESTION 7

Chief Zeta created a Trust many years ago for the benefit of his four children, Alpha, Beta, Cepha and Delphi. A lawyer was appointed as the Trustee to his Estate.

For the year ended 30 September 2014, the Trust income amounted to ₦3,120,000. Each of the beneficiaries receives an annuity of ₦150,000 every year while the expenses incurred on the administration of the Trust was ₦57,500 per annum. The trustee is on a remuneration of 2% of the Computed Income.

Chief Zeta instructed that discretionary payments of ₦22,500, ₦17,500, ₦15,000 and ₦12,500 respectively should be made to Alpha, Beta, Cepha and Delphi respectively. In addition, nine of the ten portions of the remainder of the Computed Income should be shared equally among the four children.

Chief Zeta has requested you to supervise the administration of the above Trust.

You are requested to:

a. State the basis of assessment of Estates, Trusts or Settlements. (1 Mark)

b. Identify the persons chargeable to Income Tax under the Trust or Settlement created by Chief Zeta. (3 Marks)

c. Compute the income of the Trust. (3 Marks)

d. Determine the amount due to each beneficiary. (6 Marks)

e. Explain how the Computed Income should be apportioned and how the Income Tax burden will be shared by all the parties. (Ignore Withholding tax). (2 Marks)

(Total 15 Marks)

NIGERIAN TAX RATES

1. CAPITAL ALLOWANCES

		Initial %	Annual %
Office equipment		50	25
Motor vehicles		50	25
Office buildings		15	10
Furniture and Fittings		25	20
Industrial buildings		15	10
Non-Industrial buildings		15	10
Plant and Machinery	- Agricultural Production	95	Nil
	- Others	50	25

2. INVESTMENT ALLOWANCE 10%

3. RATES OF PERSONAL INCOME TAX

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

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

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

4. COMPANIES INCOME TAX RATE 30%

5. TERTIARY EDUCATION TAX (2% of Assessable Profit)

6. CAPITAL GAINS TAX 10%

7. VALUE ADDED TAX 5%

SUGGESTED SOLUTION ON COMPULSORY QUESTION

QUESTION 1

(a) List of documents to be provided by BICCI Nigeria Limited are as follows:

(i) Revenue and VAT on Revenue
The sales invoices indicating the actual revenue and the VAT element.

(ii) Undisclosed Revenue
The company's bank statements, bank tellers, stock records, daily revenue register, cash books, receipt booklets, Waybill register etc.

(iii) Directors' Current Account
Minutes of Board of Directors' meeting, cheque stubs, bank statements and vouchers, Sales invoices relating to purchases, Debit and Credit Notes, Assets Disposal Register.

(iv) Directors' fees
As in (iii) above

(v) Rent
Rent agreement, cheque stubs, bank statements and vouchers, Withholding Tax receipts evidencing deductions, receipts issued by the landlord.

(vi) Professional fees and Commission
Withholding Tax receipts, professional bills relating to relevant transactions, payment vouchers, bank statements.

(vii) Cost of sales
Stock records, Purchase invoices, Credit and Debit notes, Journal vouchers, bank statements, Waybills, Goods Received Notes.

(viii) Selling and Distribution expenses; and Admin expenses
All documentary evidence relating to revenue and expenditure.

(b)

BICCI NIGERIA LIMITED
COMPUTATION OF INCOME TAX LIABILITY
FOR 2011 TO 2014 YEARS OF ASSESSMENT

Assessment Year	2014	2013	2012	2011
	₦	₦	₦	₦
Net profit/(loss) per accounts	81,836	1,167,877	(1,075,843)	3,334,632
Add: Depreciation	2,675,000	2,006,250	1,504,688	1,125,516
Assessable profit	2,756,836	3,174,127	428,845	4,460,148
Deduct: Capital allowances	1,837,891	2,116,085	285,897	2,973,432
Total profit	918,945	1,058,042	142,948	1,486,716
Tax liability				
Companies Income tax @ 30% of Total profit	275,684	317,413	42,884	446,015
Tertiary Education tax @ 2% of Assessable profit	55,137	63,483	8,577	89,203

c (i) BICCI NIGERIA LIMITED
COMPUTATION OF VALUE ADDED TAX COLLECTED

Assessment Year	2014	2013	2012	2011
	₦	₦	₦	₦
Undisclosed Revenue	16,458,000	13,989,000	9,093,000	4,232,000
VAT @ 5%	822,900	699,450	454,650	211,600
Payments during the year	(445,100)	(376,650)	(244,800)	(173,100)
Net VAT payable	379,800	322,800	209,850	38,500
Add: Penalty @ 10%	37,980	32,280	20,985	3,850
Add: Interest @ 15%	56,970	48,420	31,478	5,775
Amount payable	474,750	403,500	262,313	48,125

Additional VAT payable = ₦1,188,688

c (ii) WITHHOLDING TAX COLLECTED

Assessment Years	2014	2013	2012	2011
	₦	₦	₦	₦
Directors' fees	1,625,000	2,125,000	1,145,000	960,000
Rent	3,500,000	3,500,000	2,625,000	2,625,000
	5,125,000	5,625,000	3770,000	3,585,000
WHT @10% (A)	512,500	562,500	377,000	358,500
Prof fees	1,200,000	1,200,000	950,000	950,000
Commission	2,825,000	1,875,000	970,000	376,000
	4,025,000	3,075,000	1,920,000	1,326,000
WHT@ 5% (B)	201,250	153,750	96,000	66,300
(A) + (B)	713,750	716,250	473,000	424,800
Add penalty @ 10%	71,375	71,625	47,300	42,480
Add interest 15%	107,063	107,438	70,950	63,720
Total WHT Payable	892,188	895,313	591,250	531,000

(d) BICCI NIGERIA LIMITED

COMPUTATION OF REVISED TAX LIABILITIES

Assessment Years	2014	2013	2012	2011	Total
	₦	₦	₦	₦	₦
Adjusted profit per Client's information	2,756,836	3,174,127	428,845	4,460,148	10,819,956
Add:					
Overstatement of Cost of sales (60%)	6,076,800	5,165,400	3,357,600	1,846,800	16,446,600
Overstatement of selling and distribution expenses (60%)	4,950,000	3,960,000	3,366,000	3,197,700	15,473,700
Overstatement of Admin expenses (60%)	2,511,098	1,883,324	1,412,493	1,059,370	6,886,285
Revised Assessable profit (RAP)	16,294,734	14,182,851	8,564,938	10,564,018	49,606.541
Deduct: Capital allowances	(0)	(0)	2,249,990	2,250,000	4,499,990
Revised Total Profit (RTP)	16,294,734	14,182,851	6,314,948	8,314,018	45,106,551

Tax Liabilities					
Revised Companies Income Tax liability – 30% of RTP	4,888,420	4,254,855	1,894.484	2,494,205	13,531,964
Deduct: Companies Income Tax paid	2,430,399	1,885,488	1,210,936	143,887	5,670,710
Net Company Income tax payable/ refundable	2,458,021	2,369,367	683,548	2,350,318	7,861,254
Add: Penalty @ 10%	245,802	236,937	68,355	235,032	786,126
Interest 15%	368,703	355,405	102,532	352,548	1,179,188
Net income tax payable/refundable	3,072,526	2,961,709	854,435	2,937.898	9,826,568

The Management of BCCI Nigeria Limited is advised to object to the tax assessment raised on it by the tax authority within 30 days of the date of service of the Notice of Assessment, failure to do so, will enable the tax authority to enforce the payment of the tax assessment.

The Notice of Objection must be in writing and addressed to the Chairman, Federal Inland Revenue Service. The grounds of objection must be clearly stated.

Workings

BICCI NIGERIA LIMITED
COMPUTATION OF CAPITAL ALLOWANCE

Date of purchase of assets 2 October 2009

Cost of assets ₦18,000,000

Assessment Year 2009	₦	₦
Cost		18,000,000
Deduct: Initial allowance (50%)	9,000,000	
Annual allowance (25%)	2,250,000	
		(11,250,000)
W.D.V c/f to A.Y. 2010		6,750,000
Assessment Year 2010		
Deduct: Annual allowance		2,250,000

W.D.V c/f to A.Y. 2011	4,500,000
Assessment Year 2011	
Deduct: Annual allowance	2,250,000
W. D. V c/f to A. Y. 2012	2,250,000
Assessment Year 2012	
Deduct: Annual allowance	2,249,990
W. D. V c/f to A.Y. 2013	10
Assessment Year 2013	
Deduct: Annual allowance	0
W. D. V c/f to A.Y 2014	10

BICCI NIGERIA LIMITED
COMPUTATION OF REVISED TAX LIABILITY

Assessment Years	2014	2013	2012	2011	Total
	₦	₦	₦	₦	₦
Revised Tertiary Education Tax @ 2% of RAP	325,895	283,657	171,299	211,280	992,131
Payments during the year	(244,421)	(184,377)	(94,214)	(27,675)	(550,687)
Net VAT payable	81,474	99,280	77,085	183,605	441,444

EXAMINER'S REPORT

The question tests candidates' knowledge of tax audit computations.
Few candidates attempted the question, they demonstrated poor understanding of the question and performance was also very poor.

The commonest pitfall was the inability of the candidates to compute capital allowance correctly.

Candidates are advised to pay attention to tax audit procedures and computations.

SOLUTION 2

(a) The difference between employment income and part-time income is that employment income can be said to be income earned from a contract of service while part-time income is income earned from contract for services.

Employment can be brought to an end at the prerogative of the employer or the employee. Part -time engagement usually comes to an end at the end of the contract or upon the delivery of a service.

(b)(i) The reasons why tax payers are expected to file income tax is because it is mandatory under the income tax law to do so, and to avert imposition of Best of Judgment assessment.

(ii) Within ten days of the end of every month, an employer shall pay to the nearest tax office, all taxes deducted from his employees.

(iii) Tax payers are expected to file income tax returns with the relevant tax authority of their State of residence or State where they have their principal place of residence or in case of a tax payer who resides in the Federal Capital Territory Abuja, should file with the Federal Inland Revenue Service.

(c) The following are the circumstances that may arise to cause a tax authority to raise a Best of Judgement assessment:

(i) Where a company files its returns, audited accounts and tax computations, the tax authority may refuse to accept same if found unsatisfactory and therefore proceed to determine based on its “Best of Judgement”, the company’s Total Profit and raise its assessment thereon accordingly.

(ii) Where a company has failed to submit a self-assessment return, audited accounts, etc, and the FIRS is of the opinion that it is liable to tax, it may proceed, based on its “Best of Judgement “ to determine the total profit of such a company and raise an assessment thereon accordingly.

(d) MR SOLA ABIJAH

COMPUTATION OF INCOME TAX LIABILITY FOR 2012 ASSESSMENT YEAR

	₦	₦
Emolument		8,250,000.00
Freelance Income		4,068,750.00
Public Relations Income		2,704,222.50
Benefits –in-kind		
Official car (5% of ₦ 2,500,000)	125,000.00	
Driver's allowance	1,250,000.00	1,375,000.00
Gross Income		16,397,972.50
	₦	₦
Reliefs		
(i) Consolidated Relief Allowance		
(₦200,000 + 20% of ₦ 16,397,972.50)	3,479,594.50	
(ii) Pension Contribution	660,000.00	
(iii)National Housing Fund Contribution	206,650.00	(4,345,844.50)
Chargeable Income		12,052,128.00

Tax Payable

	₦	%	₦	₦
First	300,000	7		21,000
Next	300,000	11		33,000
Next	500,000	15		75,000
Next	500,000	19		95,000
Next	1,600,000	21		336,000
Balance	8,852,128	24		2,124,511
	12,052,000			

Tax payable		
		2,684,511
Less: Withholding tax:		
Part- time writing	193,750.00	
Public relations	128,772.50	322,522.50
Final tax liability		2,361,988.50

EXAMINER'S REPORT

The question tests candidates' knowledge of taxation of individuals in full- time and part - time employment.

Many candidates attempted the question and performance was good.

SOLUTION 3

1)(a) STEPS TO BE TAKEN WHEN THERE IS A CHANGE OF ACCOUNTING DATE

(i) Determine the year of assessment in which the company failed to make up accounts to its normal year –end.

(ii) Identify the two subsequent tax years.

(iii) Compute the Assessable Profits on the preceding year basis for the three relevant tax years, using the old accounting date.

(iv) Compute the Assessable Profits on the preceding year basis for the three relevant tax years using the new accounting date.

(v) Aggregate the Assessable profits in (iii) and (iv) above and compare the two.

(vi) It is the practice of the Revenue to choose the higher of the Assessable Profits for the 3 years in (v) above.

(b) HOPEFUL LIMITED

COMPUTATION OF ASSESSABLE PROFITS FOR 2011-2013 ASSESSMENT YEARS

USING OLD ACCOUNTING DATE

Y.O.A	Basis Period	Assessable Profit
		₦
2011	1/6/2009 -31/5/2010	300,000
2012	1/6/2010- 31/5/2011 (₦645,000 + 5/12 x ₦1,575,000)	1,301,250
2013	1/6/2011 – 31/5/ 2012 (7/12 x (₦1,575,000+5/12 x ₦1,876,500)	1,700,625
		3,301,875

USING NEW ACCOUNTING DATE

Y.O.A	Basis Period	Assessable Profit
		₦
2011	1/1/2010 -31/12/2010 5/12 x ₦300,000 + ₦645,000	770,000
2012	1/1/2011- 31/12/2011	1,575,000
2013	1/1/2012 – 31/12/ 2012	1,876,500
		4,221,500

Comment:

Based on the foregoing calculations, it is apparent that Hopeful Limited would be subject to tax by the relevant tax authority in 2011 to 2013 on the basis of the new accounting date.

(c). HOPEFUL LIMITED

COMPUTATION OF ASSESSABLE PROFITS FOR 2011-2013 ASSESSMENT YEARS

Y.O.A	Basis Period	Assessable Profit	
		₦	₦
2011	Higher of:		
	PYB: 1/6/2009- 31/5/2010	300,000	
	AYB: 1/1/2011-31/12/2011	1,575,000	1,575,000
2012	AYB: 1/1/2012- 31/12/2012		1,876,500

EXAMINER'S REPORT

The question tests candidates' knowledge of the assessment of tax payers when there are abnormal bases situation and tax provisions of change of accounting date.

Most candidates attempted the question and performance was good

SOLUTION 4

(a) (I) AARINOLA SUNKANMI & CO

COMPUTATION OF CHARGEABLE INCOME OF EACH PARTNER PRE- ADMISSION OF MARIAM

	Aarinola	Olasunkanmi	Murphiefe	Total
	₦	₦	₦	₦
INCOME				
Share of Profit(See Working)	441,625	220,813	220,812	883,250
Salaries	70,000	30,000	30,000	130,000
Cost of passage	12,000			12,000
Interest on loan	7,500	-	7,500	15,000
	531,125	250,813	258,312	1,040,250
Balance Charge(See working	18,870	9,435	9,435	37,740
	549,995	260,248	267,747	1,077,990
Less: Capital allowances	109,700	54,850	54,850	219,400
Income from Partnership	440,295	205,398	212,897	858,590
Less:				
Consolidated Relief Allowance	288,059	241,080	242,579	771,718
Chargeable Income/(Loss)	152,236	(35,682)	(29,682)	86,872

(a) (ii) AARINOLA SUNKANMI & CO

COMPUTATION OF CHARGEABLE INCOME OF PARTNERS

POST-ADMISSION OF MARIAM

	Aarinola	Murphiefe	Mariam	Total
	₦	₦	₦	₦
INCOME				
Share of Profit(See working)	441,625	309,138	132,487	883,250
Salaries	70,000	30,000	30,000	130,000
Cost of passage	0	0	0	0
Interest on loan	7,500	7,500	-	15,000
Interest on Capital	0	0	5,000	5,000
	519,125	346,638	167,487	1,033,250
Balancing Charge(See working)	18,870	13,209	5,661	37,740
	537,995	359,847	173,148	1,070,990
Less: Capital allowances	109,700	76,790	32,910	219,400
Income from Partnership	428.295	283,057	140,238	851,590
Less:				
Consolidated Relief Allowance	285,659	256,611	228,048	770,318
Chargeable Income/(Loss)	142,636	26,446	87,810	81,272

(b) The basis period for the existing partners is preceding year basis.

Workings

(i) Determination of Adjusted Profit

	₦	₦
Net Profit for the year		1,380,000
Add back:		
Depreciation	450,000	
Legal expenses	14,000	464,000
		1,844,000
Less:		
Profit on sale of fixed assets		77,500
Computed Income		1,766,500

(ii) Share of Computed Income

		Aarinola	Olasunkanmi	Murphiefe	Mariam
	₦	₦	₦	₦	₦
Adjusted Profit	1,766,500				
Pre-admission					
1/1/14-30/6/14					
6/12 x ₦1,766,500	883,250				
Share Profit					
2:1:1	(883,250)	441,625	220,813	220,812	0
Post-Admission					
1/7/14-31/12/14					
6/12 x ₦1,766,500	883,250				
Share of profit					
10:7:3	(883,250)	441,625	0	309,138	132,487
	0	883,250	220,813	529,950	132,487

(iii) Appropriation of Capital Allowance and Balancing Allowance

		Aarinola	Olasunkanmi	Murphiefe	Mariam
	₦	₦	₦	₦	₦
Capital allowance	366,300				
Add:					
Balancing					
allowance	72,500				
Total	438,800				
Pre-Admission					
1/1/14-30/6/14					
6/12 x ₦438,800	219,400				
Share of Profit					
2:1:1	(219,400)	109,700	54,850	54,850	0
Post-Admission					
1/7/14-31/12/14					
6/12 x ₦438,800	219,400				
Share profit					
10:7:3	(219,400)	109,700	0	76,790	32,910
Total	0	219,400	54,850	131,640	32,910

(iv) Appropriation of Balancing Charge

	₦	Aarinola ₦	Olasunkanmi ₦	Murphiefe ₦	Mariam ₦
Balancing Charge	75,480				
Pre-Admission					
1/1/14-30/6/14					
6/12 x ₦75,480	37,740				
Share of Profit					
2:1:1	(37,740)	18,870	9, 435	9,435	0
Post-Admission					
1/7/14-31/12/14					
6/12 x ₦75,480	37,740				
Share of Profit					
10:7:3	(37,740)	18,870	0	13,209	5,661
Total	0	37,740	9,435	22,644	5,661

EXAMINER'S REPORT

The question tests candidates' knowledge of the taxation of partners in partnerships.

Many candidates attempted the question and performance was fair. The "Commonest" pitfall was the inability of the candidates to apportion the pre and post admission profits of the Partnership.

Candidates are advised to pay attention to partnership profits computations when there are retirement and admission of partners.

