THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

PATHFINDER

MAY 2016 SKILLS EXAMINATION

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SUBJECTS

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – MAY 2016

FINANCIAL REPORTING

Time Allowed: 3hours

ANSWER FIVE OUT OF SEVEN QUESTIONS IN All

SECTIONA: COMPULSORY (30 MARKS)

QUESTION 1

GBENGANIG Plc. Trial balance as at December 31, 2015 is shown below:

	₦	₦
Revenue		2,290,125
Administrative expenses	237,150	
Selling and distribution expenses	175,200	
Legal and professional expenses	81,150	
Allowance for receivables - 31/12/15		8,625
Inventories –finished goods - 31/12/14	276,750	
Work-in-progress - 31/12/14	49,125	
Inventories – raw materials at cost-31/12/14	162,600	
Purchases – raw materials	1,125,900	
Carriage inwards - raw materials	15,750	
Manufacturing wages	375,000	
Manufacturing overheads	187,500	
Authorised and issued 900,000 ordinary shares of N0.50 each fully paid		450,000
150,000 8.4% cumulative preference shares of Nl each fully paid		150,000
Revaluation surplus		65,000
Share premium		150,000
General reserve		85,000
Retained earnings-31/12/14		425,250
Patents and trademarks	323,250	

Freehold property at cost	375,000	
Leasehold property at cost	112,500	
Amortization of leasehold · property - 31/12/14		22,500
Plant and equipment at cost	225, 000	
Accumulated depreciation – plant and equipment- 31/12/14		102,750
Furniture and fittings at cost	75,000	
Accumulated depreciation – furniture and fittings - 31/12/14		23,625
Motor vehicles at cost	112,500	
Accumulated depreciation – motor vehicles 31/l2/14		37,500
10% loan notes		150,000
Trade payables		146,250
Trade receivables	266,445	
Bank overdraft		76,875
Cash	7,680	
	4,183,500	4,183500

(i) A gain of N20,000 made on the revaluation of old freehold property during the year is yet to be accounted for.

(ii) Inventories at December 31, 2015 were:

	N
Raw materials	168,900
Finished goods	413,025
Work-in-progress	56.700

(iii) Legal and professional expenses include:
Solicitor's fees for purchase of new freehold land during the year N7,500.

(iv) Provision is to be made for the full year's interest on the loan notes.

(v) The leasehold land and buildings – are held on 50years lease, with 40 years unexpired life left as at the end of December 31, 2014.

(vi) Depreciation for the year is to be charged as follows:
- Plant and equipment 8% on cost – charged to production
- Furniture and fittings 10% on cost — charged to administration
- Motor vehicles 20% on carrying amount – charged -25% to administration and 75% to selling and distribution.

(vii) Income tax on the profit for the year is estimated at N68,900 and is due for payment on February 28, 2016.

(viii) Dividend of N2.25k per ordinary share capital is recommended for payment by the directors. No dividend was paid in the previous financial year.

Required:

a. Prepare the statement of profit or loss and other comprehensive income for the year ended December 31, 2015.

b. A statement of financial position as at December 31, 2015 in accordance with International Financial Reporting Standards.

(Total 30 Marks)

SECTION B: ANSWER ANY TWO OUT OF THREE QUESTIONS IN THIS SECTION (40 MARKS)

QUESTION 2

a. A Parent Company acquired 60% equity interest in a subsidiary company for N440million. The market value of the net assets of the subsidiary on acquisition date was N400million. The parent company estimates that the full 100% interest in the subsidiary company would have cost N640million.

Required:

a. Calculate the goodwill at acquisition date where non-controlling interest is measured:

   i. As a proportionate share of the net assets of the subsidiary company.

   ii. At fair value (the full good will method). (5 Marks)

b. The statement of financial position of PAPA Pie and MAMA Pie as at December 31, 2015 were as follows:-

	PAPA PLC **N'OOO**	**MAMA PLC** **N'OOO**
Property Plant & Equipment	9,000	5,000
Investment in MAMA Pie.	5,000	
Other Assets	2,000	1,500
	16,000	6500
Share Capital	500	500
Retained Earnings	14,500	5,000
Other liabilities	1,000	1,000
	16,000	6,500

PAPA Plc acquired 80% equity interest in MAMA Plc two (2) years ago.

At the date of acquisition MAMA's retained earnings stood at N3million and the fair value of its net assets was N5million. This was ₦l.5million above the carrying amount of the net assets at this date. The fair value adjustment related to an asset that had a remaining useful economic life of 10 years as at the date of acquisition.

The goodwill arising on consolidation has not suffered any impairment.

Required:

Prepare consolidated statement of financial position of PAPA Pie Group as at December 31, 2015, on the assumption that non-controlling interest is valued at fair value (the full goodwill method). (15 Marks)
N.B: Show all workings. **(Total 20 Marks)**

QUESTION 3

On October 1, 2015 Panda purchased 75% of the equity shares in Sanda. The acquisition was through a share exchange of two shares in Panda for every three shares in Sanda.

The stock market price of Panda's shares at October1, 2015 was ₦6 per share.

The summarized statements of comprehensive income of the two companies for the year ended March 31, 2016 are:

	Panda **N'000**	**Sanda** **N'000**
Revenue	675.000	360,000
Cost of sales	(390,000)	(165,000)
Gross profit	285,000	195,000
Distribution costs	(35,400)	(18,000)
Administrative expenses	(40,500)	(34,500)
Finance costs	(2,250)	(1,800)
Profit before tax	206,850	140,700
Income tax expense	(72,000)	(41,700)
Profit for the year	134,850	99,900

	Panda **N'000**	**Sanda** **N'000**
Other comprehensive income		
Gain on revaluation of land(note(i))	3.750	1.500
Loss on fair value of equity financial asset	(1,050)	(600)
Investment	2,700	900
Total comprehensive income	137,550	99,900

The following information is relevant:

(i) The equity of the companies at October l, 2015 (i.e. just before the share exchange took place) is available:

		Panda	Sanda
		₦'000	₦'000
Equity shares of Nl	Each	375,000	240,000
Share premium		150,000	Nil
Revaluation reserve	(land)	12,600	Nil
Retained earnings		135,000	220,500

(ii) Immediately after the acquisition of Sanda on October 1, 2015, Panda transferred an item of plant with a carrying amount of N4million to Sanda at an agreed value of N7.5million. At this date the plant had a remaining life of two and half years. Panda had included the profit on this transfer as a reduction in its depreciation costs. All depreciation is charged to cost of sales.

(iii) After the acquisition Sanda sold goods to Panda for N60million. These goods had cost Sand a N45million. N18million of the goods sold remained in Panda's closing inventory.

(iv) Panda's policy is to value the non-controlling interest of Sanda at the date of acquisition at its fair value which the directors determined to be N150million.

(v) The goodwill of Sanda has not suffered any impairment.

(vi) All items in the above statements of comprehensive income are deemed to accrue evenly over the year unless otherwise indicated.

Required:

a. Show your computation of the amount paid by Panda and the goodwill arising on the acquisition of Sanda on October 1, 2015. (6 Marks)

b. Prepare the consolidated statement of comprehensive income of Panda for the year ended March 31, 2016. (14 Marks)

(Total 20 Marks)

QUESTION 4

Quintet Plc sells provisions through its stores located in various retail shopping centres in the major cities in Nigeria. It has of recent been experiencing declining profitability and the board is wondering if this development is peculiar to the company or related to the sector as a whole. It is also not clear as regards the company's solvency. As such it has engaged a consulting firm that specializes in analyzing corporate reports producing average ratios across many businesses to rate performance. Below are the ratios that have been provided by the consulting firm for Quintet Plc.'s business sector based on the year end of June 30, 2015.