SOLUTION 5

a (i). COVENANT CONSTRUCTION LIMITED

SCHEDULE OF CAPITAL EXPENDITURE ALLOCATION AND QUALIFYING CAPITAL EXPENDITURE ON NORMAL BASIS

YEAR OF ASSESSMENT (YOA)	Basis Period for Assessment	Basis Period for Qualifying Expenditure	Qualifying Capital Expenditure	Amount ₦
2011	3/8/11-31/12/11	3/8/11-31/12/11	Tractor & Grader	7,500,000
			Motor Vehicle for Field Operations	13,500,000
			Construction site Factory Building	11,250,000
			Furniture, F&F	778,250
			Plant & Machinery	580,000
2012	3/8/11-31/7/12	1/1/12-31/7/12	Motor Vehicle	1,375,000
2013	1/8/11-31/7/12	-	-	-
2014	1/8/12-31/7/13	1/8/12-31/7/13	Building	1,350,000
			Generator	450,000
			Factory extension	575,000
2015	1/8/13-31/7/14	1/8/13-31/7/14	Pick-up Van	1,050,000

a (ii). COVENANT CONSTRUCTION LIMITED

SCHEDULE OF CAPITAL EXPENDITURE ALLOCATION AND QUALIFYING CAPITAL EXPENDITURE ON REVISED BASIS (TAX PAYER'S RIGHT OF ELECTION)

YEAR OF ASSESMENT (YOA)	Basis Period for Assessment	Basis Period for Qualifying Expenditure	Qualifying Capital Expenditure	Amount ₦
2011	3/8/11-31/12/11	3/8/11-31/12/11	Tractor & Grader	7,500,000
			Motor Vehicles for Field Operations	13,500,000
			Construction site (FB)	11,250,000
			Furniture, F&F	778,250
			Plant & Machinery	580,000
2012	1/1/12-31/12/12	1/1/12-31/12/12	Motor Vehicle	1,375,000
			Building	1,350,000
2013	1/1/13-31/12/13	1/1/13-31/12/13	Generator	450,000
			Factory extension	575,000
			Pick-up Van	1,050,000

(b) Assets acquired by Covenant Construction Limited before it commenced business would be deemed to have been acquired on the first day of the new business.

(c) The relevant tax years and corresponding basis periods covered by (a) above are:

i. On Normal Basis

YOA	Basis Period for Assessment
2011	3/8/11- 31/12/11
2012	3/8/11- 31/7/12
2013	-
2014	1/8/12- 31/7/13
2015	1/8/13- 31/7/14

ii. On the basis of Right of Election

YOA	Basis Period for Assessment
2011	3/8/11-31/12/11
2012	1/1/12-31/12/12
2013	1/1/13-31/12/13

EXAMINER'S REPORT

The question tests candidates' knowledge of the computation of capital allowances especially pre-acquisition capital expenditure.

Few candidates attempted the question and performance was also poor.

The commonest pitfall was the inability of the candidates to differentiate between basis for assessment and basis for capital allowances.

Candidates are advised to practise extensively the computation of capital allowances.

SOLUTION 6

(a) The Value Added Tax Act makes specific provisions with regard to the rendition of VAT returns by Vatable persons. S.15 (1) provides that a taxable person shall render to the Board, on or before the 21st day of the month following that in which the purchase or supply was made, a return of all taxable goods and services purchased or supplied by him during the preceding month in such manner as the Board may, from time to time, determine.

A taxable person shall on rendering a return:

(i) If the Output tax exceeds the Input tax, remit the excess to the FIRS; or

(ii) If the Input tax exceeds the Output tax, be entitled to a refund of the excess tax from the FIRS, on production of such documents, as may be required of him from time to time. An importer of taxable goods shall, before clearing those goods, pay to the Board the tax due on those goods. The Nigerian Customs Service shall before releasing taxable goods to its importer demand the Value Added Tax Compliance Certificate issued by the FIRS on those goods.

(b) ANALYSIS OF LOSSES CARRIED FORWARD UNDER EACH INCOME

	Agric Production	Grain Distribution
	₦	₦
2011	(770,000)	(225,000)
2012		
Loss b/f	(770,000)	(225,000)
Profit /(loss)	(630,000)	280,000
Loss C/F	(140,000)	NIL
2013		
Loss b/f	(140,000)	NIL
Profit (Loss)	(600,000)	(150,000)
Loss c/f	(740,000)	(150,000)
2014		
Loss b/f	(740,000)	(150,000)
Profit/(Loss)	990,000	140,000
Loss c/f	NIL	(10,000)
2015		
Loss b/f	NIL	(10,000)
Profit /(Loss)		120,000
Loss c/f	NIL	NIL

(c) HIDDEN TREASURES LIMITED

COMPUTATION OF TAX LIABILITIES FOR 2011-2016 ASSESSMENT YEARS

Assessment Year		Agric Production	Grain Distribution	Total
		₦	₦	₦
2011	Loss for the year	(770,000)	(225,000)	(995,000)
	Capital allowance	(0)	(0)	(70,000)
	Loss and Capital allowance c/f	(770,000)	(225,500)	1,065,000
	Taxable profit			NIL
	Companies Income Tax (30% of Total Profit			NIL
	Tertiary Education Tax(2% of Assessable Profits)			NIL

2012	Loss b/f to A.Y 2012		(770,000)	(225,000)	(995,000)
	Profit for the year		630,000	280,000	910,000
	Unrelieved Loss c/f		(140,000)	55,000	
	Deduct: Capital allowances: B/f from A.Y 2011		70,000		
	For the year		65,000		
			135,500		
	But limited to		(55,000)	(55,000)	
	Unrecouped CAs c/f		80,000		
	Total profit			0	
	Companies Income Tax(30% of Total profit)				NIL
	Tertiary education Tax (2% of Ass. Profit)				18,200
2013	Loss for the year		(600,000)	(150,000)	(750,000)
	Loss b/f from A.Y 2012		(140,000)	0	(140,000)
	Unrelieved loss c/f		(740,000)	(150,000)	(890,000)
	Add: Capital allowances				
	B/F from A.Y. 2012	80,000			
	For the year	125,000			(205,000)
	Losses and capital allowances c/f to A.Y 2014				1,095,000
2014	Profit for the year		990,000	140,000	1,130,000
	Losses b/f from A.Y. 2013		(740,000)	(150,000)	(890,000)
			250,000	(10,000)	(240,000)
	Deduct: Capital allowances B/F from A.Y 2013	205,000			
	For the year_	115,750			
		320,750			
	But restricted to	(250,000)	(250,000)		(250,000)
	Unrelieved CAS c/f	70,750			
	Total profit		0	(10,000)	(10,000)

	Companies Income Tax			NIL
	Tertiary Education Tax			₦22, 600
2015	Profit for the year	30,000	120,000	150,000
	Loss brought forward		(10,000)	(10,000)
		30,000	110,000	140,000
	Deduct: Capital/ All			
	B/F from A.Y 2014 70,750			
	For the year 85,000			
	155,750			
	But Limited to (140,000)			
		(30,000)	(110,000)	(140,000)
	Unrecouped			
	CAS c/f 15,750			
	Total Profit	0	0	0
	Companies Income Tax (30% of Total Profit)			NIL
	Tertiary Education Tax (2% of Assessable Profit)			N3,000

EXAMINER'S REPORT

The question tests the candidates' knowledge of the treatment of losses in the computation of tax payer liabilities.

Few candidates attempted the question and performance was poor.

The commonest pitfall was the inability to carry forward losses from one period to another.

Candidates are advised to pay attention to different treatment of losses.

SOLUTION 7

(a). The basis of assessment of Estates, Trusts or settlements is preceding year basis.

(b). The following persons are chargeable under a Trust or Settlement.

i. Executor
ii. Trustee
iii. The beneficiary including any annuitant
iv. The Settlor or the person who created the Trust in circumstances where he can direct the disposition of the income or the right thereto.

(c).

THE TRUST OF CHIEF ZETA
COMPUTATION OF INCOME OF THE TRUST
FOR 2015 YEAR OF ASSESSMENT

	₦	₦
Income from the Trust		3,120,000
Deduct: Authorised payments		
Annuity (N150,000 per beneficiary x 4)	600,000	
Administrative expenses	57,500	
Trustee remuneration (2/102 x CI)	48,284	
		705,784
Total Computed income		2,414,216
Deduct: Discretionary payments:		
Alpha	22,500	
Beta	17,500	
Cepha	15,000	
Delphi	12,500	(67,500)
Net Computed income		2,346,716
Distribution to beneficiaries (9/10 x NCI)	2,112,044	
Distributed to:		
Alpha	528,011	
Beta	528,011	
Cepha	528,011	
Delphi	528,011	
	(2,112,044)	
Amount taxable in the hands of the Trustee		234,672

(d). Amount due to the beneficiaries

	Alpha	Beta	Cepha	Delphi
	₦	₦	₦	₦
Annuity	150,000	150,000	150,000	150,000
Discretionary payments	22,500	17,500	15,000	12,500
Share of distributable income	528,011	528,011	528,011	528,011
Total	700,511	695,511	693,011	690,511

(e) The share of Computed Income should be based on the agreement between the creator of the Trust and the Trustee. Usually, it is shared among the beneficiaries and the Trustee.

Consequently, the tax is borne by the beneficiaries of the income from the Trust and the Trustee pays the tax on amount retained.

EXAMINER'S REPORT

The question tests candidates' knowledge of the computation of tax payable by Estates, Trusts and Settlements.

Many Candidates attempted the question and performance was good.

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATIONS - MAY 2015

PERFORMANCE MANAGEMENT

Time Allowed: 3 hours

ATTEMPT FIVE QUESTIONS IN ALL

SECTION A: COMPULSORY QUESTION (30 Marks)

QUESTION 1

TADEFO Limited is a manufacturing company which produces and assembles car components. The company has two main production departments: Machining and Assembling. Each of the two departmental managers is responsible for producing annual budgets based on targets set by the management. From last year's budget, TADEFO Limited hoped to turn an expected 10 percent rise in total revenue into a 20 percent increase in the company's profits.

The following budgeted information relates to TADEFO Limited for the forthcoming period:

	Products		
	ACQ	BEZ	CFJ
Sales and production (units)	30,000	50,000	40,000
	₦	₦	₦
Selling price (per unit)	73	45	95
Prime cost (per unit)	65	32	84
	Hours	Hours	Hours
Machine Department (machine hours per unit)	4	2	5
Assembly Department (direct labour hours per unit)	2	7	3

Overheads can be re-analysed into 'cost pools' as follows:

Cost pool	₦'000	Cost driver	Quantity for the period
Machine services	359	Machine hours	425,000
Assembly services	328	Direct labour hours	532,000
Set-up costs	36	Set-ups	720

Order processing	165	Customer orders	34,000
Purchasing	88	Suppliers' orders	12,400
	976		

You have also been provided with the following estimates for the period:

	ACQ	BEZ	CFJ
Number of set-ups	220	130	210
Customers orders	18,000	10,000	10,000
Suppliers' orders	5,200	3,600	4,200

Required:

a. Prepare and present a profit statement using activity-based costing. (14 Marks)

b. What would you consider to be the weaknesses of an incremental budgeting system for a company such as TADEFO Limited? (5 Marks)

c. Describe Activity-Based Budgeting (ABB) and comment on the advantages of its use by TADEFO Limited. (5 marks)

d. Explain how the use of Zero-Based Budgeting (ZBB) can motivate employees. (3 Marks)

e. "Encouraging employee participation in budget setting is beneficial" Discuss. (3 Marks)

Total (30 Marks)

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

QUESTION 2

Ozoigbondu Nigeria Limited is a company that is into buying and selling of plastic containers. The company is financed by a capital of ₦15million inclusive of reserves in a mix of 30% and 70% of debt and equity respectively.

The Company has been in trading business for the past six years and has consistently adhered to its corporate policy on sales, purchases and inventory management.

The company's policy on sales is to ensure that sales are collected as follows:

(i) Cash sales is 40% of the monthly sales.

(ii) The balance of the month's sales is to be collected in the month following sales.

The policy on purchases is in agreement with the supplier's policy which is to pay for all supplies in the month following. The company's stock policy is to reserve 30% of the month's purchases as closing inventory.

The following information is available for the five years 2010 to 2014:

	2010	2011	2012	2013	2014
	₦	₦	₦	₦	₦
Monthly Sales	3,400,000	3,600,000	4,200,000	4,800,000	7,200,000
Monthly Purchases	2,000,000	2,400,000	2,800,000	3,200,000	4,800,000
Monthly Salaries	350,000	350,000	430,000	430,000	480,000
Monthly Rent	100,000	100,000	100,000	100,000	100,000
Monthly Cash Expenses	200,000	220,000	240,000	280,000	360,000

Additional information:

(i) The company purchased a motor vehicle in July 2013 which was paid for in September 2013. The cost of the motor vehicle was ₦5,000,000.

(ii) Annual depreciation for the motor vehicle is 20%.

(iii) The Cash Balance as at 31st December 2011 was ₦4,000,000.

(iv) The company's salaries, rent and expenses were paid in the month they were due.

Required:

a. Prepare a Profitability Statement for 2012, 2013 and 2014. (10 Marks)

b. Prepare a Cash Flow Statement for 2012, 2013 and 2014. (7 Marks)

c. Determine and comment on the liquidity ratio (current ratio) for 2014. (2 Marks)

d. Compute the gearing ratio. (1 Mark)

(Total 20 Marks)

QUESTION 3

Pakex is a division of an automobile group that has five years remaining on a leased premises in which it sells self-assembled motorcycles. The management is proposing an investment of ₦48million on immediate improvements to the interior of the premises in order to stimulate sales by creating a more effective selling environment. The following information is available:

(i) The expected increase in revenue following the improvements is ₦40million per annum. The average contribution to sales ratio is expected to be 40%.

(ii) The cost of capital is 16% and the division has a target Return on Capital Employed of 20% based on the net book value of the investment at the beginning of the year.

(iii) At the end of the five year period, the premises improvements will have a NIL residual value.

(iv) The management staff turnover at Pakex division is high. The division's investment decisions and management performance measurement are currently based on the figures for the first year of the proposal.

In addition to the above information, there is an alternative proposal that suggests a forecast of the increase in revenue per annum from the premises improvements as follows:

Year	1	2	3	4	5
	₦m	₦m	₦m	₦m	₦m
Increase in Revenue	56	40	40	24	16

All other factors are expected to remain the same.

Required:

a. Prepare a summary of the statement of the management's investment proposal for years 1 to 5 showing Residual Income and Return on Capital Employed for each year using the straight line depreciation method.
(10 Marks)

b. Comment on the use of the figures from the Statement in (a) above as a decision-making and management performance measure. (4 Marks)

c. Calculate the Residual Income and Return on Capital Employed for year 1 using the alternative proposal. (6 Marks)
(Total 20 Marks)

QUESTION 4

BADEGY Limited is a medium-sized company. The company is in the process of deciding its pricing policy for the next period.

The following information is available from its records:

	Previous period Revenue: ₦'000		Current period Revenue: ₦'000
100,000 units at ₦130	13,000	106,000 units at ₦130	13,780
Costs	10,000	Costs	10,774
Profit	3,000	Profit	3,006

It was discovered that between the previous and current periods, there was a 4% general cost inflation and it is forecast that costs will rise further by 6% in the next period. As a matter of policy, the company did not increase the selling price in the current period although competitors raised their prices by 4% to allow for the increased costs. A survey by a team of management consultants was commissioned and has found that the demand for the product is elastic with an estimated price elasticity of demand of 1.5. This means that volume falls by $1\frac{1}{2}$ times the rate of real price increase. Various options are to be considered by the Board.

You are required to:

a. Show the budgeted position of the company if it maintains the ₦130 selling price for the next period when it is expected that competitors will increase their prices by 6%. (15 Marks)

b. What would the budgeted position be if the company also raises its price by 6%? (5 Marks)

(Total 20 Marks)

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

QUESTION 5

CAROSSI Limited makes quality wooden products such as tables, chairs, benches and doors. Historically, the company has used mainly financial performance measures to assess the performance of the company as a whole. The company's Chief Executive Officer has just been informed of the 'Balanced Scorecard Approach' and is eager to learn more.

CAROSSI Limited has two Divisions X and Y, each with its own cost and revenue streams. Each Division is managed by a divisional manager who has the power to make all investment decisions within the Division. The cost of capital for both Divisions is 15 percent. Historically, investment decisions have been made by calculating the Return on Investment (ROI) of any opportunities and presently, the return on investment of each Division is 18 percent.

A recently appointed manager for Division X strongly feels that using Residual Income (RI) to make investment decisions would result in better 'goal congruence' throughout the organisation.

Each Division is currently considering the following separate investments:

	Division X	Division Y
Capital required for investment	₦88.2m	₦46.0m
Revenue generated from investment	₦46.4m	₦28.1m
Net profit margin	30 percent	35 percent

The company is seeking to maximise shareholders' wealth.

Required:

a. Describe the Balanced Scorecard Approach to performance measurement.
(8 Marks)

b. Determine both the return on investment and residual income of the new investment for each of the two divisions. Comment on these results and take into consideration the manager's views about residual income.
(7 Marks)
(Total 15 Marks)

QUESTION 6

Markus Limited manufactures three products and operates a marginal costing system.

The following information has been extracted from the company's records:

Products	X	Y	Z
Units budgeted to be produced and sold	3,600	6,000	3,400
Selling Price (₦)	120	110	100
Requirement per Unit:			
Direct Material (kg)	5	3	4
Direct Labour (Hours)	4	3	2
Direct Labour Hour rate (₦)	4	4	4
Direct Material Cost per Kg (₦)	8	8	8
Variable Overheads (₦)	14	26	16
Fixed Overheads (₦)	20	20	20
Maximum possible sales (units)	8,000	10,000	3,000

All the three products are produced from the same direct material using the same types of machine and labour. Direct labour, which is the key factor, is limited to 37,200 hours.

You are required to:

a. Determine the most profitable product mix. (6 Marks)

b. Prepare a statement of profitability for the product mix. (9 Marks)

(Total 15 Marks)

QUESTION 7

The use of internet has made the entire universe a global village. Managers can comfortably sit in their offices connected to the internet and the world wide web to obtain all necessary information for their business needs.

Required:

a. Discuss the concept of globalisation and how management information system has enhanced effective management performance. (10 Marks)

b. What arguments will you advance against globalisation as it relates to management performance? (5 Marks)

(Total 15 Marks)

Formulae

Learning curve

$Y = ax^b$

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

a = the time taken for the first unit of output

x = the cumulative number of units produced

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

LR = the learning rate as a decimal

Demand curve

$P = a - bQ$

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

a = price when Q = 0

$MR = a - 2bq$

LINEAR REGRESSION AND CORRELATION

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

$$Y = a + bX \quad \text{or} \quad Y - \bar{Y} = b(X - \bar{X})$$

Where

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

and $\quad a = \bar{Y} - b\bar{X}$

or solve

$$\sum Y = na + b\sum X$$
$$\sum XY = a\sum X + b\sum X^2$$

Coefficient of Correlation

$$r = \frac{\text{Covariance}\ (XY)}{\text{Std.Dev}(X).\ \text{Std.Dev}(Y)} = \frac{n\sum XY - \sum X \sum Y}{\sqrt{\left(n\sum X^2 - (\sum X)^2\right)\left(n\sum Y^2 - (\sum Y)^2\right)}}$$

FINANCIAL MATHEMATICS

Compound Interest (Values and Sums)

Future Value S, of a sum of X, invested for *n* periods, compounded at r% interest

$$S = X(1 + r)^n$$

Annuity

Present value of an annuity of ₦1 per annum receivable or payable for *n* years, commencing in one year, discounted at r% per annum

$$PV = \frac{1}{r}\left[1 - \frac{1}{(1 + r)^n}\right]$$

Perpetuity

Present value of ₦1 per annum, payable or receivable in perpetuity, commencing in one year, discounted at r% per annum.

$$PV = \frac{1}{r}$$

Annuity Table

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

Where r = discount rate

n = number of periods

Periods

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

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

Standard normal distribution table

	0·00	0·01	0·02	0·03	0·04	0·05	0·06	0·07	0·08	0·09
0·0	0·0000	0·0040	0·0080	0·0120	0·0160	0·0199	0·0239	0·0279	0·0319	0·0359
0·1	0·0398	0·0438	0·0478	0·0517	0·0557	0·0596	0·0636	0·0675	0·0714	0·0753
0·2	0·0793	0·0832	0·0871	0·0910	0·0948	0·0987	0·1026	0·1064	0·1103	0·1141
0·3	0·1179	0·1217	0·1255	0·1293	0·1331	0·1368	0·1406	0·1443	0·1480	0·1517
0.4	0.1554	0·1591	0·1628	0·1664	0·1700	0·1736	0·1772	0·1808	0·1844	0·1879
0·5	0·1915	0·1950	0·1985	0·2019	0·2054	0·2088	0·2123	0·2157	0·2190	0·2224
0·6	0·2257	0·2291	0·2324	0·2357	0·2389	0·2422	0·2454	0·2486	0·2517	0·2549
0·7	0·2580	0·2611	0·2642	0·2673	0·2704	0·2734	0·2764	0·2794	0·2823	0·2852
0·8	0·2881	0·2910	0·2939	0·2967	0·2995	0·3023	0·3051	0·3078	0·3106	0·3133
0·9	0·3159	0·3186	0·3212	0·3238	0·3264	0·3289	0·3315	0·3340	0·3365	0·3389
1·0	0·3413	0·3438	0·3461	0·3485	0·3508	0·3531	0·3554	0·3577	0·3599	0·3621
1·1	0·3643	0·3665	0·3686	0·3708	0·3729	0·3749	0·3770	0·3790	0·3810	0·3830
1·2	0·3849	0·3869	0·3888	0·3907	0·3925	0·3944	0·3962	0·3980	0·3997	0.4015
1·3	0.4032	0.4049	0.4066	0.4082	0.4099	0.4115	0.4131	0.4147	0.4162	0.4177
1.4	0.4192	0.4207	0.4222	0.4236	0.4251	0.4265	0.4279	0.4292	0.4306	0.4319
1·5	0.4332	0.4345	0.4357	0.4370	0.4382	0.4394	0.4406	0.4418	0.4429	0.4441
1·6	0.4452	0.4463	0.4474	0.4484	0·4495	0.4505	0.4515	0.4525	0.4535	0.4545
1·7	0.4554	0.4564	0.4573	0·4582	0·4591	0.4599	0·4608	0·4616	0.4625	0.4633
1·8	0.4641	0.4649	0.4656	0.4664	0.4671	0.4678	0.4686	0.4693	0.4699	0·4706
1·9	0.4713	0.4719	0.4726	0.4732	0.4738	0.4744	0.4750	0.4756	0.4761	0.4767
2·0	0.4772	0.4778	0.4783	0.4788	0.4793	0.4798	0.4803	0.4808	0·4812	0.4817
2.1	0.4821	0.4826	0.4830	0.4834	0.4838	0.4842	0.4846	0·4850	0.4854	0.4857
2·2	0.4861	0.4864	0.4868	0·4871	0.4875	0.4878	0.4881	0·4884	0.4887	0.4890
2·3	0.4893	0·4896	0.4898	0.4901	0.4904	0.4906	0.4909	0.4911	0.4913	0.4916
2·4	0.4918	0.4920	0.4922	0.4925	0.4927	0.4929	0·4931	0.4932	0.4934	0.4936
2·5	0.4938	0.4940	0.4941	0.4943	0.4945	0.4946	0.4948	0.4949	0.4951	0.4952
2·6	0.4953	0.4955	0·4956	0.4957	0.4959	0.4960	0.4961	0·4962	0.4963	0·4964
2·7	0.4965	0.4966	0.4967	0.4968	0.4969	0.4970	0.4971	0.4972	0.4973	0·4974
2·8	0.4974	0.4975	0.4976	0.4977	0.4977	0·4978	0.4979	0.4979	0.4980	0.4981
2·9	0·4981	0.4982	0.4982	0.4983	0.4984	0.4984	0.4985	0.4985	0.4986	0·4986
3·0	0·4987	0.4987	0·4987	0.4988	0.4988	0.4989	0.4989	0·4989	0.4990	0·4990

SECTION A

SOLUTION 1

a)

TADEFO LIMITED

ACTIVITY BASED COSTING PROFIT STATEMENTS

	ACQ	BEZ	CFJ	TOTAL
Units produced/sold	30,000	50,000	40,000	120,000
	₦'000	₦'000	₦'000	₦'000
Sales	2,190.00	2,250.00	3,800.00	8,240.00
Less:				
Prime cost	1,950.00	1,600.00	3,360.00	6,910,00
Overheads:				
Machine services	101.40	84.50	169,00	354,90
Assembly services	37.02	215.95	74.04	327.01
Set-up costs	11.00	6.50	10.50	28.00
Order processing	87,354	48.53	48.53	184.414
Purchasing	36.904	25.549	29.807	92.26
	2,223.678	1,981.029	3,691.877	7,896.584
Profit/(loss)	(33.678)	268.971	108.123	343.416

Workings

(i) Step 1: Calculate the rate/cost driver for each of the cost pools

Cost pool	Cost	Quantity for the period	Rate/cost driver
	₦		₦
Machine services	359,000	425,000	0.845/machine hr
Assembly services	328,000	532,000	0.617 dir. Lab.hr
Set-up costs	36,000	720	50/set-up
Order processing	165,000	34,000	4.853/customer order
Purchasing	88,000	12,400	7.097/supplier's order

(ii)

Allocation of costs to different products

	ACQ	BEZ	CFJ
Units produced/sold	30,000	50,000	40,000
Machine services			
Machine hours/unit	4	2	5
Total machine hours	120,000	100,000	200,000
Cost at ₦0.845/hour	₦101,400	₦84,500	₦169,000
Assembly services			
Assembly hours/unit	2	7	3
Total assembly hours	60,000	350,000	120,000
Cost at ₦0.617/hour	₦37,020	₦215,950	₦74,040
No of set-ups	220	130	210
Cost at ₦50/set-up	₦11,000	₦6,500	₦10,500
No of customer orders	18,000	10,000	10,000
Cost at ₦4.853/hour	₦87,354	₦48,530	₦48,530
No of suppliers orders	5,200	3,600	4,200
Cost at ₦7.097/order	₦36,904	₦25,549	₦29,807

b)

Incremental budgeting is a form of budgeting in which a budget is based on the current year's results plus an extra amount for estimated growth or inflation in the following year. It is administratively easy to prepare but it is inefficient because it encourages slack and wasteful spending to creep into budgets, hence making it to become a normal feature of actual spending.

Car components manufacturing operates in a highly competitive environment. Continuous improvement is very important and driving down of costs to the lowest level is essential as much as possible. It is therefore unlikely that incremental budgeting will provide the necessary tools for such an environment.

Incremental budgeting approach will be adequate only if current operations are effective, efficient and economical as much as possible without alternative options available to TADEFO Limited. Traditional incremental budgeting do not take into account alternative options neither does it look for ways of improving performance.

c) Activity Based Budgeting (ABB) is the use of costs determined by using activity based costing as a basis for preparing budgets. It involves defining the activities that underlie the financial figures in each function and using the level of activity to decide how much resource should be allocated to that function, how well it is being managed and to explain variances from budget. Its principle is that activities drive costs and the objective is to control the causes of costs rather than the costs themselves. The essence is that in the long run, costs will be better managed and understood.

Activities must be examined and split up according to their ability to add value because it is not all activities that are value adding. Activity Based Budgeting (ABB) ensures that an organisation's overall strategy, any actual or likely changes in that strategy is taken into account because it attempts to manage the business as the sum of its inter-related parts.

Activity Based Budgeting (ABB) implementation leads to the realization that the business as a whole needs to be managed with a great reference to the behavior of activities and cost drivers identified. The set up costs for TADEFO Limited's assembly line are clearly identified and hence can be budgeted for and controlled.

d) Zero Based Budgeting (ZBB) can motivate employees because they do not set targets based on historical data but on those consistent with their future objectives and those of the organization. It ensures that employees benefit by re-thinking an activity from the scratch, though it calls for extra work.

Zero Based Budgeting (ZBB) aims to eliminate slack, hence, employees raise the expectations of their own achievement and through increasing job satisfaction, enhance their motivation. It also encourages goal congruence through increasing flexibility especially if incentives schemes are based on the budget setting process.

e) Encouraging employee participation in budget setting has several advantages. Budgets should be realistic and acceptable to employees. Employees who are familiar with specific operations will provide the information for the budget and knowledge spread among several levels of management is pulled together. Morale and motivation are improved as it is hard for people to be motivated to achieve targets set by others. Operational managers' commitment to organizational objectives is increased and co-ordination between units is improved.

EXAMINER'S REPORT

The question tests candidates on Budgeting and Budgetary Control using Activity Based Costing approach. The principles of Incremental Budgeting System, advantages of Zero Based Budgeting (ZBB) and the use of budgeting as a factor for employee motivation are also examined.

Candidates are expected to prepare the company's profit statement using activity based costing techniques, state the weaknesses of increment budgeting, describe Zero-Based Budgeting and how budgeting can be for employee motivation.

All candidates attempted the question but performance was poor. Many candidates mix-up the computation of absorption rate of cost drivers on the cost pools.

Candidates could not correctly articulate the merits of Activity-Based Costing and could not explain how Zero-Based budgeting can motivate employee.

Candidates are advised to update their knowledge on the principles of budgeting and the various types of budgets giving great attention to their merits and demerits.

SECTION B

SOLUTION 2

a) OZOIGBONDU NIGERIA LIMITED

PROFITABILITY STATEMENT OF FOR THE 3 YEARS 2011, 2013 AND 2014

	2012	2013	2014
	₦	₦	₦
Sales	50,400,000	57,600,000	86,400,000
Closing stock	840,000	960,000	1,440,000
	51,240,000	58,560,000	87,840,000
Less:			
Purchases	33,600,000	38,400,000	57,600,000
Opening stock	720,000	840,000	960,000
	34,320,000	39,240,000	58,560,000
Gross profit	16,920,000	19,320,000	29,280,000
Expenses	2,880,000	3,360,000	4,320,000
Rent	1,200,000	1,200,000	1,200,000
Wages	5,160,000	5,160,000	5,760,000
Depreciation	-	500,000	1,000,000
	9,240,000	10,220,000	12,280,000
Net profit	7,680,000	9,100,000	17,000,000

b)

OZOIGBONDU NIGERIA LIMITED
CASH FLOW STATEMENT FOR THE 3 YEARS ENDED 2012, 2013, 2014

		2012	2013	2014
		₦'000	₦'000	₦'000
Cash Inflow:				
Cash sales		20,160	23,040	34,560
Receivables		29,880	34,200	50,400
	A	50,040	57,240	84,960
Payables		33,200	38,000	56,000
Expenses		2,880	3,360	4,320
Salaries		5,160	5,160	5,760
Rent		1,200	1,200	1,200
Motor vehicles		-	5,000	-
	B	42,440	52,720	67,280
Net cash flow (A – B)		7,600	4,520	17,680
Opening cash balance		4,000	11,600	16,120
Closing cash balance		11,600	16,120	33,800

c) Current ratio

$$= \frac{\text{Current asset}}{\text{Current liabilities}}$$

$$= \frac{₦39{,}560{,}000}{₦4{,}800{,}000} = 8.24:1$$

The standard current ratio is 2: 1

Ozoigbondu Nigeria Limited's current ratio is higher than the approved standard of 2:1. Meaning that the company is carrying too much cash. A cash level of ₦33,800,000 is on the high side. This cash should be put into productive or investment ventures to generate profit.

d) Gearing ratio

$$= \frac{\text{Debt capital}}{\text{Total capital}}$$

$$= \frac{₦15{,}000{,}000 \times 30\%}{₦15{,}000{,}000}$$

$$= \frac{₦4{,}500{,}000}{₦15{,}000{,}000} = 30\%$$

The ratio concentrates on the longer term stability of the organization in the area of its finances.

Workings

(i) Computation of closing stock

	Purchases	Reservation rate	Closing stock
	₦		₦
December 2011 (Monthly)	2,400,000	30%	720,000
December 2012 (Monthly)	2,800,000	30%	840,000
December 2013 (Monthly)	3,200,000	30%	960,000
December 2014 (Monthly)	4,800,000	30%	1,440,00

(ii) Cash from receivables

	2011	2012	2013	2014
	₦	₦	₦	₦
Sales	43,200,000	50,400,000	57,600,000	86,400,000
Cash sales (40%)	17,280,000	20,160,000	23,040,000	34,560,000
Credit sales (60%)	25,920,000	30,240,000	34,560,000	51,840,000
Outstanding receivables	2, 160,000	2,520,000	2,880,000	4,320,000
Cash flow debtors	23,760,000	27,720,000	31,680,000	47,520,000
Add receivables due	-	2,160,000	2,520,000	2,880,000
Total receipts		29,880,000	34,200,000	50,400,000

(iii) Cash payables

	2011	2012	2013	2014
	₦	₦	₦	₦
Purchases	28,800,000	33,600,000	38,400,000	57,600,000
Outstanding	2,400,000	2,800,000	3,200,000	4,800,000
Payment to suppliers	26,400,000	30,800,000	35,200,000	52,800,000
Old balance paid		2,400,000	2,800,000	3,200,000
Total payment to suppliers		33,200,000	38,000,000	56,000,000

Current asset in 2014

	₦
Closing inventory	1,440,000
Receivables	4,320,000
Cash Balance	33,800,000
	39,560,000

Current liabilities in 2014

	₦
Payables	4,800,000

EXAMINER'S REPORT

The question tests candidates' knowledge of the preparation of Income Statement and Cash Flow Statements.

Candidates are expected to prepare Profitability Statement, Cash Flow Statement and Compute Current and Gearing ratios.

Candidates are also expected to correctly determine the amount of receivables, payables and relevant opening and closing stocks.

About 80% of candidates who attempted the question could not clearly distinguish between the features of profit statement and cash flow and thus affected the computation of the required ratios.

Candidates' performance could improve with the effective use of Pathfinders and Study Texts.

SOLUTION 3

a)

PAKEX DIVISION STATEMENT SUMMARY

Year	1	2	3	4	5
	₦'000	₦'000	₦'000	₦'000	₦'000
Opening investment	48,000	38,400	28,800	19,200	9,600
Net cash flow	16,000	16,000	16,000	16,000	16,000
Less depreciation	9,600	9,600	9,600	9,600	9,600
Net profit	6,400	6,400	6,400	6,400	6,400
Less: interest on capital	7,680	6,144	4,608	3,072	1,536
Residual income	(1,280)	256	1,792	3,328	4,864
ROCE	13.3%	16.7%	22.2%	33.3%	66.7%

b)

Management is motivated to focus only on the outcomes of the first year for any new project because of the criterion used for performance measurement and investment decisions. Using straight-line depreciation, Residual Income is negative and the Return on Capital employed (ROCE) of 13.3% is less than the target return of 20%. Therefore, if the focus is only on the performance measures for the first year the project will be rejected even though Residual Income and ROCE rise steadily throughout the five-year period.

c)

	Year 1
	₦'000
Investment at beginning of year	48,000
Net cash flow (40% x ₦56million)	22,400
Less: Depreciation	9,600
Profit	12,800
Less: Interest on capital	7,680
Residual Income	5,120
ROCE	26.7%

Workings

Net cash flows per annum = 40% of ₦40,000,000
= ₦16million

Depreciation on straight line = $\frac{₦48,000,000}{5}$
= ₦9,600,000

Interest on capital at 16% p.a.

			₦
Year 1	=	₦48,000,000 X 0.16 =	7,680,000
Year 2	=	₦38,400,000 x 0.16 =	6,144,000
Year 3	=	₦28,800,000 x 0.16 =	4,608,000
Year 4	=	₦19,200,000 x 0.16 =	3,072,000
Year 5	=	₦9,600,000 x 0.16 =	1,536,000

ROCE for each year is based on = profit

Investment

EXAMINER'S REPORT

The question tests candidates understanding of Investment decision making using Residual Income (RI) and Return on Capital Employed (ROCE).

Candidates are expected to prepare Summary Statement in appraising the validity of the investment proposal based in Residual Income (RI) and Return on Capital Employed computed. They are also expected to appraise the alternative proposal based in the same criteria.

Candidates could not correctly interpret the question as many of them were computing the Net Present Value as a method of appraisal instead of RI and ROCE. Poor presentation of solution in tabular form was a major shortcoming. Even though, Part (c) of the question requested for the computation in the alternative proposal for Year 1 only, many candidates wasted valuable time computing for years 1 – 5.

Candidates are advised to clearly understand questions before attempting them. Proper presentation of results should be mastered by candidates.

SOLUTION 4

a) BADEGY LIMITED
PRICING POLICY
BUDGET POSITION OF THE COMPANY

EFFECT OF COMPETITORS INCREASE IN PRICE WILL RESULT INTO:	₦'000
Sales (Workings 3) (115,540 @ ₦130)	15,020.22
Cost (Workings 4)	12,448.09
Profit	2,572.11

b) Computation of budgeted position if company also raises its price by 6%:

	₦'000
Sales (Workings 5)	13,292.188
Cost (Workings 6)	10,392.446
	2,899.742

Considering options 1, 2 and 3 as per the above computations, the company will be better off effecting the increase in prices of 6% as profit will be approximately ₦2.9m as against ₦2.4m and ₦2.6m.

NOTES

i. CURRENT POSITION

	₦'000
Sales 106,000 units @ ₦130	13,780.00
Cost (Workings 1)	10,774.00
Profit	3,006.00

ii. BUDGET FOR NEXT PERIOD

	₦'000
Sales 106,000 @ ₦130	13,780.00
Cost (Workings 2)	11,420.00
Profit	2,360.00

Workings

1. Current price per unit

$$\frac{₦\ 10,774.000}{106,000} = ₦101.64$$

2. Total Cost = ₦10,774,000 x 1.06 = ₦11,420.440

3. Sales Computation in units

106,000 + (6% x $1^1/_2$) 9% = 9,540 units

= 106,000 + 9,540 = 115,540units

4. Cost 115,540 x ₦101,64 x 1.06%

= ₦12,448,090

5. Sales computation in units as a result of increase in price:
106,000units minus (9% x 106,000) = 9,540units
= (106,000 – 9,540) = 96,460units

Current sales price per unit ₦130 x (1.06%) = ₦137.8

New total sales figure = ₦137.8 x 96,460 = ₦13,292,188

6. Cost of sales = 96,460 x ₦101.64 x 1.06%

= ₦10,392,446

ALTERNATIVE SOLUTIONS FOR QUESTION 4

(a) BADEGY LIMITED

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

= 1.5

When the company's price fell by 4% in real terms, demand increased by 4% x 1.5 i.e. 6%.