Debt to equity	38%
Gross profit margin	35%
Operating profit margin	12%
Return on year –end capital employed (ROCE)	16·8%
Net asset turnover	1·4 times
Current ratio	1·25:1
Average inventory turnover	3 times
Trade payables' payment period	64 days

The financial statements of Quintet Plc for the year ended September 30, 2015 are:

Income statement

	N'000	N'000
Revenue		224,000
Opening inventory	33,200	
Purchases	175,600	
	208,800	
Closing inventory	(40.800)	(168,000)
Gross profit		56,000
Operating costs		(39,200)
Finance costs		(3,200)
Profit before tax		13,600
Income tax expense		(4,000)
Profit for the year		9,000

Statement of financial position

	₦'000	₦'000
Assets		
Non-current assets		
Property and shop fittings	102,400	
Deferred development expenditure	20,000	122,400
Current assets		
Inventory	40,800	
Bank	4,000	44,800
Total assets		167,200
Equity and liabilities		
Equity		
Equity shares of ₦1each		60,000
Property revaluation reserve		12,000
Retained earnings		34,400
		106,400
Non-current liabilities		
10% loan notes		32,000
Current liabilities		
Trade payables	21,600	
Current tax payable	7,200	28,800
Total equity an liabilities		167,200

Note:

(i) Net asset is defined by the consulting firm as total assets less current liabilities.

(ii) The deferred development expenditure relates to one off payment for a franchise as a sole distributor of a particular product under negotiation but not yet concluded as at September 30, 2015 although payment has already been made.

Required:

a. Compute the equivalent ratios for Quintet Plc that have been provided by the consulting firm for the business sector. (9 Marks)

b. Write a report to the board which assesses the profitability and solvency performance of Quintet Plc in comparison to its business sector averages. For clarity solvency is a measure of liquidity and gearing. (11 Marks)

N.B: Ignore Income Tax (Total 20 Marks)

SECTIONC: ANSWER ANY TWO OUT OF THREE QUESTIONS IN THIS SECTION (30 MARKS)

QUESTION 5

a. As one of the accountants of Oluwaseun Plc, a company which has migrated to IFRS, you are aware that IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors contains guidance on the use of accounting policies and accounting estimates.

Required:

Explain the basis on which the management of an entity such as Oluwaseun Plc must select its accounting policies and distinguish, with an example, between changes in accounting policies and changes in accounting estimates.

(6 Marks)

b. The directors of Oluwaseun Pie. Are disappointed by the draft profit for the year ended September 30, 2015. One of your staff, who is an assistant accountant, has suggested one area where he believes the reported profit may be improved, if it is acceptable to the company's management.

Included in the financial statement of Oluwaseun Plc is an item of plant which had cost ₦80million to purchase and installed three years ago on October 1, 2012. It is the policy of Oluwaseun Plc to depreciate this plant on a straight-line basis over a five-year period, assuming anil residual value. The depreciation of the plant has progressed as envisaged, but at the start of the current year (October 1, 2014) the production manager estimated that the plant was likely to last eight years in total from the date of its purchase as against the original five year period upon which current depreciation is based.

The assistant accountant has calculated that, based on an eight-year life (with no residual value) the accumulated depreciation of the plant at September 30, 2015 would be N30million (N80million/8 years x 3). In the financial statements for the year ended September 30, 2014, the accumulated depreciation was 32million (N80million/5 year x 2). Therefore, by adopting an eight-year life, Oluwaseun can avoid making a depreciation charge in the current year and instead N2million (N32million-N30million) from the accumulated depreciation account will be credited to the income statement in the current year to improve the reported profit.

Required:

i. Comment on the acceptability of the assistant accountant's suggestions.

(6 Marks)

ii. Illustrate how the suggestions will affect the financial statements of Oluwaseun Plc based on the correct application of the relevant IFRS.

(9 Marks)

(Total 15 Marks)

QUESTION 6

The statement of financial position extract of Apapta Limited is given as follows:

	2015	**2016**
	N'000	**N'000**
Inventories	3,950	3,250
Receivables	2,151	2,675
Investments (Marketable Securities)	430	375
Cash	565	-
	7,460	6,300
Payables amounts due within one year	(3,865)	(3,755)
	3,595	2,545
Payables are analysed as follows: Trade payables	2,600	2,215
Company Income Tax	695	820
Dividend payable	570	540
Bank overdraft	-	180
	3,685	3,755

Its profit or loss account extract is as follows:

Sales	17,795	16,715
Cost of sales	(12,100)	(11,200)
Gross profit	5,695	5,515
Cost of sales is analysed as follows:		
Opening inventory	3,250	3,150
Add: Purchase	12,800	11,300
Less: Closing inventory	(3,950)	(3,250)
	12,100	11,200

In 2014 and 2015, credit sales were 83% of total sales.

Required:

a. Calculate the working capital cycle for 2015 and 2014. (9 Marks)

b. Compute the ratios listed below and comment on the company's liquidity over the two years.

   i. Cash ratio
   ii. Current ratio
   iii. Quick ratio (6 Marks)

(Total 15 Marks)

Question 7

a. After initial recognition in the Financial Statements, Financial Assets are measured, either at fair value or amortised cost according to the provisions of IAS 39-financial Instruments; Recognition & Measurement.

Required:

Briefly explain how fair value and amortised costs of financial assets are determined and give one example each of the class of financial assets that can be measured using the methods. (6 Marks)

b. Anifowose Plc issued a debt instrument at it fair value of N100million on January 1, 2013. The debt instrument is to mature in 2017. It has a principal amount of N125million and carries fixed interest rate of 4.72%

that is paid annually. The effective interest rate is 10% and on December 31, 2015 had a fair value of 105 for every ₦10 nominal value.

The company makes up its accounts to December 31, every year.

Required:

i. Show your computation schedule for the amortised cost of the financial liability up to December 31, 2015 on the assumption that the financial liability is valued at amortised cost.

ii. What is the value of the financial liability as a December 31, 2015, if the fair value option is adopted by Anifowose Plc? (9 Marks)

(Total 15Marks)

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

PROFESSIONAL LEVEL EXAMINATIONS – MAY 2016

FINANCIAL REPORTING

SOLUTION 1

Gbenga Nig. Plc.

Statement of Profit or Loss and other comprehensive income for the year ended December 31, 2015

	Note	₦	₦
Revenue			2,290,125
Cost of Sales	1		(1,572,000)
Gross Profit			718,125
Less Expenses:			
Administrative expenses	2	324,300	
Selling and distribution expenses	3	186,450	
Finance cost	4	27,600	538,350
Profit before taxation			179,775
Income tax expense			(68,900)
Profit for the year			110,875
Other comprehensive income			
Items that cannot be reclassified to profit or loss			
Gain on revaluation of freehold property			20,000
Total comprehensive income			130,875

EPS = N0.12 i.e 12 kobo

Gbenga Nig. Plc.
Statement of Financial Position as at December 31, 2015

Assets	Note	₦	₦
Non-Current Assets:			
Property, Plant and equipment	5		698,375
Patents and trademarks			323,250
			1,021,625
Current assets:			
Inventories	6	638,625	
Trade receivables (₦266,445 - 8,625)		257,820	
Cash and cash equivalents		7,680	904,125
			1,925,750
Equity and liabilities:			₦
Equity			
Authorised and issued 900,000 ordinary shares of 50k each			450,000
Share premium			150,000
Revaluation surplus (₦65,000 + 20,000)			85,000
General Reserve			85,000
Retained earnings (₦425,250 + 130,875)			536,125
			1,306,125
Non-current liabilities			
10% loan notes			150,000
8.4% cumulative preference shares of ₦1 each			150,000
Current liabilities:			
Trade payables		146,250	
Income tax expense		68,900	
Bank overdraft		76,875	
Interest on loan		15,000	
Preference shares dividend		12,600	319,625
			1,925,750