When the company's price fell by 6% in real terms, demand will increase by 6% x 1.5 i.e. 9%.

Determination of fixed and variable costs:

Adjust current period's costs to previous period prices

$\frac{10,774}{1 + 4\%} = 10,360$

Use high/low method to determine fixed/variable cost split.

Period	Unit	Cost
	'000	₦'000
Current	106	10,360
Previous	(100)	(10,000)
Difference	6	360

Variable cost per unit = $\frac{₦360,000}{6,000}$ = ₦60

Fixed cost = ₦10,000,000 – (100,000 x ₦60)

Fixed cost = ₦4,000,000

Variable cost per unit next period:

= ₦60 x (1 + 4%) x (1 + 6%) = ₦66.144

Fixed cost per unit next period

= 4,000,000 x (1 + 4%) x (1 + 6%) = ₦4,409,600

Budget position at ₦130	₦
Sales: 106,000 x (1 + 9%) x ₦130	15,020,200
Variable costs: 106,000 x (1 + 9%) x ₦66.114	(7,642,278)
Contribution	7,377,922
Fixed costs:	4,409,600
Profit	2,968,322

Budget position at ₦130 + 6%	
Sales 96,460 x 130 x (1 + 6%) 137.80	13,292,188
Variable cost 96,460 x 66,144	6,380,250
Contribution	6,911,938
Fixed cost	4,409,600
Profit	2,502,338

EXAMINER'S REPORT

The question tests candidates' knowledge of Budgeting and Pricing Policy decisions.

Candidates are expected to prepare the company's budgeted position showing the effect of inflation and change in price, likely effect of competitor's reaction and elasticity of demand. About 70% of the candidates avoided the question and the performance of candidates who attempted it was poor.

Many candidates were unable to factor in elasticity of demand into the budgeting process and price changes. The effect of inflation factor on changes in quantity in demand also posed a great challenge.

Candidates are advised to familiarize themselves with budgeting techniques and pricing strategies and ensure adequate preparations for the examination.

SOLUTION 5

a) The Balanced Scorecard Approach to performance measurement emphasises the need to provide management with a set of information which covers all relevant areas of performance in an objective and unbiased manner. The information provided cover both financial and non-financial aspects such as profitability, customer satisfaction, innovation and internal efficiency. It focuses on four different perspectives:

(i) Customer perspective – This considers how new and existing customers view the organisation. It should identify targets that matter to customers such as cost, quality, delivery etc.

(ii) Internal perspective – This makes an organisation to consider what processes it must excel at, to achieve financial and customers' objectives. This perspective aims to improve internal processes and decision making.

(iii) Innovation and learning perspective – This requires the organisation to consider how it can continue to improve and create value. The organisation must acquire new skills and develop new products to maintain a competitive position in their respective market(s) and provide a basis from which the other perspectives of the balanced scorecard can be achieved.

(iv) Financial perspective – This considers whether the organisation meets the expectations of its shareholders and how it creates value for them. It focuses on traditional measures such as growth, profitability and cost reduction.

b) Division X

(i) Return on Investment (ROI)

Net profit = 46.4m x 30% = 13.92m

$$ROI = \frac{\text{[illegible]}}{\text{[illegible]}} \text{[illegible]} 100\%$$

$$= \frac{₦13.92m}{₦88.2m} \times 100\% = 15.78\%$$

Residual Income (RI)

Imputed interest charge = capital employed x cost of capital

₦88.2m x 15% = ₦13.23m

RI = Net profit - input interest charge

Net profit = ₦13.92m, Imputed interest charge = ₦13.23m

RI = ₦13.92m – ₦13.23m
= ₦0.69m

(ii) Division Y

Return on Investment (ROI)

Net profit = ₦28.1m x 35% = ₦9.835m

$$ROI = \frac{\text{Net profit}}{\text{Capital employed}} \times 100\%$$

$$= \frac{₦9.835m}{₦46.0m} \times 100\% = 21.38\%$$

Residual Income

Net profit = ₦9.835m, capital employed = ₦46.0m

Imputed interest charge = ₦46.0m x 15%
= ₦6.9m

R.I = ₦9.853m – ₦6.9m = ₦2.935m

(iii) The current return on investment (ROI) of each division is 18 percent. It is likely that the manager of Division X will reject any proposal based solely on ROI as the Division X investment only has a ROI of 15.78%.

The proposed investment would reduce Division X's ROI by 2.22 percentage points.

Division Y manager will likely accept the proposal as the Division's investment has a ROI of 21.38%. The proposed investment would increase Division Y's ROI by 3.38 percentage points.

Division Y equally has a more healthy RI unlike Division X. The use of ROI as a sole decision tool by the organisation would lead to a lack of goal congruence between Division X and the company as a whole.

The use of RI as an investment measure helps divisions to make decisions that are in the best interest of the organisation.

EXAMINER'S REPORT

The question tests candidate knowledge on divisional performance measurement with emphasis on Return on Investment (ROI) and Residual Income.

Candidates are expected to focus on the four perspectives of the Balanced Score Card and compute the Return on Investment and Residual Income stating comments thereon.

Candidates displayed a good understanding of the question but the presentation of solution in Part (b) was their greatest undoing. A number of candidates did not clearly show their workings.

Candidates are advised to ensure adequate coverage of the syllabus in order to excel in the Institute's examinations.

SOLUTION 6

a)

MARKUS LIMITED

DETERMINATION OF MOST PROFITABLE PRODUCT MIX

Products	X	Y	Z
	₦	₦	₦
Selling price	120	110	100
Less marginal cost:			
Direct material cost	40	24	32
Direct labour cost	16	12	8
Variable overhead	14	26	16
Total marginal cost	70	62	56
Contribution per unit	50	48	44
Contribution per labour hour	12.5	16	22
Ranking of products	3rd	2nd	1st

Products	Units	Available labour hours		
Z	3,000	3,000 X 2 hours	=	6,000 hours
Y	10,000	10,000 x 3 hours	=	30,000 hours
X	300	-300 x 4 hours	=	1,200 hours
				37, 200 hours

b) PROFITABILITY STATEMENT FOR THE PRODUCT MIX

		₦
Contribution:	X: 300 units @ ₦50	15,000
	Y: 10,000 units @ ₦48	480,000
	Z: 3,000 units @ ₦44	132,000
Total contribution		627,000
Less: Fixed overhead		
	₦	
	X = 3,600 x ₦20 = 72,000	
	Y = 6,000 x ₦20 = 120,000	
	Z = 3,400 x ₦20 = 68,000	260,000
Maximum profit		367,000

EXAMINER'S REPORT

The question tests candidates' knowledge on Marginal Costing Technique and optimal product mix using the contribution per limiting factor approach.

Candidates are expected to determine the contribution per unit and per unit of limiting factor, product profitability using the limiting factor and maximization of contribution per limiting factor (hours)

Candidates displayed a poor understanding of the question and performance was also poor.

Candidates demonstrated a shallow knowledge of Marginal Costing Techniques as many applied absolute profit instead of contribution per limiting factor in taking decisions.

Candidates are advised to utilize the Institute's Pathfinders in their preparation for the examinations.

SOLUTION 7

a)

Globalisation refers to the process of denationalization of clusters of political, economical and social activities. It is an evolution which is systematically restructuring interactive phase among nations, by breaking down barriers in the area of culture, commerce, communication and several other fields of endeavour.

Globalisation is a growing worldwide interdependence of people and countries made possible as a result of huge advances in technology. Barriers in trade are broken down and the world major financial markets are integrating as a result of globalisation. It is a world without frontiers where business, products, people and their ideas are freely disseminated and diffused. It makes global exchange of knowledge, commerce and culture to freely interact.

With the aid of satellite communications, internets, fibre optics cable, digital information transactions, and high speed computers, management of any organization can safely monitor the activities and trend of their company's performance. It ensures strong economic integration.

Globalisation makes possible the wide spread of materials, wealth, knowledge and culture. Corporate work places can be effectively managed online. It has equally made it easier to open up other countries market, thereby leading to expansion of trade. Internet technology has revolutionized communication. It enhances easy, cheap and quick access to people and information worldwide.

Globalisation has given rise to global market value system, global marketing, access to international financial market and it has effectively removed the world trade barriers.

Hence, with the attendant benefits that come with globalization, managers of organizations can increase their entities productivity from any remote area of the world and receive information as and whenever required.

Management Information System (MIS) is the effective use of information to aid the activities of managers. The activities of managers include:

- Presentation of materials which is enhanced by the use of word processing equipment such as word processors. The use of spreadsheets also aid the presentation and preparation of accounting information.

- Teleconferencing, which involves conferencing of managers in different locations also aid the effectiveness of managers.

Electronic Commerce (e-Commerce) is another area of MIS where wide varieties of goods and services are made available to enhance the activities of the managers.

The production of good information also enables the company to gain more competitive advantage over rivals of the same line of business and it encourages specialization by managers.

Globalisation enables companies to gain more competitive advantage over rivals in the same line of business. Wide varieties of goods and services are made available. Specialization is enhanced as excess products have markets.

b) The criticisms against globalization

Despite the numerous benefits of globalization, it is not without criticisms. It has been argued that globalization has widened the gap between the rich and the poor. Though global wealth has increased, it is held in fewer hands, organizations and countries.

Globalisation brought about environmental degradation. The quest for growth and profitability by orgasniations has made many of the companies to abandon or ignore environmental protection and sustenance. Environmental pollution is rampant and environmental offenders are daily increasing.

Though globalization has enriched the world scientifically, economically, politically and socio-culturally, there appears to be no global government to regulate globalization.

Globalisation has made different countries and cities of the world to be under one roof, but democracy is literarily eroded and seeds of stability eroded in most countries. This has negative effect on organizations performance.

Human animal and plant diseases can spread more quickly through globalization. Economic depression in one country can trigger adverse reaction across the globe. It can lead to capital flight where funds are moved from country where interest on return on investment is low to a country where the interest is high.

Companies are faced with greater competition. This can put smaller organisations at a disadvantage as they do not have resources to compete on global scale.

Globalizations do not maximize sustainable economic growth. With globalisation comes the activities of fraudsters, hackers etc.

EXAMINER'S REPORT

The question tests candidates' knowledge on Globalization and the use of Management Information System (MIS) to enhance management performance. It also requests for the criticisms of globalization.

About 60% of the candidates attempted the question and performance was below average.

Many candidates did not do well as they restricted their explanations only to Internet services.

Candidates are advised to familiarize themselves with the concept of Globalization and how Management Information Systems (MIS) support management performance.

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – MAY 2015

AUDIT AND ASSURANCE

Time Allowed: 3 hours

ATTEMPT FIVE QUESTIONS IN ALL

SECTION A COMPULSORY QUESTION (30 Marks)

QUESTION 1

a. The Nigerian Standards on Auditing (NSA) 14 on Audit Evidence (ISA 500) deals with the auditors' responsibility to design and perform audit procedures to obtain audit evidence to be able to draw reasonable conclusion on which to base the auditors' opinion.

Required:

i. Explain the term "audit evidence". (2 Marks)

ii. Illustrate with ONE example each FIVE sources of audit evidence. (5 Marks)

Iii. State THREE qualities of good audit evidence. (3 Marks)

b. You are in charge of the audit of Chino International Limited. While trying to conclude the audit for the year ended December 31, 2013, the following issues arose:

(i) The Ultimate Bank of Nigeria Limited had dispatched its letter of confirmation in respect of Chino International Limited for the year ended December 31, 2013 directly to your firm but was lost in transit. The Financial Controller who wanted the audit completed soonest brought his own copy of the bank confirmation urging you to accept it.

(ii) A debtor who accounts for 40% of the entire receivables in the books of Chino International Limited sent a confirmation which is materially lower than the balance stated in the books. The Financial Controller is unable to provide an acceptable reconciliation.

(iii) The Managing Director/Chief Executive tells you that the inventories have been physically counted and valued using the most appropriate basis of valuation at year-end.

(iv) At the final audit meeting, the Managing Director and the Finance Director refused to sign the letter of representation because of a material disagreement with your opinion on the inadequacy of disclosure of the company's accounting policies in accordance with International Financial Reporting Standards. Their explanation was that the Directors have statutory responsibility to prepare the company's financial statements and not the independent auditors, who have been provided with all the relevant information required to enable them form their opinion.

Required:

i. Identify and analyse one relevant audit matter in respect of each of the above issues. (8 Marks)

ii. Explain how you will treat these issues in your summary of significant audit matters in the audit report. (12 Marks)

(Total 30 Marks)

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

QUESTION 2

a. Assurance engagement is an assignment in which a practitioner expresses a conclusion designed to enhance the degree of confidence of the intended user, other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria.

Required:

i. Describe the TWO categories of assurance engagement. (4 Marks)

ii. State and explain briefly the FIVE elements of an assurance engagement. (5 Marks)

b. i. Describe the term "expectation gap" in the context of an audit. (3 Marks)

ii. State THREE examples of the misunderstanding inherent in the public expectation of the role of external auditors. (3 Marks)

iii. State how the expectation gap can be bridged. (3 Marks)

c. State the authority that appoints the auditors for the audit of Nigerian National Petroleum Corporation (NNPC). (2 Marks)

(Total 20 Marks)

QUESTION 3

Ahmed, Biodun and Chukwu are partners in a firm of builders specializing in house alteration, improvements and redecoration. Since commencement of business four years ago, they have been fairly successful. The firm's turnover now is about ₦120 million. In the fourth year, Chukwu introduced his sister Eucharia to the firm as a dormant partner. She brought in ₦80million as her own capital as against Ahmed's ₦40million, Biodun's ₦20million and Chukwu's ₦60million. Eucharia lives abroad and only comes over once a year.

The books are kept by Biodun who has HND in Business Administration. There has never been a proper audit of the accounts but the firm's financial advisor reviewed the books once without giving any form of opinion on the accounts.

At a recent partners' meeting, Ahmed raised issues on Biodun's interpretation of the partnership agreement which is a fairly complicated document. Eucharia who has been told that the other partners are living sophisticated lifestyles, suggested that they should have the firm's accounts audited.

Required:

a. Justify the benefits the partners would derive from engaging the services of an independent auditor. (5 Marks)

b. Describe other services accountants provide in addition to auditing. (5 Marks)

c. State the differences between statutory and non-statutory audits. (5 Marks)

d. Describe briefly FIVE fundamental principles of independent auditing. (5 Marks)

(Total 20 Marks)

QUESTION 4

a. List TWO control objectives and THREE control activities that should be put in place for each of the following:

   i. Cash sales (5 Marks)
   ii. Lodgements into bank (5 Marks)

b. Internal controls are essential features of any organisation that is run effectively. However, it is important to realise that internal controls have inherent limitations.

Required:

State FIVE inherent limitations of internal controls. (5 Marks)

c. In a medium size trading organisation, the accountant was given additional responsibility of making recoveries from debtors. On one occasion, when an insurance claim of ₦10million was received, he credited it to the account of a debtor and misappropriated an amount of ₦10million he had recovered in cash from the debtor.

Required:

Describe the weaknesses in the internal control system which led to this situation. (5 Marks)

(Total 20 Marks)

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

QUESTION 5

a. A. Y. Rollys and Co., is a medium size firm of Chartered Accountants that acts as auditors to two major competing telecommunication companies.

Required:

Comment on the above scenario in line with ICAN's Professional Code of Conduct and Guide for Members in the context of ethical conflict. (8 Marks)

b. It was discovered that the engagement partner has been a major shareholder in one of the telecommunication companies before the firm commenced the audit of the company and the engagement partner's wife is also a major distributor to one of the companies.

Required:

Evaluate the above situation and advise the firm accordingly. (7 Marks)

(Total 15 Marks)

QUESTION 6

The independent auditor must evaluate the validity of audit evidence obtained before it is relied upon.

Required:

a. In the course of an audit, the auditor makes many enquiries from clients' directors and employees.

   i. State the factors an auditor should consider in evaluating oral evidence provided by officers and employees. (3 Marks)

   ii. Assess the sufficiency, appropriateness and limitation of oral evidence. (2 Marks)

b. An auditor's tests may include re-computation of various accounting ratios for comparison with prior years and industry averages.

   Discuss the sufficiency, appropriateness and limitation of ratio analysis as audit evidence. (5 Marks)

c. An auditor observes the physical inventory count of a manufacturing company's finished goods which consist of expensive and highly complex equipment. Discuss the sufficiency, appropriateness and limitations of the audit evidence provided by such observation. (5 Marks)

(Total 15 Marks)

QUESTION 7

It is said that internal control forms the bedrock of reliable financial reporting. In every audit, the auditor should obtain sufficient understanding of the internal control of an entity to enable him adequately plan the audit.

Required:

Illustrate the objectives of the auditor in considering an entity's

a. Control Environment. (3 Marks)
b. Risk Assessment. (3 Marks)
c. Control Activities. (3 Marks)
d. Information and Communication. (3 Marks)
e. Monitoring. (3 Marks)

(Total 15 Marks)

SOLUTION 1

(a)

i. Audit evidence:

According to Nigerian Standard on Auditing No. 14, Audit evidence is defined as information used by the auditor in arriving at the conclusions on which the auditor's opinion is based. Audit evidence includes both information contained in the accounting records underlying the financial statements and other information.

ii. Sources from where the auditor may obtain audit evidence are:

- ✓ Inspection of (looking at an item)
  - tangible assets
  - entries in accounting records
  - documents (e.g. invoices)
- ✓ observation
  - watching a procedure (e.g. physical inventory counts, distribution of wages, opening of mails, etc.)
- ✓ inquiry
  - Seeking information from knowledgeable persons inside or outside the entity.
  - Evaluating responses to those enquiries
  - Corroborating those responses with other audit evidence
  - It may be necessary to obtain written representations from management and/or those charged with governance to confirm response to overall enquiries in respect of some matters.
- ✓ External confirmation
  - A specific type of enquiry – seeking confirmation from a third party (e.g. bank or suppliers)
- ✓ Recalculation
  - Checking the mathematical accuracy of documents or records (e.g. adding up the list of year-end trade receivables)

- ✓ Reperformance
  - Independently carrying out procedures or controls which were originally performed by the clients (e.g. reperforming the ageing of year-end trade receivables.)

- ✓ Analytical procedures
  - Evaluating and comparing financial and/or non-financial data for plausible relationship and investigating unexpected fluctuations.

iii. The qualities of good audit evidence are determined in relation to its relevance, reliability and sufficiency.

- Relevance – good audit evidence must be relevant to the matter under consideration. Audit evidence is relevant when it assists the auditor in forming his/her opinion on the subject or area being considered.

- Reliability – this refers to the extent to which the auditor can base his/her opinion on the evidence. The following rules apply in relation to reliability:
  - External evidence is more reliable than internal;
  - Documentary evidence is more reliable than oral;
  - Auditor's own evidence is more reliable than others;
  - Original evidence is more reliable than photocopies;
  - Multiple evidence is better than single.

- Sufficiency – the auditor must determine the level of evidence that suffices for the formation of his/her opinion. The judgement will depend on:
  - How persuasive the evidence is;
  - The auditor's knowledge of the business;
  - The level of reliability of the internal control system;
  - The level of audit risks involved.

b.(i) Relevant audit matters in respect of each of the above issues are:

- Bank Confirmation letter was dispatched directly to the audit firm but was lost in transit. No matter the urgency, the use of financial controller's copy of bank confirmation letter cannot be accepted because it is not a reliable evidence. The auditor can request for another copy or perform alternative test like test of transactions and balances which is substantive test e.g. review of bank reconciliation statements, in order to establish the correct balances for the bank concerned.

- Where two sources of audit evidence are contradictory in material respect, both should not be accepted until the inconsistency is resolved. In this situation, the auditor should carry out a test of transactions that transpired between the client and the customer during the period in question, possibly through vouching.
- To an auditor, inventory audit is not done orally but by attending the inventory count and appropriate documentation would need to be made during the inventory count. Therefore, the auditor cannot rely on what the Managing Director/Chief Executive said concerning the inventory value. Also, the appropriate basis of valuation at the year-end is the policy the company must adopt consistently in the preparation of financial statements.
- The Managing Director and Finance Director need to be re-educated on the signing of letter of representation, indication of which would have been stated in the audit engagement letter. Even if it is the responsibility of the management to prepare the financial statements, the auditor is to certify that it shows a true and fair view. The explanation given by the Managing Director and the Finance Director for not signing the letter of representation is not acceptable.

ii. The issues referred to above will be treated in the audit report in the following ways:

- ✓ The loss of the bank confirmation letter is not a direct fault of the management. As stated above, it behoves the auditor to carry out substantive tests or requests for another copy from the bank. If satisfied, the auditor would issue an unmodified audit report.
- ✓ The inability to reconcile the accounts of a debtor, which is 40% of the entire receivables, with the confirmed balance which shows a material difference is an infraction which should be reflected in the domestic report to management. It should also be reported in the auditors' statutory report to the members as an "adverse opinion" since the financial statements

could be materially misstated because of its pervasive nature and significant uncertainty regarding the existence and valuation of the asset.

- ✓ The non-attendance and observation of the ‘physical count’ of the inventories by the auditors and the directors’ unconfirmed assertions of most appropriate basis of valuation at the year-end is a strong weakness which, if material, should attract a disclaimer in the auditors’ report for lack of sufficient and reliable evidence. It should also form part of the matters in the report to management.
- ✓ Refusal to sign letter of representation by the Managing Director and Finance Director because of a material disagreement on disclosures of accounting policies in accordance with International Financial Reporting Standards (IFRS) will attract “an adverse opinion” in the auditors’ report to members, because of the unresolved material disagreement.

EXAMINER’S REPORT

The question, tests candidates’ knowledge of Audit Evidence. Being a compulsory question, almost all the candidates attempted the question. Candidates performed above average in part (a) but poorly in part (b) where candidates were expected to apply their knowledge to audit practice situations.

Candidates’ major shortcomings were their inability to interprete scenarios and apply their knowledge to proffer solutions to ensuing issues.

Candidates should, in line with current dispensation, learn how to apply their skills to practical issues.

SOLUTION 2

a. i. The two categories of assurance engagement are:

✓ REASONABLE ASSURANCE
In a reasonable assurance engagement, the practitioner expresses the conclusion in the positive form, e.g. "in our opinion, the financial statements give a true and fair view".

This form of expression conveys reasonable assurance. The objective of a reasonable assurance assignment is to reduce assignment risk to an acceptable level so that the reporting accountant is able to give a positive opinion. To be in a position to express a conclusion in the positive form like this, it requires that the practitioner obtains sufficient and appropriate evidence as part of the interactive, systematic engagement process.

✓ LIMITED ASSURANCE
In a limited assurance engagement, the practitioner expresses the conclusion in the negative form, e.g. "based on our review, nothing has come to our attention that causes us to believe that the accompanying financial statements do not give a true and fair view".

This form of expression conveys a level of limited assurance that is professional to the level of the practitioner's evidence-gathering procedures, given the characteristics of the subject matter. The objective of a limited assurance engagement is a reduction in assurance engagement risk to a level that is acceptable in the circumstances of the engagement.

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

✓ A tripartite relationship:

- Practitioner – the individual providing professional services that will review the subject matter and provide the assurance, e.g. a Chartered Accountant; the audit firm in a statutory audit.
- Responsible party – the person(s) responsible for the subject matter e.g. the Directors are responsible for preparing the financial statements to be audited.

- Intended users – the persons or class of persons for whom the practitioner prepares the assurance report e.g. the shareholders in a statutory audit.

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

✓ Suitable criteria
This represents the rules against which the subject matter is evaluated in order to reach an opinion. In a statutory audit, this would be the applicable reporting framework (e.g. IFRS and Company law).

✓ Evidence
Information used by the practitioner in arriving at the conclusion on which his opinion is based. This must be sufficient, reliable and relevant.

✓ Assurance report
The report (normally written) containing the practitioner's opinion. This is issued to the intended users following the gathering of evidence.

b.(i) The term "expectation gap" refers to the fact that the public perception of the role and responsibilities of the independent auditor is different from the statutory role and responsibilities. The expectations of the public are often set at a level higher than that at which the independent auditor actually operates

(ii) The examples of the misunderstanding inherent in the public expectation of the role of independent auditor include the following:

- The public believes that the audit opinion in the audit report amounts to a "certificate" that the financial statements are correct and may be relied upon for all decision-making purposes, including decisions about takeovers and investments.
- The public assumes that in carrying out the audit work, the auditor tests 100% of the transactions undertaken during the accounting period.
- The public also assumes that the audit opinion is a continuous guarantee rather than a guarantee as at the reported period.

- The public assumes that the auditors prepare the accounts and should therefore guarantee its completeness.

(iii) Expectation gap can be bridged in the following ways:

- Corporate governance codes have been changed to strengthen the role and responsibilities of directors for good internal control and accounting systems in some economies including Nigeria.
- The standard format of the audit report has been expanded in recent times in an attempt to clarify what is involved in an audit and the relative responsibilities of the directors and the auditors
- Critics reported that those groups who are promoting "expectation gap" within the public may not understand the attempts that have been made to remedy the problems associated with "expectation gap". Professional accountancy bodies, therefore, should endeavour to create awareness of their functions to correct the misconception in the minds of the public.

c.(i) The authority that appoints the auditors for the audit of Nigerian National Petroleum Corporation (NNPC) is the top management of the NNPC following the recommendation of the office of the Auditor–General for the Federation who would have earlier sent an approved list of auditors from where the management would pick the auditor that they appoint.

EXAMINER'S REPORT

The question tests candidates understanding of assurance engagement in Part (a) and the expectation gap between the public and statutory responsibilities of the auditor in Part (b) while Part (c) is a public sector audit process. About 80% of candidates attempted the question.

They exhibited good understanding of Parts (a) and (b) but performed poorly in Part (c). Candidates are advised to cover the syllabus adequately for future examinations.

SOLUTION 3

a. The benefits that the partners will derive from the engagement of independent auditor include the following:

   i. The book-keeper, Biodun, may not be suitably qualified to do the job hence; an independent auditor will guide him and the other partners on how to improve record keeping.

   ii. The auditors' findings and conclusions will be more acceptable by the partners and may pave way for resolution of any conflict in the partnership.

   iii. The partnership accounts will be more acceptable by authorities such as government, banks and other financial institutions and business associates.

   iv. The audited accounts constitute a reliable evidence for computing the amount due from the firm to a retiring or deceased partner.

   v. The engagement of an independent auditor serves as a moral deterrent and checks on the partners against fraudulent practices.

   vi. Because the auditor is not related to any of the partners, he/she will be objective and independent in the conduct of the audit.

   vii. The engagement of an independent auditor will make the Internal Revenue Services to place more confidence in the firm's financial information for tax assessment of the partners.

b. Other services that accountants can provide in addition to auditing include the following:

   i. Book-keeping and accountancy services;
   ii. Investigation such as fraud, loss of profit, inventory, shortage, etc.;
   iii. Secretarial services;
   iv. Tax consultancy;
   v. Share valuation and registration services;
   vi. Management consultancy services;
   vii. Financial advisory services;
   viii. Receivership and Executorship Services;
   ix. Acting as Reporting Accountants during share issues; and
   x. Arbitration Support Services.

c. The differences between Statutory and Non-Statutory Audit include:

i. Statutory audit is mandatory and must be carried out in compliance with the relevant laws while non-statutory audit is optional, it is at the discretion of parties engaging the auditors.

ii. The objective of statutory audit is as provided in the enabling laws such as CAMA, BOFIA Insurance Act, and Statutory Corporations enabling laws etc., while the objective of non-statutory audit is as provided by the parties engaging the auditors.

iii. Standards and guidelines are to be adhered to strictly in statutory audits while compliance with standards and guidelines may be principle-based in non-statutory audits.

iv. In statutory audit, independence is very fundamental while it is less emphasized in non-statutory audit.

v. The auditor in statutory audit reports to members based on the issues specified in the applicable legislations while the auditor in non-statutory audit reports to the parties that engage him based on the terms of reference agreed at the commencement of the audit.

vi. The scope of work of auditors in statutory audit is as defined by the applicable legislations while the scope of work in a non-statutory audit is as defined by the appointing party.

d. Fundamental concepts of independent auditing are as follows:

i. Accountability – independent auditor acts in the interest of primary stakeholders while also having regard to the wider public interest.

ii. Integrity – auditors should act with integrity, discharging their responsibilities with honesty, fairness and faithfulness. Integrity helps to insulate auditors from matters of conflict of interest and elevate their objectivity.

iii. Objectivity and independence – auditors should be seen to be objective in all their dealings with their clients. They express opinions independently of the entity and its directors.

iv. Judgment – auditors apply professional judgment taking account of materiality in the context of matters in which they are reporting.

v. Clear communication – auditors' report contain clear expression of opinion which are set out in writing for proper understanding.

vi. Providing value – auditors add to the reliability and quality of financial reporting. They provide to directors and officers constructive observations arising from the audit process, thereby contributing to the effective operation of the business entity.

vii. Professional competence and due care – auditors have a duty to maintain their professional knowledge and skills at such a level that a client or employer receives a competent service based on current developments in practice, legislation and techniques. Auditors should act diligently and in accordance with applicable technical and professional standards.

viii. Confidentiality – auditors should respect the confidentiality of information acquired as a result of professional and business relationships and should not disclose such information to third parties without authority or unless there is a legal or professional right or duty to disclose.

ix. Professional behaviour – auditors should behave with courtesy and consideration towards all with whom they come into contact in a professional capacity. They should comply with relevant laws and regulations and should avoid any action which discredits the profession.

EXAMINER'S REPORT

The question tests candidates on the concept of auditing services, derivable benefits and other accountancy's services. Over 60% of the candidates attempted the question and they showed fair understanding in Parts (a), (b) and (d) but performed poorly in Part (c). The commonest pitfall is that candidates could not differentiate between statutory and non-statutory audit.

Candidates are advised to prepare well in future before taking the examinations.

SOLUTION 4

a. i. Control objectives in respect of cash sales are to ensure that:

- ✓ all cash that the company is entitled to is received;
- ✓ all cash received is properly accounted for and entered correctly in the records;
- ✓ all such cash received is deposited promptly and intact in the bank;

- ✓ cash sales are made at approved company prices.
- ✓ cash sales proceeds are physically safeguarded.

Control activities in respect of cash sales:

- ✓ Prescribe and limit the number of persons who are authorized to receive cash e.g. salesmen, sales' assistants, cashiers, collectors, etc.;
- ✓ Establish means of evidencing cash receipts e.g. pre-numbered duplicate receipts, cash registers with blockable till, POS rolls, etc.;
- ✓ Ensure that customers are aware that they must receive a receipt form or till receipt or ensure that the amount rung up on the cash register is clearly visible to the customers;
- ✓ Immediate and intact banking. Cash received for expenses should be from funds drawn from the bank using an imprest system;
- ✓ Investigation of 'shorts' and 'overs' in excess of an allowed limit should be carried out promptly;
- ✓ Independent comparison of agreed till roll totals with subsequent banking records;
- ✓ Persons handling cash should not have access to other funds or sales ledger records or to make cash purchases;
- ✓ Rotation of duties and provision of cover for holidays (which should be compulsory) and sickness;
- ✓ Collections by collectors and sales representatives should be banked intact daily. There should be independent reconciliation of amounts banked with records;
- ✓ Approved selling prices must be displayed in the sales office or the showroom;
- ✓ Cash sales proceeds must be verified by the cashier and kept in the safe pending lodgement;
- ✓ Surprise cash count must be undertaken by persons other than the cashier;
- ✓ There must be cash holding insurance policy in place;
- ✓ Fidelity bond guarantee should be taken on all staff handling cash.

ii. Lodgments into bank – control objectives are to:

- ✓ ensure that all cash and cheques received are banked intact;

- ✓ ensure that all cash and cheques received are banked without delay at prescribed intervals, preferably daily;
- ✓ ensure that all cash and cheques received are accounted for and recorded accurately;
- ✓ eliminate diversion of sales proceeds;
- ✓ eliminate fraud in cash management.

Lodgments into bank – control activities:

- ✓ Cash and cheques should be banked intact;
- ✓ Cash and cheques should be banked without undue delay;
- ✓ The bank pay–in–slip should be prepared by an individual with no access to cash collection points, purchase or sales ledgers;
- ✓ Banking should be made with security in mind hence; the use of escort should be adopted where appropriate.
- ✓ There should be independent comparison of paying–in–slip with collection records, post lists and sales ledges records;
- ✓ Periodic preparation and verification of reconciliation statements;
- ✓ Direct lodgement to banks by customers where feasible.

b. Inherent limitations of Internal Control include:

- Cost–Benefit Analysis – A requirement that the cost of an internal control procedure should be commensurate with the gain of instituting the internal control procedure may result into its absence.
- Routine Transactions – Internal control can only be directed at routine transactions. The one-off unusual transaction tends not to be the subject of internal control.
- Potential Human Errors – Potential human errors caused by stress of workload, alcohol, carelessness, mistakes of judgment, misunderstanding of instructions and apathy.
- Possibility of Circumvention – the possibility of circumstances of controls either alone or through collusion with parties outside or inside the entity.
- Management Fraud/Management Overriding the Control – deliberate fraud committed either by Directors in misrepresenting the financial statements.
- Human Factor/Fraud – however secure the computer code designed to prevent access, there is always some hackers who break in.

- Environmental Factors – changes in environment making controls inadequate.

c. The weaknesses in the internal control system leading to the situation explained in the question include:

- Lack of segregation of duties – The accountant was given additional responsibility of making recoveries from debtors in addition to his original role of carrying out transactional recording of accounting information.
- Payment allowed in cash – The Company's policy to receive payment from debtors in cash was a weakness that encouraged misappropriation of cash. Instead of payment of debt by cash, debtors should have been made to either pay their money directly into the company's designated bank account or make their payment with draft or cheque or other instruments; or even with electronic payment method, to comply with current directive of the Central Bank of Nigeria.
- Lack of supervision – The accountant was not supervised by a senior officer. The supervisory control over the accountant's duties would have gone a long way to discourage the accountant from the misappropriation of the cash.
- Failure of reconciliation of sales proceeds is another weakness that encouraged the cash misappropriation.
- Lack of use of official receipts for all collection received is a weakness that facilitated the fraud.
- The weak system of receipts of mail and invariably cheques sent by mail or dispatch may have encouraged the misappropriation of cash.
- The size of the organization and volume of transactions notwithstanding, the establishment lacked an internal audit department which would have strengthened the internal control.

EXAMINER'S REPORT

The question tests candidates understanding of Internal Control system. About 70% of the candidates attempted the question.

Candidates showed lack of understanding in Part (a) while they exhibited good understanding of Parts (b) and (c) as reflected by the high marks earned in those

Parts. The common pitfall is their inability to distinguish between control activities and control objectives.

Candidates are advised to improve on their preparation for future examinations.

SOLUTION 5

Professionally, there are no known legal and regulatory reasons why a firm of Chartered Accountant cannot act as auditors to two competing entities. The firm should take reasonable steps to manage any conflict of interest relating to the clients that may arise to avoid untoward circumstances.

The firm should deploy safeguards to reduce or eliminate inherent threats and these safeguards must be communicated to the two clients. Some of the safeguards would include:

i. Use of different engagement partners and audit staff for the different audit assignments.

ii. Taking steps including giving standing instructions to prevent leakages of confidential information between the different audit teams and sections within the firm.

iii. Review of the audit working papers by a partner other than the engagement partner.

iv. Where it is believed that continuance of the engagement would, even with safeguards, materially prejudice the interest of the two clients, the engagement of one or both entities should be reconsidered. The clients may also make informed decision of retaining the firm considering disclosure of safeguards. The firm should discontinue with one or both engagements, If adequate disclosure is not possible because of confidentiality or other constraints.

v. Owning shares in one of the client companies would amount to having undue advantage over the other company and this would cause conflict of interests. It would also be regarded as 'insider dealing' and 'a related party transaction'. The engagement partner should dispose of the shares notwithstanding that the investment was made before the firm was appointed as auditors, otherwise, there could arise "self-interest threat". There may not be anything wrong if the wife of the engagement partner is a major distributor, especially if it is in the normal commercial sense, in the normal course of business and particularly if the appointment as distributor had been made before the firm took up the appointment. If the appointment is made after the commencement of the audit engagement, the engagement partner should disengage from the audit for ethical reasons or his wife discontinue to be a major distributor or otherwise, this would tantamount to "related party dealing".

EXAMINER'S REPORT

The question tests candidates understanding of ICAN's Professional Code of Conduct and Guide for members. Less than 50% of the candidates attempted the question and they exhibited poor understanding of the question. Their major pitfall is their inability to know how to advise the firm based on the scenario highlighted.

Candidates are advised to cover adequately all parts of the syllabus when preparing for future examination.

SOLUTION 6

a. The factors that the auditor should consider in evaluating oral evidence include:

i. - Documentary evidence is more dependable than oral evidence.
However, if documentary evidence is not available, the auditor should consider taking oral evidence.
- The complexity of the issue under consideration.
- The risk involved where oral evidence is tendered.
- Integrity of the officers giving the evidence.

ii. The auditor must determine the level of evidence that suffices for the formation of his opinion. In the absence of other source of evidence, the auditor should evaluate the oral evidence in the following ways.