Notes/Workings:

1.	**Cost of Sales:**		₦
	Opening Inventory- Raw materials		162,600
	- Work in progress		49,125
	- Finished goods		276,750
	Purchases of raw materials		1,125,900
	Carriage inwards - raw materials		15,750
	Manufacturing wages		375,000
	Manufacturing overhead		187,500
	Depreciation - Plant and equipment (wk 7)		18,000
	Closing Inventory - Raw materials	168,900	
	- Work in progress	56,700	
	- Finished goods	413,025	(638,625)
			1,572,000
2.	**Administrative expenses:**		₦
	Per trial balance		237,150
	Legal and professional expenses (N81,150 – 7,500)		73,650
	Depreciation (wk 7)		11,250
	Authorisation of leasehold property (wk 8)		2,250
			324,300
3.	**Selling and distribution expenses:**		₦
	Per trial balance		175,200
	Depreciation (wk2)		11,250
			186,450
4.	**Finance Cost:**		₦
	Interest on loan notes at 10%		15,000
	Preference shares dividend at 8.4%		12,600
			27,600

5. **Property, plant and equipment (PPE)**

	Freehold property	**Leasehold Property**	**Plant & Equipment**	**Furniture & Fittings**	**Motor Vehicle**	**Total**
	₦	₦	₦	₦	₦	₦
Cost Jan 1, 2015	375,000	112,500	225,000	75,000	112,500	900,000
Solicitors fees	7,500	-	-	-	-	7,500
Revaluation gain	20,000	-	-	-	-	20,000
	402,500					927,500
Accumulated Dep. Jan 1	-	(22,500)	(102,750)	(23,625)	(37,500)	(186,375)
Depreciation/ amount for the year	-	(2,250)	(18,000)	(7,500)	(15,000)	(42,750)
Carrying amount Dec 31, 2015	402,500	87,750	104,250	43,875	60,000	698,375

6. **Inventories:**

	₦
Raw materials	168,900
Work-in-progress	56,700
Finished goods	413,025
	638,625

7. **Depreciation for the year:**

	Admin	Selling & Dist.	Production
	₦	₦	₦
Plant and Equipment @ 8% on cost	-	-	18,000
Furniture & Fitting " 10% on cost	7,500	-	-
Motor vehicle @ 20% on C. A	3,750	11,250	-
	11,250	11,250	18,000

8. Amortisation of leasehold property:

$$\frac{\text{₦}112{,}500 - \text{₦}22{,}500}{40 \text{ years}}$$

$$= \underline{\underline{\text{₦}2{,}250}}$$

9. Earnings per share EPS:

$$\frac{\text{₦ }110{,}875}{900{,}000 \text{ shares}}$$

$$= 0.12 \text{ i.e } 12 \text{ kobo}$$

10. An ordinary dividend of ₦2.25 per share amounting to ₦2,025,000 was proposed during the year.

MARKING GUIDE

a)	STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED DECEMBER 31, 2015:		Marks
-	Calculation of Gross Profit:		
	Title of statement	$^{1}/_{3}$	
	Revenue	$^{1}/_{3}$	
	Cost of Sales	$^{1}/_{3}$	
	Gross profit	$^{1}/_{3}$	$1^{1}/_{3}$
-	Determination of profit before taxation:		
	Administrative expenses	$^{1}/_{3}$	
	Selling and distribution expenses	$^{1}/_{3}$	
	Finance Cost	$^{1}/_{3}$	
	Profit before taxation	$^{1}/_{3}$	$1^{1}/_{3}$
-	Determination of profit for the year:		
	Income tax expense	$^{1}/_{3}$	
	Profit for the year	$^{1}/_{3}$	$^{2}/_{3}$
-	Ascertainment of Total Comprehensive income:		
	Gain on revaluation of freehold property	$^{1}/_{3}$	
	Total comprehensive income	$^{1}/_{3}$	
	EPS presentation	$^{1}/_{3}$	1
-	Workings/calculation of figures for:		
	Cost of sales	4	
	Administrative expenses	$1^{2}/_{3}$	

	Selling and distribution expenses	1	
	Finance cost	1	$7^{2}/_{3}$
b)	STATEMENT OF FINANCIAL POSITION AS AT DECEMBER 31, 2015:		
-	Presentation of non-current assets:		
	Title of statement	$^{1}/_{3}$	
	Property, plant and equipment (PPE)	$^{1}/_{3}$	
	Patents and trademarks	$^{1}/_{3}$	
	Total non-current assets	$^{1}/_{3}$	$1^{1}/_{3}$
-	Determination of total current assets:		
	Inventories	$^{1}/_{3}$	
	Trade receivables	$^{1}/_{3}$	
	Cash and cash equivalent	$^{1}/_{3}$	
	Total current assets	$^{1}/_{3}$	
	Total assets	$^{1}/_{3}$	$1^{2}/_{3}$
-	Presentation of equity:		
	Authorised and issued share capital	$^{1}/_{3}$	
	Share premium	$^{1}/_{3}$	
	Revaluation surplus	$^{1}/_{3}$	
	General reserve	$^{1}/_{3}$	
	Retained earnings	$^{1}/_{3}$	
	Total equity	$^{1}/_{3}$	2
-	Presentation of non-current liabilities		
	10% loan notes	$^{1}/_{3}$	
	8.4% cumulative preference shares	$^{1}/_{3}$	$^{2}/_{3}$
-	Presentation current liabilities:		
	Trade payables	$^{1}/_{3}$	
	Income tax	$^{1}/_{3}$	
	Bank overdraft	$^{1}/_{3}$	
	Interest on loan	$^{1}/_{3}$	
	Preference shares dividend	$^{1}/_{3}$	
	Total current liabilities	$^{1}/_{3}$	
	Total equity and liabilities	$^{1}/_{3}$	$2^{1}/_{3}$
-	Workings/Calculation of figures for:		
	Property, plant and equipment schedule	6	
	Inventories at year end	1	
	Depreciation/amortization	$2^{1}/_{3}$	
	Earnings per share	$^{1}/_{3}$	
	Note on proposed dividend	$^{1}/_{3}$	10
	TOTAL MARKS FOR THE QUESTION		30

Examiners' Report

The question tests candidates' knowledge of the presentation of financial statements. Candidates are required to prepare a statement of profit or loss and other comprehensive income and a statement of financial position of a company. Majority of the candidates attempted the question as it is compulsory and the performance was fair. About 55% of the candidates who attempted the question obtained 50% of the mark allocated.

The commonest pitfall is the inability of some candidates to present the financial statements in an appropriate format. Some also lost valuable marks due to wrong calculation of the amount for cost of sales.

Candidates are advised to study and practice past examination questions on the preparation and presentation of financial statements.