- ✓ How persuasive the oral evidence is;
- ✓ The auditors knowledge of the business vis – a – vis the oral evidence;
- ✓ The level of reliability of the Internal Control System;
- ✓ The level of the risk involved.

b. Sufficiency, appropriateness and limitations of the use of ratio analysis as audit evidence:

i. When there are unusual or outstanding or non-recurring items, ratio analysis may not be desirable.
ii. The size of the entity and its operations.
iii. The knowledge gained in the previous audit of the enterprise.
iv. Availability of non-financial information to support financial information.
v. The reliability, relevance and comparability of the information available.
vi. The cost-effectiveness of the use of analytical review in relation to other forms of audit evidence.
vii. It requires good quality staff (with a high level of intelligence, experience and training).

c. The auditor shall obtain sufficient and appropriate audit evidence regarding the existence and condition of inventory by, among others, attendance at physical inventory counting:

i. The attendance at the stocktaking provides evidence that the inventory exists.

ii. Observation of the count and inspecting the inventory will show evidence of its condition.

iii. The value can also be obtained from inspecting the inventory and checking the relevant underlying procurement and costing records.

iv. Limitations of the audit evidence provided by such observations include:

- ✓ The need for proper determination of value because of the nature and materiality of the items of high value equipment especially in relation to evaluation of the cost elements.
- ✓ The essence of the use of an external expert or valuer is to reduce the risk of material misstatement.
- ✓ The assurance that the operation of control is not limited to the time of the auditors' stocktaking observation.

EXAMINER'S REPORT

The question tests candidates' ability to discuss sufficiency, appropriateness and limitations of audit evidence. Less than 50% of the candidates attempted the question and performance was poor

The commonest pitfall was candidates' misinterpretation of the question, hence missing out completely the requirements of the question.

Candidates should study hard for examinations and try to understand the requirements of the questions before attempting them

SOLUTION 7

a. Control Environment - The objectives of the auditor in considering an entity's control environment are to, among others:

   i. ascertain the integrity and ethical values of those charged with the management of an entity.

   ii. Confirm top management commitment to competence.

   iii. ascertain that the roles of board of directors and various committees are clearly defined.

   iv. evaluate management philosophy and operating style.

   v. have an overview of the entity's organizational structure

   vi. ensure that appropriate human resources, policies and procedures are in place.

b. Risk Assessment – The objectives of the auditor in considering an entity's risk assessment are to, among others:

   i. consider entity – wide objectives and associated business risks.

   ii. review process – level objectives.

   iii. evaluate entity's risk identification and analysis process.

   iv. review the entity's process for change management.

   v. evaluate mitigating factors against identifiable risks.

c. Control Activities – The objectives of the auditor in considering an entity's control activities are to, among others:

i. ensure that control policies and procedures are in place and adequate.

ii. review system application and network security.

iii. evaluate Application Change Management.

iv. review policies on Business Continuity and recovery.

v. evaluate outsourcing policies of the entity.

d. Information and Communication – The objectives of the auditor in considering an entity's information and communication are to, among others:

   i. evaluate the entity's policy on quality of information.

   ii. review communication strategy of the entire entity.

   iii. review the effectiveness of communication.

   iv. review timeliness of information and communication.

e. Monitoring – The objectives of the auditor in considering an entity's monitoring are to, among others:

   i. review on-going monitoring activities.

   ii. be able to conduct separate evaluations.

   iii. review the procedure for reporting deficiencies.

   iv. review problem identification and resolution.

EXAMINER'S REPORT

The question tests candidates on the objectives of the auditor in considering an entity's elements of internal control. Less than 50% of candidates attempted the question and performance was below average. The commonest pitfall was candidates' lack of understanding of the requirements of the question.

It is recommended that candidates should in future cover all parts of the syllabus and understand the requirements of the question.

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATIONS - MAY 2015

PUBLIC SECTOR ACCOUNTING & FINANCE

Time Allowed: 3 hours

ATTEMPT FIVE QUESTIONS IN ALL

SECTION A COMPULSORY QUESTION (30 Marks)

QUESTION 1

Nigeria presents an illuminating example of a developing mixed economy. The economy is mono-cultural and almost entirely dependent on the extraction and exportation of crude petroleum.

Nigeria has operated a multi-level system of government for over five decades. The fiscal structure involves the allocation of expenditure responsibilities and taxing powers among the Federal, State and Local Governments as embodied in the Nigeria 1999 Constitution. The public sector plays a significant role in the management of the economy at all levels of development.

The Nigerian experience in fiscal federalism, however, reveals that revenue allocation has always been a subject of controversy and various revenue Commissions have been set up to look into the allocation formula. Specifically, there have been discordant voices from different parts of the country on what to give priority; derivation, population or absorptive capacity.

Unfortunately, revenue - diversification capacity is low at all levels of government and statutory allocations from the Federation Account remain the most important source of revenue to the lower levels of government. Adoption of deficit budgets is widespread and fiscal operations of governments have resulted in overall deficits in the attempt to provide many social goods and services simultaneously.

Required:

a. Assess the nature of the Nigerian economy as a mixed and mono-cultural economy. (4 Marks)

b. Explain any THREE main roles the public sector can possibly play in this economy. (6 Marks)

c. Compare "Fiscal Federalism" and "Federation Account". (4 Marks)

d. Appraise each of the principles of revenue allocation in the scenario on the basis of efficiency. (6 Marks)

e. Identify and explain the causes and likely consequences of widespread deficit financing among the various governments in the Federation.

(10 Marks)

(Total 30 Marks)

SECTION B: ATTEMPT ANY TWO QUESTIONS IN THIS SECTION (40 Marks)

QUESTION 3

International Public Sector Accounting Standard (IPSAS 25) states that Employee Benefits are all forms of consideration given by an entity in exchange for service rendered by employees. This standard applies to all public sector entities other than Government Business Enterprises.

You are required to:

a. Identify THREE categories of employee benefits that are included in this standard. (6 Marks)

b. Explain the concept of Government Business Enterprises. (4 Marks)

c. Discuss the Defined Contribution Plans (2 Marks)

d. Identify FOUR differences between International Public Sector Accounting Standard 25 and International Accounting Standard (IAS) 19 on Employee Benefits. (8 Marks)

(Total 20 Marks)

QUESTION 4

The Cabinet of the Federal Government of Nigeria, a developing country operating a unitary system of government is considering rationalisation and re-engineering of the operations of two States that are economically unviable.

The Finance Minister is considering policy interventions in the following areas:

(i) Strengthening public expenditure management to ensure that all public expenditures are wholly, necessarily, reasonably and exclusively incurred for the purposes for which they are meant.

(ii) Changing the basis under which Public Sector Financial Statements are prepared from Committed Basis to Cash Basis.
(iii) Introduction of Fund Accounting System.

You are required to:

a. State FIVE basic controls exercised over Government expenditure (2½ Marks)

b. Briefly explain the concept of Cash Basis of Accounting and state FOUR advantages and FOUR disadvantages inherent in such a system. (8½ Marks)

c. Discuss any SIX types of Funds stipulated in the Constitution of the Federal Republic of Nigeria, 1999 as amended. (9 Marks)

(Total 20 Marks)

SECTION C: ATTEMPT ANY QUESTIONS IN THIS SECTION (30 Marks)

QUESTION 5

Compare and contrast "Fixed Plan" and "Rolling Plan" on the basis of:
(a) Salient Features (5 Marks)
(b) Merits (5 Marks)
(c) Demerits (5 Marks)

(Total 15 Marks)

QUESTION 6

"By the Fiscal Responsibility Act, 2007, the Medium-Term Expenditure Framework (MTEF) represents a strategy for the realisation of the ideals of prudency and transparency in the management of the country's resources". Discuss.

(Total 15 Marks)

QUESTION 7

The table below shows the data from the Debt Management Office (DMO) and Central Bank of Nigeria (CBN) on debt obligations and Gross Domestic Product (GDP) for the period between 2011 and 2014.

Year	External Debt (₦b)	Domestic Debt (₦b)	Gross Domestic Product (₦b)
2011	454.7	1,753.3	18,564.6
2014	590.4	3,228.0	24,794.2

Required:

a. Calculate the debt ratios for the year 2011 and 2014 and comment on the results. (4 Marks)

b. Compute the growth rates of external and domestic debt over the period 2011 and 2014, and comment on the results. (6 Marks)

c. Differentiate between "external debt" and "internal debt". (5 Marks)

(Total 15 Marks)

SOLUTION 1

(a) (i) The Nigerian economy is characterised as a mixed economy because both the private and the public sectors are involved in the ownership, control and allocation of production resources.

(ii) The economy is mono-cultural in the sense that the oil sector alone contributes over 90% of the foreign exchange earnings annually since 1970s till date.

(b) The main roles of the public sector in the economy include:

(i) Allocative role: To promote optimal allocation of resources for adequate provision of public and merit goods. Merit goods are of special importance to the public.

(ii) Distributive role: To reduce income inequality using its expenditure responsibilities and taxing powers.

(iii) Stabilisation role: To promote macro-economic stability i.e. price, interest rate and exchange rate, stability towards improving the performance of the real sector.

(iv) Control and regulation of monopolistic powers: To prevent exploitation of people thereby enabling them to enjoy high standard of living.

(v) Administration of justice and maintenance of law and order: To prevent criminal and fraudulent practices and ensure freedom of activities.

(vi) Making central planning for large structural changes in the economy.

(c) (i) Fiscal Federalism refers to the scope and structure of the tiers of governmental responsibilities and functions and the allocation of resources among the tiers of government. It defines the allocation of tax powers and expenditure responsibilities among the levels of government.

(ii) Federation Account is the account into which centrally collectible revenues are paid, except for the proceeds of Personal Income Tax of the personnel of the Armed Forces of the Federation, the Nigerian Police Force, the Ministry of External Affairs and the residents of Federal Capital Territory.

It 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.

(d) (i) Principles of derivation. It states that the State on which the bulk of the revenue is obtained should have extra share over and above what other States receive. This principle discourages complacency and encourages all States to create revenue opportunities for the centre. The principle could help foster efficient use of the States resources in the bid to maximise revenue opportunities

(ii) Principles of population. It states that States with large population should receive larger extra share above others with smaller population. This principle promotes equity, that is, to provide equal opportunity for people to enjoy desirable standards of living. It is therefore a principle that could involve sacrificing on efficiency criterion in the use of resources.

(iii) Principle of absorptive capacity. It asserts that funds should be allocated to the states in accordance to their abilities to make proper use of them. This principle emphasises efficient use of resources to promote the welfare of the people.

(e) Causes and consequences of Deficit Financing:

(i) Low level of revenue generation and low or limited revenue diversification: The obvious limited revenue diversification is one of the principal causes of deficit financing by all the three tiers of government in Nigeria.

(ii) Large size of government at various tiers undertaking ambitious social/economic projects simultaneously: The effect of such proliferation is the allocation of limited financial resources by different agencies handling almost identical responsibilities.

(iii) Political and economic instability: The instability in the economic and political environment, coupled with insecurity, affect productive activities which normally would have favoured increased revenue.

(iv) Constitutional limitation: Another factor contributing to the observed deficit financing is the fact that lower tiers of government are not usually empowered to raise taxes and collect the proceeds. As a result, the problem has always been on who should raise what, not how the revenue should be shared.

(v) Policy maker's insensitivity, especially in borrowing to bridge revenue gap and the insincerity to put in place an appropriate measures that could address the issue.

EXAMINER'S REPORT

The question tests candidates' knowledge of the nature and performance of the Nigerian economy; the practice of fiscal federalism and revenue allocation principles and the causes and consequences of deficit financing, at all levels of governance.

All the candidates attempted the question and performance was poor.

The commonest pitfall was candidates' inability to identify and explain the concepts and principles in the given scenario. Candidates are expected to use the ideas in the passage as the starting point and expound on them to demonstrate their knowledge of the ideas.

Candidates are advised to always reflect well on the scenario provided, bring their knowledge of Public Sector Accounting and Finance (PSAF) to bear in answering the question.

SOLUTION 3

(a) Employee benefits include:

(i) Short-term employee benefits, such as wages, salaries and social security contributions, paid annual leave and paid sick leave, profit-sharing and bonuses (if payable within twelve months of the end of the period) and non-monetary benefits (such as medical care, housing, cars and free or subsidised goods or services) for current employees.

(ii) Past-employment benefits, such as pensions, other retirement benefits, post employment life insurance and post employment medical care.

(iii) Other long-term employee benefits which may include long-service leave or sabbatical leave, jubilee or other long-service benefits, long-term disability benefits and, if they are not payable wholly within twelve months after the end of the period, profit-sharing, bonuses and deferred compensation and

(iv) Termination benefits are employee benefits payable as a result of either:

(i) An entity's decision to terminate an employee's employment before the normal retirement dates; or

(ii) An employee's decision to accept voluntary redundancy in exchange for those benefits.

(b) Government business enterprises mean enterprises that have all the following characteristics:

(i) Power to contract in their own names
(ii) Have been assigned the financial and operational authority to carry on businesses
(iii) Sell goods and services, in the normal course of their businesses, to other enterprises
(iv) Are not reliant on continuing government funding to be a going concern (other than purchases of outputs at arm's length); and
(v) Are controlled by a public sector entity

(c) Defined Contribution Plans are post-employment benefit plans under which an entity pays fixed contributions into a separate entity (a fund) and will have no legal or constitutional obligation to pay further contributions if the fund does not hold sufficient assets to pay all employee benefits relating to employee services in the current and prior periods.

(d) The differences between International Public Sector Accounting Standard 25 and International Accounting Standard 19, include the following:

(i) IPSAS 25 contains additional guidance on public sector bonus plans while IAS 19 does not contain such benefits in its plan.

(ii) IPSAS 25 requires that entities' apply a rate that reflects the time value of money for discounting post-employment obligations. It also requires entities to disclose the basis on which the discount rate has been determined. IAS 19 requires entities to apply a discount rate based on yields on high quality corporate bonds consistent with the currency of the post-employment benefits obligations.

(iii) IPSAS 25 uses different terminology in certain instances, from IAS 19. Examples are the use of the terms 'revenue', 'statement of financial performance', and 'statement of financial position'. IAS 19, uses 'income'. ' income statement' and 'balance sheet' as equivalent terms.

(iv) IPSAS 25 requires entities to determine an initial liability for defined benefit plans on first adoption. IAS 19 requires entities to determine a transitional liability for defined benefit plans.

(v) IPSAS 25 includes a rebuttable presumption that long-term disability payments are not usually subject to the same degree of uncertainty as the measurement of post-employment benefits. IAS 19 does not include such a rebuttable presumption.

EXAMINER'S REPORT

The question tests specific provisions of IPSAS 25 and IAS 19 on Employee Benefits.

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

Candidates failed to exhibit the required knowledge for all the parts of the question. Candidates are advised to prepare better for future examination.

SOLUTION 4

The followings are the basic control means over government expenditure;

(a) (i) Executive control
(ii) Legislative control
(iii) Ministry of Finance control
(iv) Treasury control
(v) Departmental control

CONCEPT OF CASH BASIS OF ACCOUNTING:

(b) This is the basis of Accounting under which revenues are recorded only when cash is received and expenditures recorded only when cash is paid irrespective of the fact that the transactions leading to the receipt or payment of cash now may have occurred in previous accounting period. Financial sum prepaid under the Cash Basis provide readers with information about sources of cash raised during the period, the purpose for which cash was used and the cash balances at the reporting date.

The advantages of Cash Basis

i. It is simple to understand.

ii. It permits easy identification of those who authorised payment and receive revenue.

iii. It allows comparison between budgeted figures and actual amount

iv. It permits delegation of work in certain circumstances.

v. It easy to operate.

vi. It is factual; that is, it records the true position of cash transactions in the period.

vii. It allows for comparison between amount provided in the budget and amount actually spent.

Disadvantages of Cash Basis

i. It makes no allowance for depreciation because assets are written off in the year of purchase.

ii. It does not show an accurate picture of the state of financial affairs at the end of the period.

iii. It is of little use in making economic decisions.

iv. It eliminates Receivables and Payables as regards to outstanding at the end of the year.

v. It does not allow for sound cash flows management

vi. It does not accord with matching concept

(c) Types of fund are:

i. General Fund or Consolidated Revenue Fund: It is a fund established for resources which are devoted to financing the general administration or services of Government. It is also called Consolidated Revenue Fund. Section 5 of the Finance (Control and Management) Act of 1958) Cap 144, 1990 stipulated that the management of the Fund shall be in accordance with the requirements of the Constitution of Nigeria.

ii. Capital Project Fund or Capital Development Fund: This is a fund created to accommodate resources meant for the acquisition of capital assets or facilities. It is also known as Development Fund. It can into existence by virtue of Section 18 of Finance (Control and Management) act of 1958.

iii. Special Fund: It is a Fund created for specific purposes, e.g. South African relief Fund, African staff Housing scheme Fund (A. S. H. S.).

iv. Trust Fund: It is a Fund whose resources are held by Government as a trustee. It is used for the purpose stated in the Trust Deed, e.g. Petroleum Technology development Fund and Research Foundation Fund.

v. Contingency Fund: It is a Fund whose resources are meant for expenditure or anticipated expenditure of uncertain amounts. An example is the expenditure on natural disaster. Section 15 of the Finance (Control and Management) act 1958 brought the Fund into existence.

vi. Inter-Government Service Fund: This established to provide service to other Funds, e.g. Government Clearance Fund which helps to maintain (transitionally) the balance between the Federal Government and other State Governments in respect of transactions.

vii. Revolving Fund: Revolving Fund is also known as Working Capital Fund. It is created to finance services provided by a designated unit to other Departments within a single Government set-up. An example of a Revolving Fund is Revolving Loan Fund.

viii. Self-Liquidating Fund: This is a Fund into which resources are transferred periodically and out of which any money or amount left had to be transferred to a current fund, e.g. Deposit Fund. Deposits are moneys held on behalf of third parties.

EXAMINER'S REPORT

The question tests candidates understanding of control over Government expenditure in accordance with the concept of cash basis accounting and the types of funds stipulated in the Constitution of the Federal Republic of Nigeria.

About 55% of the candidates attempted the question and their performance was average.

The commonest pitfall of the candidates was their inability to interprete the question correctly.

Candidates' are strongly advised to ensure thorough understanding of requirements of questions before proffering solutions.

SOLUTION 5

(a) Salient features of Fixed Plan and Rolling Plan

(i) Fixed Plan

- This is a plan for four, five, six or seven years.
- It lays down definite aims and objectives which are required to be achieved over the fixed plan period.
- Physical targets and financial outlays are seldom changed except under emergencies.

(ii) Rolling Plan

- This is a plan for the current year which includes the annual budget and the foreign exchange budget.
- There is also a plan for a number of years, like three, four or five years.
- It is changed every year in keeping with the requirements of the economy.

(b)

(i) Fixed Plan - Merits

- It fixes targets and priorities rigidly for achieving the objectives laid down in the plan.

- The plan ensures public cooperation and political will to make the plan a success.
- There is no element of uncertainty in this type of planning.
- The planning machinery, the public sector and the private sector are definite about the objectives and targets of the plan which are to be achieved during a given plan period.

(ii) Rolling Plan – Merits

- The concept of rolling plan is devised to overcome the rigidities encountered in the fixed plans.
- There are planned targets, projections and allocations that are not fixed for the plan period, but are liable to revision in keeping with the changing conditions of the country.
- It not only provides greater flexibility, but also a clearer perspective and a better view of the priorities.
- It takes into consideration such unforeseen natural and economic changes such as floods, drought, war, and hike in oil prices etc which may affect the economy adversely.

(c) (i) Fixed Plan - Demerits

- More often than not, the actual achievements have always fallen short of targets, arising from distortions in the price structure and availability of essential commodities.
- It fails to take into account unforeseen changes which may occur in the economy during the period of plan.
- It is unsuitable for large projects which are not merely lumpy but have a long gestation period of ten to fifteen years.

(ii) Rolling Plan – Demerits

- The targets are prone to changes, it is not possible to achieve these targets laid down in the plan within a fixed time period.
- It creates uncertainties in the private and public sectors of the economy when the plan is continually revised.
- The execution of the rolling plans is quite challenging and very demanding in terms of planning machinery, communication

systems and information flow, data collection and need for cohesive policy instrument.

EXAMINER'S REPORT

The question tests candidates' understanding of the salient features, merits and demerits of "Fixed Plan" and "Rolling Plan".

About 70% of the candidates attempted the question and performance was average.

However, most of them lost marks for their inability to provide necessary explanation of the merits and demerits of the plans.

Candidates are advised to continue to have more exposure and understanding of the concepts and methodology of planning. The Pathfinder and Study Text of the Institute are good learning materials to gain such understanding.

SOLUTION 6

(a) The enactment of the Fiscal Responsibility Act 2007 in Nigeria, is aimed at providing for prudent management of the nation's resources, ensuring long-term macro-economic stability of the national economy and securing greater accountability and transparency.

(b) The ideals of prudency, stability, accountability and transparency find full expression in the design and preparation of the Medium-Term Expenditure Frame-work (MTEF). These are underscored in the following:

(i) Medium-Term Expenditure Frame-work (MTEF) is meant to serve as the basis for the preparation of the estimates of the revenue and expenditure to be presented to the National Assembly.

(ii) In consultation with States, the Federal Government prepares and submits to the National Assembly MTEF for the next three financial years for deliberation/consideration.

(iii) The content of MTEF includes details on the macro-economic setting and projections as well as the underlying assumptions. Others are information on fiscal strategy, a consolidated debt statement, estimates of revenue and expenditure.

(iv) The Minister of Finance is responsible for the preparing MTEF which he does by means of public consultation on such issues in respect of the macro-economic framework, fiscal strategy document and development priorities.

(v) The consultation is made open to the public, the press, the citizens, group of citizens etc. In addition, the Minister seeks inputs from a number of organisations. National Planning Committee (NPC), Joint Planning Commission (JPC), National Assembly, Central Bank of Nigeria (CBN), National Bureau of Statistics, Revenue Mobilisation Allocation and Fiscal Commission (RMAFC) etc.

(c) Through extensive consultation, deliberation and consideration at several levels of governance, including reaching down to the grassroots, MTEF holds considerable prospect of achieving the ideals of prudency, accountability and transparency. However, it all depends on the reality of such consultation and quality as well as exhaustive deliberation of the MTEF.

EXAMINER'S REPORT

The question tests candidates' knowledge of the Fiscal Responsibility Act, 2007. Candidates are expected to examine the aims of the Act, design, contents and the preparation of the Medium Term Expenditure Framework (MTEF). They are also expected to appraise the MTEF against the backdrop of the ideals of prudency, accountability and transparency in the management of the country's resources.

About 30% of the candidate attempted the question and performance was poor.

Majority of the candidates did not have full grasp of the requirements of the question. Their responses therefore lacked depth.

Candidates are advised to have thorough understanding of the Act as well as MTEF. They should also take time to have good understanding of the requirements of questions.

SOLUTION 7

(a) Debt ratio is the ratio between a country's government debt and its Gross Domestic Product (GDP). It is calculated as

Debt ratio $= \frac{\text{[illegible]}}{\text{[illegible]}}$

Debt ratio for 2011

Total debt stock = ₦454.7b + ₦1,753.3b = ₦2,208b

Gross domestic Product (GDP) = ₦18,564.6

Debt ratio = $\frac{2,208}{18,564.6} = 0.1189$

$\cong$ **0.12 (or 12%)**

Debt ratio for 2014

Total debt stock = ₦590.4b + ₦3,228.0b = ₦3,818.4b

Gross Domestic Production (GDP) = ₦24,794.2b

Debt ratio $= \frac{3,818.4}{24,794.2} = 0.1540$

$\cong$ **0.15 (or 15%)**

Debt Ratios: 2011 and 2014 (Summary by Type of Debt)

Figures in %

Year	External Debt	Domestic Debt	Total Debt
2011	2.45	9.44	11.89
2014	2.38	13.02	15.40

<u>Comments</u>

(i) Over the period (2011 and 2014) the total debt ratios rose from about 12% to 15%.

(ii) The increased debt ratio was much more pronounced with respect to domestic debt than external debt.

(iii) Hence, over the period, Nigeria contracted more of domestic debt obligations than external ones.

(b) Growth rates of Debt Stock is obtained using the following formula r = $n\sqrt{\frac{A}{P}} - 1$

where

r: growth rate of debt stock;
n: number of years;
P: initial debt stock; and
A: accumulated debt stock at the end of the period

External Debt

n = 3 P = ₦454.7b A = ₦590.4b

r = $3\sqrt{\frac{590.4}{454.7}} - 1$

r = 1.0899 – 1
= 0.899
r = ≅ 0.09 (or 9%)

Domestic Debt

n = 3 P = ₦1,753.3b A = ₦3,228b

r = $3\sqrt{\frac{3,228.0}{1,753.3}} - 1$

= 1.2231 – 1
= 0.2231
r = ≅ 0.22 (or 22%)

Comments

(i) The growth rate of debt stock is much higher for internal/domestic debt than the external debt.

(ii) The significant increase in domestic debt could lead to crowding-out effect, namely the private domestic investors being sidelined and disadvantaged in terms of access to funds.

(iii) The dominance of the public sector in this respect could undermine. competition and the realisation of Pareto optimality in the economy.

(c) External debts are debts incurred by the government by borrowing from foreign lenders including governments or international financial institutions, such as Paris Club, London Club of creditors, Multilateral creditors, Bi-lateral creditors and Private Sector creditors. These loans including interests must usually be paid in the currency in which the loan was made. In other words, it refers to unpaid portion of external resources required for developmental purposes and balance of payment support which could be repaid when they fall due.

Internal debts are debts that the government of a country owe to its citizens. It can be described as payment of interest or repayment of principal. Internal debts can be contracted from Commercial Banks, Insurance Companies, Savings Institutions, States and local Governments, Corporations and Individuals; and through financial instruments like Treasury Bills, Treasury Certificates, Promissory Notes etc.

EXAMINER'S REPORT

The question tests candidates' understanding of the computation and interpretation of debt indicators. They are also expected to be able to make clear distinction between external debts and internal debts.

About 98% of the candidates attempted the question and performance was poor.

The candidates had problem computing debt ratios and growth rates of the two types of debts.

The candidates are advised to read widely and prepare for the examination adequately for better performance.

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATIONS - MAY 2015

MANAGEMENT, GOVERNANCE AND ETHICS

Time Allowed: 3 hours

ATTEMPT FIVE QUESTIONS IN ALL

SECTION A: COMPULSORY QUESTION (30 Marks)

QUESTION 1

Micro Solutions (MS) is a privately owned high technology company established in 2012 by a computer engineer, Steven Luka. It is situated in the country of Naijaland, a prosperous developed nation with a stable well established political system.

Successive governments in Naijaland have promoted technology by providing grants and tax incentives. Tax credits are also provided to offset company investment in Research and Development (R&D). The government, like many governments worldwide, have invested heavily in a national telecommunications infrastructure. However, in 2014, the country suffered an economic downturn that led many companies to postpone technological investment.

By 2014, MS had employed 75 full-time staff in a new multi-purpose factory. These employees included technically qualified engineers, working in R&D, factory staff, manufacturing and assembling products, and a small sales and service support team.

Product areas

In 2014, MS had three distinct product/service areas – data communication components, network management systems and technical support. MS sells data communication components to Original Equipment Manufacturers (OEMs), who use these components in their hardware. Both the OEMs and their customers are predominantly large international companies. MS has established a good reputation for the quality and performance of its components, which are competitively priced. However, MS has less than 1% of the domestic market and faces competition from over twenty significant suppliers, most of who also compete internationally. Furthermore, one of the company's OEM customers accounts for 40% of its sales.

The international market for data communication components had increased from ₦3.3trillion in 2001 to ₦8.1 trillion in 2014. Forecasts for 2015 and beyond predict growth from increased sales to currently installed networks rather than from the installation of new networks.

The maturity of the technology means that product lifecycles are becoming shorter. Success comes from producing high volumes of reliable components at relatively low prices. MS produces components in a relatively prosperous country where there is a significant legislation defining maximum work hours and minimum wage rates. All new components have to be approved by an appropriate government approval body in each country that MS supplies. This approval process is both costly and time consuming.

The second product area is network management systems. MS originally supplied fault detection systems to a small number of large end-users such as banks, public utility providers and global manufacturers. MS recognised the unique requirements of each customer and so it customised its products to meet specific needs and requirements. They pioneered a modular design which allowed customers to adapt standard system modules to fit their exact networking requirements.

The success of its products led to it being honoured with a prestigious government technology award for "technological innovation in data communications". This further enhanced the company's reputation and enabled it to become a successful niche player in a relatively low volume market with gross margins in excess of 40%. They only have two or three competitors in this specialist market. Unlike component manufacture, there is no requirement to seek government approval for new network products.

Finally, the complexity of MS products means that technical support is a third key business area. It has an excellent reputation for this support. However, it is increasingly difficult and costly to maintain the required level of support because the company does not have a geographically distributed network of support engineers. All technical support is provided from its headquarters. This contrasts with the national and international support services of its large competitors.

Current issues
MS currently manufactures 40% of the components used in its products. The rest of the components, including semiconductors and microprocessors, are brought in from a few selected global suppliers. Serious production problems have resulted from periodic component shortages, creating significant delays in manufacturing, assembling and customer deliveries.

MS is still a relatively young organisation. There are small functional departments for sales and marketing, technical R &D, manufacturing and procurement. Steven Luka still personally undertakes all staff recruitment and staff development. He is finding the recruitment of high calibre staff a problem. MS' small size and geographical location make it difficult to attract the key personnel necessary for future growth.

Required

a. Evaluate the macro-environment of MS using a PESTEL analysis. (15 Marks)

b. Analyse the competitive environment that MS competes in. (15 Marks)

(Total: 30 Marks)

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

QUESTION 2

A large number of institutional investors pursue policies of Socially Responsible Investment (SRI) and seek to invest in suitable companies and avoid investing in others. Hilda Uzor is a fund manager working on behalf of a major Pension Fund Administrator. She has been asked to attend a conference on corporate governance because of its relevance to SRI. She is not sure of the connection between corporate governance and SRI, although she thinks it may have something to do with ethical investments.

Required

a. Explain the nature of Socially Responsible Investment (SRI) by investment institutions. (7 Marks)

b. Discuss the factors that have resulted in pressure on institutional investors for more SRI. (7 Marks)

c. Explain the connection between SRI, corporate governance and the demand for more disclosures about Corporate Social Responsibility (CSR) issues. (6 Marks)

(Total: 20 Marks)

QUESTION 3

You are a sole practitioner in public practice and you have taken on three new engagements. One is to prepare the annual accounts of AZ Trading Partners, a small business partnership with two partners, and the other two are to assist with the tax affairs of the two individual Partners.

After taking up the engagements, you are told that the partners of AZ Trading Partners have now agreed to dissolve the partnership. One partner plans to retire and the other will take over the entire business and run it as a sole trader business. The partners of AZ Trading Partners have discussed how the assets of the business should be transferred to the partner who will remain as the owner.

You are informed that the partners have privately agreed on an amount for the value of the goodwill of the business, and the retiring partner will receive 50% of this agreed goodwill value plus the return of his balance sheet capital.

You are aware that in the balance sheet of AZ Trading Partners, the main asset is a warehouse building, which is valued at cost, at ₦12m. You do not have a current valuation, but you estimate that this warehouse could have a current market value in excess of ₦25m. You do not know whether the retiring partner is aware of this, and you are concerned that the agreed value for business goodwill might therefore be too low. It has also not escaped your notice that the book-keeper for the partnership business is the husband of the partner who is remaining in the business.

Required

Consider whether or not there is an ethical issue in this situation, and whether you have a duty to bring the value of the warehouse to the attention of the retiring partner. Suggest what you should do, if anything. (20 Marks)

QUESTION 4

a. Explain the FOUR roles of Non-Executive Directors on the boards of stock market companies, and the contribution of each of these roles towards the achievement of good corporate governance. (10 Marks)

b. Explain the meaning of ‘cross-directorships’ and suggest how the existence of cross-directorships could reduce the effectiveness of Non-Executive Directors in fulfilling their roles. (10Marks)

(Total: 20 Marks)

SECTION C - ATTEMPT ANY TWO OUT OF THREE QUESTIONS IN THIS SECTION (30 Marks)

QUESTION 5

Explain what is meant by 'public interest' and indicate ways in which professional accountants and professional accountancy organisations are expected to show a concern for public interest. (15 Marks)

QUESTION 6

a. Describe the main differences between a business code of ethics and a professional code of ethics for accountants. (7 Marks)

b. Explain any FOUR situations in which an accountant might face a moral or ethical dilemma. (8 Marks)

(Total: 15 Marks)

QUESTION 7

a. Explain the meaning of reputation risk for a company, and the sources of this risk. (8 Marks)

b. Suggest the effects that reputation risk might have on a large global company. (7 Marks)

(Total: 15 Marks)

SOLUTION 1

a. PESTEL analysis is an approach used in analysing the external (Macro) environment of a business entity. Key factors that shape the nature of the external environment of an entity are grouped into the following;

P	-	Political Environment
E	-	Economic Environment
S	-	Social and Cultural Environment
T	-	Technological Environment
E	-	Ecological Environment
L	-	Legal Environment

The Macro-environment of Micro Solutions (MS) using PESTEL analysis is as follows:-

(i) Political Environment: These are political factors that tend to have strong influences on business entities and organisations. From the scenario, these include:-

Naijaland, the country where MS is located, has a stable and well established political system. This makes government policies and activities which affect MS to be more stable and predictable. Also, the absence of war and civil unrest further provide a peaceful business environment.

(ii) Economic Environment

- Naijaland's economy is developed. This will impact positively on MS's ability to source for inputs, sell its company's output and source for needed manpower. Also, needed infrastructure to support production and sales is expected to be available.
- The existence of tax incentives, including tax credit, to support Research and Development (R&D) activities will enhance MS's ability to innovate
- Government Investment in telecommunication infrastructure will further enhance MS's operations with the provision of needed telecommunication facilities.
- Although Naijaland has a developed economy, it is currently faced with an economic downturn leading to reduced investment in technology and innovation.
- The competitive environment for MS's three products varies-

  For one product, competitors are large international companies. For another, competitors are as few as two or three. This means that competitive strategies will vary across product lines.

  The market for one of its products (data communication components) shows growth prospects even though the company is weak in this market. Strategies in this market will be geared towards taking advantage of this growth prospect.

The company is exposed to international competition in one of its products (data communication components) as a supplier to large international companies. This has implication on the need to maintain international standards, in terms of product quality and right price to ensure competitiveness.

(iii) Social and Cultural Environment: The society and government value innovation. This is reflected by the existence of a government award for innovation. This serves to encourage innovation which could also be a source of competitive advantage.

(iv) Technological Environment. This consists of science and technology available to an organisation and its competitors. Tax credits and government grants to encourage R&D will encourage investment in technology. This means that technology in the industry will change more rapidly. MS can leverage on this to gain competitive advantage.

For one of MS's products, existing technology has reached maturity stage. It is further affected by rapidly changing technology. This has implication for pricing and marketing strategies aimed at increasing sales as well as avoiding obsolescence of products.

(v) Ecological Environment: This describes environmental factors that tend to have influence on strategic planning and decision making of organisations. Examples include pollution, toxic waste, etc. From the given scenario, there are no ecological factors that affect MS.

(vi) Legal Environment: This includes laws and regulations affecting a business entity as well as government approved bodies empowered by law to regulate business activities.

b. Porter's five-forces model provides a framework for analysing the strength of competition in a market. From the given scenario, MS operates in two distinct markets. This competitive analysis will be done on the basis of the two markets.

(i) <u>Threat from potential entrants</u>: New entrants increase the level of competition within the market. Thus, the existence of barriers to entry will affect the number of new entrants and therefore the level of competition in the market.

MS operates in an industry where the cost of entry is significant because it is capital and knowledge intensive. The need for government approval of new components involves a process that is lengthy and expensive and so creates significant barrier to new entrants.

Rapidly changing technology and reduction in R&D investment, occasioned by current economic downturn, could also serve as discouragement to new entrants. Other barriers include the need to offer after -sales support and high exit cost.

(ii) Threat from substitute products: This exists when customers can switch fairly easily to buying alternative products. From the given scenario, the risk of the development of substitutes will be high due to:

- Rapidly changing technology;
- Current technology has reached its maturity stage; and
- Government support for innovation is high.

(iii) Bargaining power of suppliers: The degree of influence suppliers wield through price and quality to a large extent determines the degree of competitiveness in the market.

MS will not be able to exert much influence on its suppliers. This is because:-

- Semi-conductors and microprocessors, the main inputs of MS, are sourced from a few global companies and powerful brands.
- MS experiences periodic input shortages resulting in delay in its ability to deliver to its customers.

(iv) Bargaining Power of Customers: The level of competition in a market is affected by the degree to which buyers influence prices, product specifications and terms of purchase. MS competes in two markets:

- Data communication components market:-
  - With only 1% market share, MS is a marginal supplier even though it has reputation for quality products.
  - OEMs made up of mostly international corporations are likely to demand high quality at prices favourable to them.

- Since OEMs are mostly global, alternative sources probably exist in the international market.
- From the above, OEMS will likely have significant bargaining power especially when only one of them accounts for 40% of MS's current sales.

➢ Network Management Systems Market:-
- The supply of customised products make comparison of products by buyers difficult.
- As there are only two or three other suppliers of this product, alternative choices are limited.
- Reduced bargaining power makes this product less price sensitive, thus, allowing for bigger margin. Due to low bargaining power, the level of competition in this market will be weak.

(v) Competitive Rivalry: Rivalry among competitors could affect prices and therefore profitability. Different kinds of competitive rivalry exists in the two markets.

➢ Data communication components market:- Competitive rivalry in this market is very high. This is because:
- There exists over 20 or more suppliers, many of which are global companies; and
- Many rival organisations have dedicated geographically distributed support teams.

➢ Network management systems market: Low degree of rivalry exists among competitors in this market. This is because
- There exist only two or three competitors, in the market;
- Customers are made up of small number of large end-users; and
- Products are customised to each customer's needs.