SOLUTION 2

a) i. **Calculation of Goodwill at acquisition:**

	₦million
Consideration transferred	440
NCI share of subsidiary net asset	
(40% of N400 million)	160
	600
Less Net asset of subsidiary at acquisition	(400)
Goodwill	200

ii. **Calculation of Goodwill at acquisition with fair value of NCI:**

	₦million
Consideration transferred	440
Fair value of NCI at acquisition (40% – 640)	200
	640
Less Net asset of subsidiary at acquisition	(400)
Goodwill	240

b) **Papa Plc Group**

Consolidated Statement of Financial position as at Dec. 31, 2015

Assets:	₦'000
Property, plant and equipment (PPE)	15,200
Goodwill on consolidation	1,000
Other assets	3,500
	19,700
Equity and liabilities:	
Share capital	500
Retained earnings	15,860
	16,360
Non-controlling interest	1,340
Other liabilities	2,000
	19,700

Workings

1) Calculation of Net asset of subsidiary – Mama

		At Consolidation		At Acquisition	Post Acquisition
		₦'000		₦'000	₦'000
Share capital		500		500	-
Retained earnings	5000		3,000		
Extra depreciation on FV adjustment ₦1,500 x $^{2}/_{10}$ years	(300)	4,700	-	3,000	1,700
Fair Value Reserve		1,500		1,500	-
		6,700		5,000	1,700

2) Goodwill on consolidation

	₦'000
Consideration transferred	5,000
Fair value of NCI at acquisition (20% of ₦5,000)	1,000
	6,000
Less Net asset of Mama at acquisition	(5,000)
	1,000

3) Non-controlling interest

	₦'000
Fair value at acquisition (20% of ₦5,000)	1,000
NCI share of post acquisition reserve (20% of ₦1,700)	340
	1,340

4) Consolidated Retained earnings:

	Papa Group ₦'000	**Mama ₦'000**
Retained earnings per question	14,500	5,000
Less: FV extra depreciation adjustment	-	(300)
Pre-acquisition reserve	-	(3,000)
		1,700
Group share of post acquisition reserve at 80% of ₦1,700	1,360	
	15,860	

5) **Property, Plant and Equipment (PPE)**

	Group ₦'000	Mama ₦'000
Per question	9,000	5,000
FV adjustment		1,500
Extra depreciation on FV adjustment		(300)
	6,200	6,200
	15,200	

TUTORIAL NOTE

IFRS 3 Business Combination allows permits Non-controlling interest to be valued at fair or dull goodwill method. This holds usually where the market value of non-controlling interest can be independently determined example for a listed subsidiary. The question gives the fair value of the 60% subsidiary's shares acquired by the parent at ₦440million. But the cost of the full 100% interest in the subsidiary would have been ₦640million. This is an indication that the fair value of the entire 100% is ₦640million. Applying the fair or full goodwill method means that fair of non-controlling interest will be (640 – 440) i.e. ₦200million which is the value of the 40% non-controlling interest.

Almost all the student correctly identified the ₦640million as the fair value of the subsidiary. However, some incorrectly tried to calculate the fair value of non-controlling interest as 40% x ₦640million i.e. ₦256million. It should be noted that fair value is not necessarily a market value. To this recall that according to IFRS 13, Fair Value Measurement, Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (i.e. it is an exit price). Thus the ₦440million paid is the fair value of the parent and ₦200million to non-controlling interest. This explains why there can be a bargain purchase in acquisition of subsidiary.

MARKING GUIDE

(a)	CALCULATION OF GOODWILL AT ACQUISITION		Marks
(i)	Consideration transferred	${}^{1}/_{2}$	
	Determination of NCI share of net assets	1	
	Net asset of subsidiary at acquisition	${}^{1}/_{2}$	
	Determination of Goodwill	${}^{1}/_{2}$	$2^{1}/_{2}$
(ii)	Consideration transferred	${}^{1}/_{2}$	
	Determination of fair value of NCI at acquisition	1	

Net assets of subsidiary at acquisition	$^1/_2$	
Determination of goodwill	$^1/_2$	$2^1/_2$
		5

(b) PREPARATION OF CONSOLIDATED STATEMENT OF FINANCIAL POSITION

Determination of Property, Plant & Equipment (PPE)	$2^2/_3$	
Determination of Goodwill on Consolidation	$3^1/_3$	
Calculation of other Assets	$^1/_3$	
Calculation of Share Capital	$^1/_3$	
Determination of Retained Earnings	$5^2/_3$	
Determination of Non-Controlling Interest (NCI)	$1^2/_3$	
Calculation of other Liabilities	$^1/_3$	
Calculation of Total Asset and Total Liabilities	$^2/_3$	15
TOTAL MARKS FOR THE QUESTION		20

Examiners' Report

The question tests candidates' ability to calculate goodwill on the basis of two different assumptions that is where non-controlling interest is measured as a proportionate share of the net asset of the subsidiary or at fair value. Candidates are also required to prepare consolidated statement of financial position on the assumption that non-controlling interest is valued at fair value.

Majority of the candidates attempted the question but performance was below average. Only 30% of the candidates that attempted the question scored 50% of the marks allocated. The commonest pitfall is the inability of some candidates to calculate goodwill using the two different assumptions while others could not correctly reflect the effect of fair value adjustments on the assets. Some candidates also lost valuable marks due to non indication of appropriate naira symbols (N'000) despite advice given in past examiners reports.

Candidates are advised to cover all aspects of the syllabus and prepare adequately before presenting themselves for examinations.

SOLUTION 3

a)

i) No. of shares acquired in Sanda = 75% of 240 million shares

= 180 million shares

No of shares issued by Panda in exchange

$=\frac{180\ millionshares}{3}$x 2

= 120 million shares

:. Amount paid = 120 million shares x ₦6 per share

= ₦ 720 million

ii) Calculation of Goodwill on acquisition:

		₦'000
Consideration paid		720,000
Fair value of non-controlling interest		150,000
		870,000
Less: Net asset of Sanda at acquisition:		
Equity shares of ₦1 each	240,000	
Pre-acquisition retained earnings	220,500	(460,500)
		409,500

b)

Panda Group

Consolidated Statement of Comprehensive income for the year ended March 31, 2016

	Note	₦'000	₦'000
Revenue (₦675,000 + 180,000 – 60,000)			795,000
Cost of sales	1		(419,800)
Gross profit			375,200
Distribution costs (35,400 + 9,000)			(44,400)
Administrative expenses (40,500 + 17,250)			(57,750)
Finance Costs (N2,250 + 900)			(3,150)
Profit before taxation			269,900
Income tax expense (₦72,000 + 20,850)			(92,850)
Profit for the year			177,050
Other comprehensive income:			
Gain on revaluation of land (₦3,750 + 1,500)			5,250
Loss on fair value of equity financial asset investment (N1,050 + 600)			(1,650)
Total comprehensive income			180,650
Profit attributable to:			

Owners of the parent	165,800
Non-controlling interest at 25%	11,250
	177,050
Total comprehensive income attributable to:	
Owners of the parent	169,175
Non-controlling interest at 25%	11,475
	180,650

b) Alternate solution

Panda Group

Consolidated Statement of Comprehensive income for the year ended March 31, 2016

	Panda	Sanda	Dr	Cr	Consolidated
	₦'000	₦'000	₦'000	₦'000	₦'000
Revenue	675,000	180,000	(60,000)	-	795,000
Cost of Sales	(390,000)	(82,500)	(8,000)	60,700	(419,800)
Gross profit	285,000	97,500	(68,000)	60,700	375,200
Distribution cost	(35,400)	(9,000)	-	-	(44,400)
Administrative expenses	(40,500)	(17,250)	-	-	(57,750)
Finance costs	(2,250)	(900)	-	-	(3,150)
Profit before taxation	206,850	70,350	(68,000)	60,700	269,900
Income tax expense	(72,000)	(20,850)	-	-	(92,850)
Profit for the year	134,850	49,500	(68,000)	(60,700)	177,050
Other comprehensive income:					
Gain on revaluation	3,750	1,500	-	-	5,250
Loss on fair value of equity instrument	(1,050)	(600)	-	-	(1,650)
Total Comprehensive income	137,550	50,400	(68,000)	60,700	180,650
Profit attributable to:					
Owners of the Parent					165,800
Non-controlling interest at 25%					11,250
					177,050

Total comprehensive income attributable to:	
Owners of the parent	169,175
Non-controlling interest at 25%	11,475
	180,650

Workings:

1) Cost of sales:

	₦'000
Per question - Panda	390,000
- Sanda (165,000 x $^{6}/_{12}$)	82,500
Adjustment for inter group sales/purchase	(60,000)
Adjustment for unrealized profit in inventory	4,500
Adjustment for unrealized profit on transfer of plant	3,500
Adjustment for excess depreciation charge	(700)
	419,800

2) Unrealised profit on transfer of plant:

Proceed ₦7.5m less carrying amount ₦4m = ₦3.5million

3) Unrealised profit in inventory

Total profit on sale = Sales ₦60m less cost of sales ₦45m = ₦15million

Unrealised Profit = ₦15m x $\frac{₦18m}{₦60m}$

= ₦4.5million

4) Excess Depreciation charge

$\frac{₦3.5\text{million}}{2½ years}$ x $\frac{1}{2}$ = ₦700,000

5) Non-controlling interest at 25%

On profit for the year = 25% of ₦49,500,000 less ₦1,125,000 share of unrealized = ₦11,250,000

a) On Total comprehensive income:

25% of ₦50, 400,000 less ₦1,125,000 share of unrealized

= ₦11,475,000

Tutorial:

Panda's acquisition of the Sanda on October 1, 2015 happened at the middle of the current accounting year. Therefore, the post acquisition period is 6 months (October 1, 2015 to March 31, 2016).

For consolidation purpose, only the post acquisition proportion /part of the incomes and expenses of Sanda is relevant. That is Panda's figure plus $^{6}/_{12}$of Sanda's figure.

However, for gain on revaluation and loss on fair value reported under other comprehensive income, the amounts from Sanda are not apportioned because the transactions occurred after Panda's acquisition of Sanda.

MARKING GUIDE

(a)	DETERMINATION OF CONSIDERATION TRANSFERRED AND GOODWILL ON CONSOLIDATION:		Marks
-	Calculation of consideration transferred	2	
-	Calculation of Goodwill on consolidation	4	6
(b)	CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED MARCH 31, 2016:		
-	Determination of Gross profit:		
	Title of the statement	$^{1}/_{2}$	
	Revenue	$^{1}/_{2}$	
	Cost of Sales	$^{1}/_{2}$	
	Gross Profit	$^{1}/_{2}$	2
-	Determination of profit before taxation:		
	Distribution costs	$^{1}/_{2}$	
	Administrative expenses	$^{1}/_{2}$	
	Finance costs	$^{1}/_{2}$	
	Profit before taxation	$^{1}/_{2}$	2
-	Determination of profit for the year:		
	Income tax expense	$^{1}/_{2}$	
	Profit for the year	$^{1}/_{2}$	
	Profit attributable to owners of parent	$^{1}/_{2}$	
	Profit attributable to non-controlling interest	$^{1}/_{2}$	2

-	Determination of Total Comprehensive Income:		
	Gain on revaluation of land	½	
	Loss on fair value of equity financial asset	½	
	Attributable to owners of parent	½	
	Attributable to non-controlling interest	½	2
-	Workings/Calculation of figures for:		
	Cost of sales	3½	
	Unrealise profits	1	
	Excess Depreciation	½	
	Non-Controlling Interest	1	6
	TOTAL MARKS FOR THE QUESTION		20

Examiners' Report

The question tests candidates' knowledge of group accounts. Candidates are required in part (a) of the question to compute the consideration transferred by the parent and also to determine the goodwill arising on acquisition. The part (b) required candidates to prepare a consolidated statement of comprehensive income.

Many candidates attempted the question and the performance was good as over 65% of the candidates who attempted the question obtained above 50% of the marks allocated. The commonest pitfall is the wrong calculation of the consideration transferred by the parent for the acquisition of shares in the subsidiary.

Candidates are advised to study in-depth all aspects of group accounts in the syllabus for this paper.

SOLUTION 4

a) Calculation of equivalent ratios

i) Debt to Equity:

$$\frac{\text{Debt}}{\textit{Equity}} \text{ x } \frac{100}{1} = \frac{\text{₦}32{,}000}{\text{₦}106{,}400} \text{ x } \frac{100}{1}$$

$$= 30\%$$

ii) Gross Profit Margin

$$\frac{\text{Gross Profit}}{\textit{Sales}} \text{ x } \frac{100}{1} = \frac{\text{₦}56{,}000}{\text{₦}224{,}000} \text{ x } \frac{100}{1})$$

$$= 25\%$$

iii) Operating profit margin

$$\frac{\text{PBIT or Operating profit}}{\textit{Sales}} \text{ x } \frac{100}{1} = \frac{\text{₦}16{,}800}{\text{₦}224{,}000} \text{ x } \frac{100}{1}$$

$$= 7.5\%$$

iv) Return on Capital Employed (ROCE)

$$\frac{\text{PBIT}}{\textit{Capital Employed}} \text{ x } \frac{100}{1} = \frac{\text{₦}16{,}800}{\text{₦}138{,}400} \text{ x } \frac{100}{1}$$

$$= 12\%$$

v) Net Asset Turnover

$$\frac{\text{Sales}}{\textit{Net Asset}} = \frac{\text{₦}224{,}000}{\text{₦}138{,}400}$$

$$= 1.6 \text{ Times}$$

vi) Current Ratio

$$\frac{\text{Current Assets}}{\textit{Current liabilities}} = \frac{\text{₦}44{,}800}{\text{₦}28{,}800} \text{ x } \frac{100}{1}$$

$$= 1.55 : 1$$

vii) Average Inventory Turnover

$$\frac{\text{Cost of Sales}}{\textit{Average Inventory}} = \frac{\text{₦}168{,}000}{\text{₦}37{,}000} \text{ x } \frac{100}{1}$$

$$= 4.54 \text{ Times}$$

viii) Trade Payable Payment Period

$$\frac{\text{Trade Payable}}{Credit\ Purchases} \text{ x } 365\ days = \frac{₦21{,}600}{₦175{,}600} \text{ x } 365\ days$$

$$= 44 \text{ days}$$

b) Report to the Board

From: Chief Accountant

To: Board of Directors

Date: 17th May, 2016

Subject: **Report on Profitability and Solvency Performance of Quinet Plc as at June 30, 2015**

This Report is an assessment of the profitability and solvency situation of Quinet Plc in order to ascertain what is responsible for the recent declining performance.

The assessment is based on a comparison of the relevant performance indices of our company with those of the sector in which we operate as summarized below:

Ratio	Quinet Plc	Industry
Debt to equity	30%	38%
Gross profit margin	25%	35%
Operating profit margin	7.5%	12%
ROCE	12%	16.8%
Net Asset Turnover	1.6 Times	1.4 Times
Current ratio	1.56:1	1.25:1
Average inventory turnover	4.5 Times	3 Times
Trade payable payment period	45 days	64 days

Profitability

All the profitability ratios of our company namely – gross profit margin, operating profit margin and ROCE, are lower than the corresponding industry ratios. This is an indication that there is a room for significant improvement in Quinet's profitability to catch up with its competitors in the sector. This is particularly striking considering the fact that Quinet turns its net assets and inventory more often than the industry does. Thus, an indication that the lower profitability of Quinet Plc is very likely to be due to under-pricing of its products/services.