EXAMINER'S REPORT

The first part of the question tests candidates' ability to analyse the macro-environment in which a company operates using PESTEL model. The second part requires candidates to analyse specifically the competitive environment of Micro Solutions (MS).

In part (a), candidates are expected to identify the various components of the environment represented by PESTEL, and explain, using data from the scenario provided, the implication of each component on the operation of MS. In part (b), candidates are expected to use Porters Five Forces model to analyse the competitive environment of MS again using data from the scenario provided.

Majority of the candidates understood the question and could identify the components of the macro environment. Many, however, had difficulty in identifying the elements from the scenario that are relevant to the different components. Hence, their analyses of MS were poor. As regards the (b) part of the question, only a few candidates had knowledge of Porters Model. Those who had knowledge of the model performed very well. Some others incorrectly used SWOT analysis and had difficulty in explaining the competitive environment. On the whole, performance was above average.

Candidates need to understand the scope of the syllabus and scale up the level of their preparation. Candidates are advised to use the new Study Pack in preparing for the examination.

SOLUTION 2

a. Definition

Socially Responsible Investment (SRI) is an approach to investing that takes social and environmental issues into consideration as well as the profit motive. The term ''ethical investment" is often used instead of SRI. Socially Responsible Investment is investment that ought to be undertaken by a responsible entity. It combines the financial objectives of investors with a commitment to social concerns such as social justice, economic development, healthy environment and compliance with relevant regulations and laws. These social concerns are explained below:

(i) Economic development

Some institutional investors support social concerns with their investment policy and some institutions operate ethical funds. However, SRI does not mean accepting a lower financial return as the price for investing in a socially responsible way. Low returns are unacceptable to any investment institution.

(ii) Ethical issues/Social Justice

For socially responsible investors, there is usually a subjective element to investment choices. For example, investing in gambling, illicit drugs, manufacture of weapons, dangerous chemicals, tobacco, etc, can never be ethical and acceptable even if the profitability is high.

(iii) Environmental issues

Investors' concerns about environmental issues might grow as large institutional investors acquire investment interests in many different countries and in many different companies. These universal owners have a direct concern about the future development and prosperity of entire economies and therefore need to consider the long-term implication of business activities for long-term wealth and social prosperity. Investment might also be avoided in companies with a record of creating environmental damage or pollution or committing human rights abuses.

(iv) Compliance with relevant laws and regulations.

The investment must comply with the known laws and regulations within the country and within the specific areas allowed by law. The Pencom Act 2014 as amended defines the areas of investment of pension funds.

b. Factors that have resulted in pressure on institutional investors for more SRI are as follows:

(i) Government Policies:

The Government policies have major influence on institutional investors. For example pencom ACT 2014 as amended stipulates how pension funds are to be invested by Pension Fund Administrators in equity, treasury bills, money market instruments and federal government bonds.

(ii) Trade Associations:

Institutional investors might also come under pressure from their trade associations to consider SRI. For example, Pension Operators Association may encourage their members for more SRI.

(iii) Public:

There is also public pressure for ethical investment by institutional investors as public awareness of social and environmental issues grows. Specific lobby groups might also put pressure on investors (by legal or illegal means) to avoid investing in certain companies and industries, such as companies engaged in gambling, hard drugs and manufacturing of weapons.

(iv) Human Rights Abuses /Public reputation:

Institutions might also be reluctant to invest heavily in companies with bad public reputation,i.e, a reputation for human rights abuses or causing environmental damage.

(v) Stakeholder concerns: There are also pressures within institutional investment organisations for greater awareness of SRI issues. This may be due to the accountability of some institutions such as pension funds to their donors.

(vi) Security of Investment: To guard against past failures that made pensioners not to get their pension as and when due, institutions must invest in ways that would ensure security of investment and profitability.

(vii) Risk Management: Companies' management should ensure that they do not take undue risks in the investment of funds and also ensure the sustainability of the company.

c. Relationship among SRI, corporate governance and need for disclosures about CSR.

(i) SRI has been a driver of corporate social responsibility. Since institutional investors are increasingly aware of their responsibility for socially responsible investment, they require the companies in which they invest to operate in a socially responsible way and with good corporate governance code.

(ii) Good corporate governance ensures that policy formulation encourages SRI and, hence, effective performance for the maximization of shareholders wealth.

(iii) SRI based, on good corporate governance, protects other stakeholders which include employees, creditors and pensioners.

(iv) The demand for more disclosures about CSR issues is in compliance with global and local laws and regulations (e.g. CAMA and PENCOM Act) as well as corporate governance codes.

(v) Many institutional investors expect the companies in which they invest to have regard for social and environmental issues because this is necessary to protect long-term shareholder value. They require companies to demonstrate their commitment to CSR issues, and in order to demonstrate such commitment, there must be suitable disclosures.

EXAMINER'S REPORT

The question requires candidates to explain Socially Responsible Investment (SRI), discuss the factors which have put pressure on institutional investors to do more SRI and explain the link between SRI, corporate governance and demand for more disclosures about CSR issues.

Many candidates did not understand the question as only about 60% attempted it. Performance was very poor as less than 30% of those who attempted the question scored half of the marks allocated. Most of those who attempted the question erroneously equated SRI with CSR and did not know the factors that put pressure on institutional investors to do more SRI.

Candidates need to prepare more diligently to perform well in a question of this nature.

SOLUTION 3

The question has three components to be addressed.

(a) Whether or not there is an ethical issue in the scenario.
(b) Whether or not the sole practitioner has a duty to bring the value of the warehouse to the attention of the retiring partner.
(c) What should the sole practitioner do?

(a) Ethical issues in the scenario

(i) There is the moral issue of ensuring that the retiring partner gets his or her fair share of the business on retirement. Anything short of this would be unfair and amount to an undue advantage for the partner remaining in the business.

(ii). From the details of the case, there is the ethical challenge of how to determine the value of the assets of the business. Should the practitioner work with the N12m value at cost or should he insist on a revaluation of the warehouse in order to ascertain whether or not its current value is in excess of N25m? It appears that only the latter option would be fair to all parties.

(iii). An ethical concern with the integrity and objectivity of the sole practitioner could also arise as the two partners could have a conflict of interest bordering on how to value and share the assets of the business.

(iv). There is also an ethical problem with the principle of confidentiality emanating from the engagement of the sole practitioner to assist the two partners, individually, with their tax affairs. Confidentiality may be threatened because by raising his concerns with one client, the sole practitioner could be breaching confidentiality with the other client.

(v). There is an ethical issue related to self review threat. The sole practitioner, by his engagement is to prepare the financial statement of the partnership and also is to assist in computing the tax affairs of the partners as individuals. This may result in self-review threat when performing the two assignments simultaneously.

(vi). The ethical issue of conflict of interest may arise. The bookkeeper is related to the continuing partner, so he may not have the moral standing to give a true and fair view of the value of the assets. This is depicted by the fact that the bookkeeper reported only the value at cost of the warehouse and remained silent on the ₦25 million estimated value.

(vii). The sole practitioner is to present a true and fair view of the state of affairs of the partnership and he knows that the real value is more than ₦12 million. If this is ignored, it will impair his objectivity.

b. Duty of the Sole Practitioner

The sole practitioner has a duty to bring the value of the warehouse to the attention of the returning partner because he is to prepare a true and fair view of the financial statements towards the dissolution of the partnership.

The sole practitioner obviously has the duty of objectivity to present the true value of the assets.

c. Suggestion on what Should be done by the sole practitioner

(i). The Sole Practitioner should not take the two assignments of preparing the financial statements of the Partnership and the tax computations of the individual partners together so as to remain objective. In a large accounting practice, it might be possible to appoint another senior member of staff to take over the affairs of one of the client's partners, but since he is a sole practitioner, this is not possible in this situation.

(ii). To comply with the principle of due diligence, a separate person/professional should be contacted to carry out independent evaluation of the warehouse.

(iii). It would be appropriate to arrange a meeting with both partners, where the sole practitioner should inform them that he is unable to continue providing professional services to both of them.

At the meeting, the partners might agree that the sole practitioner should continue to provide a service to one of them, but the sole practitioner should not 'take sides' and indicate any preference for one client.

EXAMINER'S REPORT

The question tests candidates' practical skills in identifying and resolving ethical problems that could confront them in carrying out their professional responsibilities as accountants.

The performance of candidates was below average. Many of them failed to realise that the question had three components and, as such, concentrated on only the first component. They also had problems specifying the ethical issues emanating from the scenario given.

Candidates are advised to pay attention to the specific demands of questions and do their best to be familiar with the ethical issues that accountants are usually confronted with in practice.

SOLUTION 4

(a) The FOUR roles for Non-Executive Directors (NEDs) on the boards of stock market companies are as follows:

(i) Strategy: NEDs makes constructive contributions to the development of the company's business strategy;

(ii) Performance : NEDs scrutinise the performance of management in meeting agreed goals and objectives. They also monitor the reporting of performance;

(iii) Risk: NEDs satisfy themselves that financial information produced by the company is accurate. They also satisfy themselves that financial controls and systems of risk management are robust and defensible; and

(iv) People: NEDs are responsible for deciding the level of remuneration of executive directors. They also have a prime role in appointing and (where necessary) removing senior management, and in succession planning.

The roles of NEDs toward the achievement of good corporate governance include the following:

(i) They ensure that the Board of Directors makes decisions that are in the best interest of shareholders;
(ii) They ensure accountability of the Board of Directors and of management to the shareholders;
(iii) They ensure that company performance is monitored and also that management of risk is effectively carried out; and
(iv) By deciding the remuneration of executive directors, the appointment of management staff and succession, they contribute significantly to good corporate governance in these areas.

Note that good corporate governance means the operation of a corporate entity by its directors and management in such a way that transparency, accountability, integrity and effective controls are assured.

(b) A cross- directorship occurs when an executive director of company A also sits on the Board of company B as a non-executive director. At the same time an executive director of company B sits as a non-executive director on the board of company A. However, where directors hold positions in more than one corporate entity, i.e, holding executive directorship in company A, while at the same time holding non-executive directorship position in company B, or vice versa, their effectiveness may become reduced due to the following:

(i) Risk of privileged information being used against one another: This is a case of insider dealings using prior knowledge to gain market advantage in capital issues;
(ii) Conflict of interest could exist in situations where non-executive directors become reluctant to criticise each other, especially on remuneration issues;
(iii) Compromise on integrity: When directors become too familiar with one another, this could cause a cycle of self-interest, hence, compromising on individual integrity; and

(iv) Loss of transparency: When compromises exist on several matters with regard to remuneration, disclosure of vital information and self interest, there will be loss of transparency and accountability.

EXAMINER'S REPORT

This question requires candidates to identify and explain the roles of Non-Executive Directors (NEDs) and show how the roles contribute to good corporate governance. They are also expected to explain the meaning of cross-directorship and discuss how cross- directorship affects the effectiveness of NEDs.

Most candidates understood the question even though only a few could mention and explain the roles of NEDs. More difficult for candidates was explaining how the roles contribute to good corporate governance. Only a few candidates could define cross-directorship or explain how it affects the effectiveness of NEDs. Performance was below average.

Candidates are advised to use the Study Text in their preparation for subsequent examinations.

SOLUTION 5

Explanation of Public Interest

Public Interest is the collective well-being of society as a whole or the community of people and Institutions in which an individual lives and works.

Showing concern for public interest means recognizing responsibilities to the public. For a professional accountant, the public includes employers, clients, government, investors, employees, creditors, customers, the business and financial communities and all the people who rely on the objectivity and integrity of professional accountants to maintain the orderly functioning of business.

Professional accountants are required to show concern for public interest in the work they do. They should put public interest before their responsibilities to their employers or clients, especially when the employer or client is acting illegally.

Accountants also have an obligation to the public in their everyday life, because they help to create and build public interest in business.

Ways in which professional accountants and professional accountancy organisations show concern for public interest include the following:

(i) Reporting any crime or misdemeanor that may negatively impact on the public;
(ii) Protecting public health and safety;
(iii) Disclosure of correct information to the public;
(iv) Exposing misuse of public funds and corruption in government;
(v) Revealing the existence of any conflict of interest of individuals in positions of power and influence;
(vi) Ensuring professional competence in handling appointments/jobs in order to ensure high quality performance;
(vii) Adherence to ethical code of conduct concerning/ensuring objectivity and independence. Where this may be compromised against the public interest, the professional accountant should turn such options down;
(viii) The role of professional accountancy organisations such as ICAN is to institute and formulate the Code of Conduct and Ethics that would guide the performance of their members;
(ix) Professional accountancy organisations should provide mechanisms for implementation of their Code of Conduct and sanctioning of errant members; and

(x) Professional accountancy organisations perform advocacy duties for the adoption of ethical codes in public life.

EXAMINER'S REPORT

This question tests candidates' knowledge of "public interest" and their ability to indicate the ways professional accountants and accountancy organisations are expected to show concern for public interest.

Many candidates could not define public interest satisfactorily and limited themselves to the ethical code of conduct of Professional Accountancy Organisations. Candidates' performance was below average.

Candidates are advised to improve on their communication skills to enable them present their ideas lucidly.

SOLUTION 6

a. Main differences between a business code of ethics and a professional code of ethics for accountants are:

(i) A business code of ethics is developed for a company and is a statement of the ethical stance of the company. It is also a statement by the company about how it expects its employees to behave in order to uphold the ethical values of the company;

A professional code of ethics for accountants on the other hand is for all individual professional accountants and is a statement of how they are expected to behave as individuals;

(ii) Professional code of ethics guides professionals to act in the public interest, while business code of ethics guides employees to act in the interest of the organization and ultimately the public;

(iii) Professional code of ethics can, in most cases, be applied internationally, while business code of ethics is restricted to an industry within a particular country; and

(iv) The failure of an accountant to comply with the professional code of ethics may ultimately lead to the withdrawal of his practising licence, while an employee of a business organization may face dismissal if he fails to comply with the business code of ethics.

b. An ethical or moral dilemma involves a conflict between two moral principles or positions whereby it can be argued that both perspectives are fair and reasonable. Ethical dilemmas typically arise in situations whereby a particular action is likely to benefit one stakeholder whilst harming another. In such a situation, a professional would have difficulty in choosing between available alternatives.

The following are situations in which an accountant might face a moral or ethical dilemma.

(i). <u>Self-interest threats or conflicts of interest</u>:
These occur when the personal interests of the professional accountant, or a close family member, are affected by the accountant's decisions or actions.

In such situations, there may be a conflict between the interest of the accountant or that of a relative on the one hand, and that of the organization he or she is working for on the other. Dilemma arising from self-interest threats could also arise when an accountant is tempted to support a decision taken by management, which might also be in the accountant's personal interests.

(ii). Intimidation threats:

A professional accountant might discover that his objectivity and independence are threatened by intimidation, either real or imagined. In order words, this threat occurs when an accountant is deterred from acting objectively by threats, actual or imagined.

Here, the dilemma would be whether or not to maintain the principle of objectivity or sacrifice it in the face of the perceived threats, which may be from employers, clients or professional colleagues. This form of dilemma could arise when an accountant is under pressure from a client or employer to do something that is contrary to accounting standard or other professional or technical standards or is asked to keep quiet about an error committed by a superior.

(iii). Self – review threats:

These occur when an accountant has to review the work or financial statement he prepared or is strictly responsible for. An extreme example would be a situation where a professional accountant prepares the annual financial statements for a corporate client and then is appointed to do the audit. The ethical dilemma would be whether or not he should accept the audit appointment.

(iv). Advocacy threats:

These occur when an accountant promotes the point of view of a client by acting, for example, as a professional witness in a legal dispute.

Acting as an advocate for the client can reach the point where the objectivity of the accountant may be compromised. In such situations, professional accountants may have problems determining the extent to which they can legitimately promote the interest of a client or employer.

(v). Familiarity threats:

These arise from knowing someone very well, possibly through a long association in business. The risk is that an accountant might become too familiar with a client and, therefore, become sympathetic to the client and more willing to accept the client's point of view. The ethical dilemma here would be on the determination of the ideal mode of relationship that should exist between a professional and his or her client.

EXAMINER'S REPORT

The question tests candidates' understanding of the distinctions between business code of ethics and professional code of ethics. It also tests their ability to identify situations in which an accountant could face an ethical dilemma.

Candidates' performance was generally poor as many of them were unable to differentiate business code of ethics from professional code of ethics. They also had difficulties specifying the kinds of ethical dilemma an accountant could face in practice.

Candidates are advised to pay attention to the details of concepts and theories in ethics as well as understand how they are to be applied in real life situations.

SOLUTION 7

(a) Explanation

Reputation risk for a company is the risk that an event or item of information will damage the standing (reputation) of the company in the opinion of the public and other people. Reputation risk is normally regarded as 'downside risk', but a company might use its public relations department to try to improve its general reputation.

The damage to reputation may be short-term or long-term depending on the extent and impact of the damage to society. It may also be limited or wide-spread. The media (including the social media) play an important role in publicising the negative events.

It is a loss in reputation caused as a result of the adverse consequences of another risk. Sources of reputation risks include the following:

i) Poor service delivery

This occurs when a company provides its customers with poor quality products and services. It includes poor or non-response to customer complaints;

ii) Unethical behaviour

When activities of companies do not meet moral and ethical standards. For instance, using child labour;

iii) Defective corporate governance
The composition of the board and top management of some organisations may be tainted by imbalance and overbearing or undue influence of some individuals over the activities of the board. This may lead to incorrect decisions;

iv) Inability to embrace innovations and technical advancements
A company that is averse to modernising its production and management processes will not acquire modern technology and innovation which will improve quality of products and productivity of staff;

v) Product risk
Procurement of low quality inputs will ultimately adversely affect the quality of the products, thus impugning the reputation of the company;

vi) Environmental risk
A company whose operations pollute the environment or accelerates its degradation will attract negative publicity to itself, thus, adversely affecting its reputation;

vii) Social risk
A company whose management is insensitive to its corporate social responsibility will harm its reputation leading to reputation risk,(e.g insensitivity to CRS, gender inequality, etc); and

viii) Abuses in employment procedures
A company with defective human resources policies will generate negative reputation.

(b) Effects of reputation risk on a large global company;

(i) Loss of sales/income;.
(ii) Reduction in profit earnings;
(iii) Loss of competent staff/inability to attract competent staff;
(iv) Legal risks;
(v) Loss of goodwill;
(vi) Inability access funds from financial institutions;
(vii) Threat to its going-concern;
(viii) Loss in market share;

(ix) Loss in the share value of the company in the stock market;

(x) Risk of withdrawal of trade mark/licences; and

(xi) A target for pressure groups and activists who may picket the company.

EXAMINER'S REPORT.

The question tests candidates' understanding of reputation risk, its sources and effects on a large global company. Candidates are expected to explain what reputation risk means and identify the effects of the risk on a large global company.

Most candidates attempted the question and performed well especially in the part (b) of the question. However, some candidate could not differentiate between the sources and effects of reputation risk on a company.

Candidates are advised to pay attention to the differences between sources and effects of reputation risks for companies.