Solvency

The short term and long term solvency of Quinet Plc seem to be better than what obtains in the industry as indicated by the company's current ratio, trade payable payment period and debt to equity ratios which are better than the industry's.

In conclusion, Quinet Plc's solvency seem to be in good shape despite the lower profitability which can be remedied with appropriate upward adjustment of its selling prices.

MARKING GUIDE

(a)	COMPUTATION OF EQUIVALENT RATIOS		Marks
-	Computation of each Equivalent Ratios (8 Ratios @ $^1/_2$mark each)	8	
-	Presentation of solution	1	9
(b)	WRITING OF REPORTS		
-	Comparison of Ratios calculated with Industrial Ratios	1	
-	Correct Interpretation of profitability position with relevant reasons	3	
-	Correct interpretation of solvency situation with relevant reasons	3	
-	Appropriate opening paragraph	1	
-	Correct closing remarks	1	
-	Presentation in Report format (Memo for or letter form)	2	11
	TOTAL MARKS FOR THE QUESTION		20

Examiners' Report

The question tests the ability of the candidates' to compute equivalent industrial ratios and to also use the ratios computed to carry out financial analysis in terms of profitability and solvency.

About 95% of candidates attempted the question and performance was average. The commonest pitfall of the candidates was their inability to use the ratios computed to carry out correct interpretation of the financial statements.

Ratio analysis and interpretation of financial statement is a regular feature at the skill level of the Institute's examination. Candidates are therefore advised to pay more attention to this section of the syllabus in order to improve on their performance in future examinations.

SOLUTION 5

a) According to the provisions of IAS 8 – Accounting policies, changes in accounting estimates and errors:

Accounting policies are the specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements.

The basis on which management of an entity must select its accounting policies are as follows:

i) When an IFRS specifically applies to a transaction, other event or condition, the accounting policy or policies applied to that item shall be determined by applying the specific IFRS.

ii) In the absence of an IFRS that specifically applies to a transaction, other event or condition, management shall use its judgment to develop and apply an accounting policy that results in the financial statements providing reliable and more relevant information about the effects of such transaction, other event or condition.

A change in accounting policy involves a change in principle, bases, rule or practice applied while a change in accounting estimate involves an adjustment of the carrying amount of an asset or liability, or the amount of the periodic consumption of an asset resulting from new information or new development. An example of change in accounting policies include; adopting the revaluation model of IAS 16 where the cost model was previously in use. Also example of changes in accounting estimates include, change in the useful lives of Property, Plant and Equipment (PPE).

b) i. In accordance with IAS 8, Accounting policies, changes in accounting estimate and correction of prior period errors, a change in accounting estimate involves a change in the periodic consumption of assets which is similar to the case of Oluwaseun Plc. In line with IAS 8, a change in accounting estimate should be applied prospectively i.e from the year of change and in future periods. In addition, IAS 16 – Property, Plant and Equipment states that when an entity changes its depreciation method and useful live such should be treated as a change in accounting estimate and the current and future years depreciation should be based on the carrying amount of the asset at the date of the change.

Drawing from the above, the assistant accountants' suggestion of crediting the income statement with an amount debited from accumulated depreciation is not acceptable and not in line with IAS 8 and 16.

ii. By applying IASs 8 and 16, the carrying amount in the date of the change i.e 1st October 2014 is derived as follows:

	₦'million
Annual depreciation before change (₦80m ÷ 5years)	16
Total depreciation to date (₦16m x 2years)	32

Therefore carrying amount at 1/10/2014 = ₦80m – ₦32m = ₦48m

So, for the year ended 30 September 2015, the depreciation charge will be ₦48m divided by 6 (i.e the revised useful life of 8 less the already used up life of 2 years). This depreciation charge should be a charge against profit or loss for the current period and in future periods until a more reliable useful life is determined.

In conclusion, the effect of this on the financial statements is to reduce the annual depreciation charge from ₦16million to ₦8million. At the end of the year the carrying amount of the asset would be (₦48m – ₦8m) ₦40million. All other things being equal a higher profit would be reported in the current year but would be much lower than it would have been if the assistant accountant's suggestion was followed.

MARKING GUIDE

(a)	SELECTION BASIS OF ACCOUNTING POLICIES & DIFFERENCES BETWEEN ACCOUNTING POLICIES AND CHANGES IN ACCOUNTING ESTIMATES		Marks
-	Definition and Explanation of Accounting Policies	1	
-	Explanation of basis of selection of Accounting Policies by an entity	2	
-	Explanation of differences between Accounting Policies and changes in accounting estimates	1	
-	Giving one (1) examples of changes in Accounting Policies	1	
-	Giving one (1) example of changes in Accounting estimates	1	6
	COMMENTS ON ACCEPTABILITY OF THE ASSISTANT ACCOUNTANT'S SUGGESTION		
(bi)	Comment that the Assistant Accountants suggestion is not acceptable		
-	Giving at least three (3) correct reasons why the Assistant Accountants suggestion is not acceptable	1	
-	Correct application of IAS 8 and IAS 16 to determine the carrying amount as at 1 Oct. 2014	3	
-	Correct illustration of how the Assistant Accountants suggestion will affect the Financial statement	3	
-		2	
			9
	TOTAL MARKS FOR THE QUESTION		15 15

Examiners' Report

The question tests candidates' knowledge of IAS 8 – Accounting Policies, Changes in Accounting Estimates and Errors. The part (a) of the question required candidates to state the basis of selecting accounting policies by an entity and to distinguish with example, changes in accounting policies from changes in accounting estimates. The part (b) required candidates to apply the provisions of IAS 8 on a given scenario.

Few candidates attempted the question and the performance was poor as only 20% of the candidates who attempted the question obtained 50% of the mark allocated. The commonest pitfall is the inability of the candidates to distinguish between changes in accounting policies and change in accounting estimates.

Candidates are advised to pay special attention to all relevant accounting standards listed in the syllabus for this paper while preparing for the examination.

SOLUTION 6

a) WORKING CAPITAL CYCLE

	Year 2015 (Days)	Year 2014 (Days)
Inventory Turnover Period (W1)	119	106
Add:		
Account Receivable Collection Period (W2)	62	70
Less:		
Account Payable Payment Period (W3)	(74)	(72)
WORKING CAPITAL CYCLE	107	104

(w1)	Year 2015	Year 2014
Inventory Turnover Period:	$\frac{Closing\ Inventory}{Cost\ of\ good\ sold} \text{ x } \frac{365}{1}$	$\frac{Closing\ Inventory}{Cost\ of\ good\ sold} \text{ x } \frac{365}{1}$
	$= \frac{3{,}950}{12{,}100} \text{ x } \frac{365}{1}$	$\frac{3{,}250}{11{,}200} \text{ x } \frac{365}{1}$
	= 119 days	= 106 days

(w2) Accounts Receivable Collection Period:	Year 2015	Year 2014
	$\frac{Trade\ Receivable}{Credit\ Sales} \text{ x } \frac{365}{1}$	$\frac{Trade\ Receivable}{Credit\ Sales} \text{ x } \frac{365}{1}$
	$= \frac{2{,}515}{14{,}770} \text{ x } \frac{365}{1}$	$\frac{2{,}675}{13{,}873} \text{ x } \frac{365}{1}$
	= 62 days	= 70 days

(W3) Accounts Payable Payment Period:	Year 2015	Year 2014
	$\frac{Trade\ Payables}{Purchases} \text{ x } \frac{365}{1}$	$\frac{Trade\ Payables}{Purchases} \text{ x } \frac{365}{1}$
	$= \frac{2,600}{12,800} \text{ x } \frac{365}{1}$	$\frac{2,215}{11,300} \text{ x } \frac{365}{1}$
	= 74 days	= 72 days

bi)	Year 2015	Year 2014
Cash Ratio	$\frac{Cash\ \&\ Cash\ Equivalent}{Current\ liabilities}$	$\frac{Cash\ \&\ Cash\ Equivalent}{Current\ liabilities}$
	$= \frac{565+430}{3,865}$	$= \frac{375-180}{3,755}$
	= 0.26:1	= 0.05:1
Current Ratio	$\frac{Current\ Assets}{Current\ liabilities}$	$\frac{Current\ Assets}{Current\ liabilities}$
	$= \frac{7,460}{3,865}$	$= \frac{6,300}{3,755}$
	= 1.93:1	= 1.68:1
Quick Ratio	$\frac{Current\ Assets-Inventory}{Current\ liabilities}$	$\frac{Current\ Assets-Inventory}{Current\ liabilities}$
	$= \frac{7,460-3,950}{3,865}$	$= \frac{6,300-3,250}{3,755}$
	= 0.91:1	= 0.81:1

bii) Comments

- Apata Limited's Liquidity position has improved slightly over the period as evidenced by the improvement in current and quick ratios.
- The improvement noted above can be easily attributable to reduction in trade receivables period indicating that customers are beginning to settle their debt in time.
- This was also reflected in the company's cash position, as the overdraft or deficit cash position in year 2014 improved to a positive cash flow in year 2015. In fact the other cash and cash equivalent of the company improved substantially.
- The significant improvement in the cash ratio was as a result of the increase in cash and cash equivalent of the company in addition to the decrease in receivable collection period.

- However, the company's working capital cycle increased due to the fact that it takes a longer time for the company to convert its inventory to sales.

MARKING GUIDE

(a)	CALCULATION OF WORKING CAPITAL CYCLE:		Marks
	Determination of working capital cycle for 2014	2	
	Determination of working capital cycle for 2015	2	
	Workings/Calculation of figures for:		
	Inventory turnover period	2	
	Accounts receivable collection period	2	
	Accounts payable payment period	1	9
(b)i.	CALCULATION OF LIQUIDITY RATIOS:		
	Cash Ratio 2014 and 2015	1	
	Current Ratio 2014 and 2015	1	
	Quick Ratio 2014 and 2015	1	3
ii.	Comments on liquidity ratio:		
	Any three appropriate comments on the company's liquidity position at 1 mark each		3
	TOTAL MARKS FOR THE QUESTION		15

Examiners' Report

The question tests candidates' knowledge of Financial Accounting ratios as well as the computation of working capital cycle and the applications of those ratios in interpreting financial statements.

Majority of the candidates attempted the question and performance was above average. However, some candidates could not calculate the working capital cycles correctly while others were unable to use the ratios computed to interpret the liquidity position of the company.

The computation and application of financial ratios questions is a regular feature of Financial Reporting paper at Skill level. Candidates are advised to familiarize themselves with various financial ratios while also making reference to Annual Reports of Companies with the aim of carrying out analysis and interpretation of the financial

statements in some of the reports. This would assist candidates to perform better in future examination of the Institute.

SOLUTION 7

a) FAIR VALUE

- Is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.
- Fair value measurement look at financial assets from the point of view of a market participant. The fair value must take into account all factors that in market participant view would be considered relevant to value.
- A quoted price in an active market provides a reliable evidence of a fair value.

EXAMPLES OF FINANCIAL ASSETS THAT CAN BE MEASURED USING FAIR VALUE

i) Available for Sale Financial Assets.

ii) Financial Assets Fair Valued through profit or loss.

AMORTISED COSTS

Amortised costs is calculated as follows:

- Amount initially recognised (Initial cost of Inv.)

  Plus:
- Interest Income recognised (using effective rate)

  Less:
- Interest actually received (cash received)

EXAMPLES OF FINANCIAL ASSETS THAT CAN BE MEASURED AT AMORTISED COST

i) Held – to - maturity Investment

ii) Loans and Receivables

i) AMORTISATION SCHEDULE

Years	1 Jan	Effective Int. @ 10%	Coupon Rate 4.72%	31 Dec.
	₦'m	₦'m	₦'m	₦'m
2013	100.0	10.0	(5.9)	104.1
2014	104.1	10.4	(5.9)	108.6
2015	108.6	10.9	(5.9)	113.6

ii) FAIR VALUE AS AT 31 DECEMBER 2015

$$\frac{125,000,000}{100} \text{ X } 105$$

$$= \text{₦}131,250,000$$

MARKING GUIDE

			Marks
(a)	EXPLANATION OF HOW FAIR VALUE AND AMORTISED COST ARE DETERMINED		
-	Explanation of how fair values are determined	2	
-	Explanation of how Amortised Costs are determined	2	
-	One example of financial asset that can be measured at fair value	1	
-	One example of financial asset that can be measured at amortised cost	1	6
(b)i.	AMORTISATION SCHEDULE OF FINANCIAL LIABILITIES		
-	Determination of opening balance of the financial liability	2	
-	Calculation of effective interest rate for each of the relevant years	2	
-	Calculation of Fixed Interest rate for each of the relevant years	2	
-	Determination of the closing balance of the financial liability	2	
(ii)	Calculation of the fair value of the financial liability	1	9
	TOTAL MARKS FOR THE QUESTION		15

Examiners' Report

The question tests the knowledge of measurement of Financial Instruments at fair value and at amortized cost as well as computation of amortized cost of financial liabilities.

Less than 25% of the candidates attempted the question and performance was poor. The commonest pitfall of the few candidates that attempted was their inability to explain fair value and amortized cost. Also majority of them could not prepare the amortization schedule of the Financial Instrument.

Candidates are advised to pay more attention to all aspect of the syllabus especially the relevant International Financial Reporting Standards (IFRS) stated in the syllabus.

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – MAY 2016

AUDIT AND ASSURANCE

Time allowed: 3 hours

YOU ARE REQUIRED TO ANSWER FIVE OUT OF SEVEN QUESTIONS IN THIS PAPER

SECTION A COMPULSORY QUESTION (30 MARKS)

Question 1

You are an employee of Ben, Tai & co, a firm of Chartered Accountants. One of the firm's clients is Keke Limited, a car rental company whose shares are not traded on a stock exchange. The company has a large fleet of vehicles which it hires out on contract basis.

The duration of a contract varies from one day to three months. Anybody wishing to hire a car must possess a valid driver's licence. In addition, they must take out insurance with Keke Limited.

You are involved in the audit of non-current assets for the year ended December 31 2015.

The company's main non-current assets are:

- Freehold land and buildings
- Office equipment (mainly computers)
- Motor vehicles

The company was formed ten years ago and all non-current assets (except for land and buildings) are maintained in a non-current assets register. The company depreciates non-current assets at the following rates:

- Freehold land and buildings - 2% on cost
- Office equipment - 20% on cost
- Motor vehicles - 50% on cost

The company has recently revalued its buildings upwards by N200 million. The directors believe that they have fallen victim to a fraudster who has disappeared with a number of the company's vehicles.

Required:

a. What is the difference between the responsibilities of management and the auditor for the prevention and the detection of fraud? Explain how these responsibilities are carried out. (6 marks)

b. Describe how you would verify the ownership of :

   i. Freehold land and buildings

   ii. Computers

   iii. Motor vehicles (6 marks)

c. Comment on the appropriateness of the depreciation rates of the non-current assets and their respective effect on the income statement.
(6 marks)

d. List the contents of a non-current asset register and describe its usefulness for Keke Limited. (6 Marks)

e. Explain the accounting effect of the revaluation of the buildings to the financial statements and the audit work you would perform in this matter.

(6 marks)
(Total: 30 marks)

SECTION B: ANSWER ANY TWO OUT OF THREE QUESTIONS IN THIS SECTION

(40 MARKS)

QUESTION 2

Sweet Dreams, a limited liability company, is a new audit client and you are at the planning meeting for the forthcoming audit. The company has grown rapidly and has May 31 as year-end. The financial statements have not been audited in previous years since the organization has only just converted from a partnership to a company.

The company's bankers have requested that an audit be undertaken on the financial statements for the year ending May 31, 2016. Higher levels of inventory required to meet the increasing demand for its products have necessitated a request for an increase in the bank's overdraft facility.

The company makes beds, buying its materials directly. At the year-end, inventory comprises raw materials, work-in-progress and finished goods. It does not undertake continuous inventory counting but does intend to perform a full inventory count on

May 31, 2016. It uses standard costing system to value finished products and work-in-progress.

Required

a. What are the objectives of the planning stage with particular attention being paid to those areas that will assist the auditor in obtaining a sound knowledge of the business? (10 marks)

b. What are the audit risks of Sweet Dreams Limited and how would you address those risks? (10 marks)

(Total: 20 marks)

QUESTION 3

You have recently been appointed the auditors of Spicer Plc, a company whose shares are traded on a stock exchange. The directors of Spicer Plc have recommended that you perform the following services:

- The statutory audit of the annual accounts
- Taxation services; and

- Consultancy services in respect of the implementation of a new information technology system

Your firm has not acted for Spicer Plc before but does act as auditors to one of its major competitors.

Required:

a. Identify and explain the professional and ethical issues that should have been identified by your firm in relation to the provision of the services outlined above, to Spicers Plc and describe the safeguards that should be in place in order to address these issues. (11 marks)

b. What are the five fundamental principles of ethics? Briefly explain their meaning. (5 marks)

c. A client's affairs should not be disclosed to third parties. However where a client has been guilty of an unlawful act, to whom should the auditor disclose this information, and in what order? (4 marks)

(Total: 20 marks)

QUESTION 4

You are carrying out the audit of the sales system of Sofa Limited, a company that manufactures office furniture. The company has annual sales revenue of N150 million. All the shares are owned by Sofi and her husband Andy. Neither is involved in the running of the business. The chairman is responsible for running the business, but does not own any of the company's shares.

The book keeper maintains all the accounting records and prepares the annual financial statements

A stand- alone computer is used to maintain the accounting records including those of the sales system. Standard accounting software is used, which was purchased from an independent supplier. For the sales system, a sales ledger is maintained to which sales, invoices, credit notes, cash and discounts are posted. When sales invoices are posted and credit notes are input to the computer, the value of the invoice or credit note is posted to both the sales ledger and the nominal ledger.

You have determined that the documents and personnel involved in the sales ledger are as follows:

- When order is received by telephone, it is recorded by the sales clerk in the sales department. This is usually done on a note pad.
- The sales clerk will then pass the sales order to the stores, to the goods outwards department where the office furniture is kept.
- If the goods ordered are in inventory, then the goods will be loaded on to one of the delivery trucks. A two-part dispatch note will be prepared to accompany the sales order. This is usually done before the stores have received the sales order from the sales department.
  - The goods are delivered to the customer together with the top copy of the goods dispatch note.
  - The driver on his return will inform the sales department that the delivery has been a success and will maintain the last copy of the goods dispatch note in the stores
  - At the end of the week the sales department prepares a sales invoice for the customer
  - When the post is received, it is opened by a staff of the sales department. The person opening the post will both make a list of all the cheques received and that same person will then go to the bank and bank the cheques. Upon return, the remittances and cheque paying-in book are passed to the book keeper for updating the receivables ledger.
  - The receivables ledger is reviewed by the book keeper on a monthly basis to see which customers are above their credit terms and will inform the sales staff who to telephone and chase their debt.

Required:

a. Identify the weaknesses in the internal control in the sales system in Sofa Limited. Propose one control to address each weakness you identify. (12 marks)

b. It has been suspected that Andy and Sofi are contemplating to manipulate the financial statements. Which assertion would you pay more attention to in the audit of receivables – completeness or existence? (1 Mark)

c. Explain your answer to part (b) and give a substantive test that would test your suspicion. (3 marks)

d. A receivables circularization frequently does not produce the same quality of audit evidence as supplier statement reconciliation. Why do you think this is so? (4 marks)

(Total: 20 Marks)

SECTION C ANSWER TWO OUT OF THREE QUESTIONS IN THIS SECTION

(30 Marks)

QUESTION 5

Alhaji Abubakar Yusuf is the managing director of Nasara Tech Limited, a private company. Nasara Tech is currently audited by Mike and Co. Alhaji Abubakar has informed you that the directors of Nasara Tech wish to appoint your firm, Adewuyi Adeyemi and Co as auditors in place of Mike and Co. but they consider that Mike and Co will not be willing to resign.

Required

a. Assuming that Mike and Co are not willing to resign, set out the statutory and other procedures which will have to be followed by Nasara Tech Limited, your firm and which may be adopted by Mike and Co in connection with this proposed appointment. You should assume that Adewuyi Adeyemi and Co have adequate resources to take on the audit of Nasara Tech Limited and that there are no issues surrounding independence or client integrity. (6 Marks)

b. Assuming that Mike and Co are willing to resign part way through their term of office, set out the procedures to be followed by Mike and Co and Nasar Tech Limited in order to effect the resignations. (4 Marks)

Your office has recently taken on a new trainee, John. You have been asked to explain to John what information is recorded in the audit process and where.

c. Set out a brief explanation for John. (5 Marks)

(Total: 15 Marks)

QUESTION 6

Control activities may be defined as policies, procedures and operations that help to enable management directives to be carried out. These activities are detailed procedures designed to prevent, or to detect and correct errors that may arise in processing information.

Required:

a. Set out the five types of control activities and illustrate each one in the context of purchases or trade payables system. (10 Marks)

b. Explain why, even where tests of controls prove satisfactory, substantive procedures can never be completely eliminated (5 Marks)

(Total: 15 Marks)

QUESTION 7

Musky Fresh Limited has been in existence, for a number of years, importing perfume. The managing director had built up the business using contacts he already had in the industry. The company imports only one brand of perfume which is manufactured exclusively by one company. The perfume is distributed via 'shops within shops' at 20 branches of a well- known store. Under this agreement, Musky Fresh Limited pays a percentage of its taking to the store, with a minimum annual payment of N100,000 per store.

The audit is nearing completion but you have just heard that the Arabian manufacturer is facing serious financial difficulties and that supplies have ceased.

Required

a. Set out the further information the auditor would require before reaching his audit opinion. (6 Marks)

You are the internal auditor of Moovy Magic Limited, which runs a chain of video rental stores.

The company guarantees that if a video is not available for rental, the customer will get free rental when that video comes back into inventory. It is not possible for customers to pre-book videos.

The company purchases a number of copies of each video, taking the above policy into account, but has no way of monitoring whether their procurement strategy is effective. Procurement decisions are made and auctioned locally and no central budgets are produced.

You have been asked by the directors to review the procurement and other strategies of the company.

Required:

b. Identify and explain the potential business risks arising from the above procurement and other strategies. Suggest controls and strategies that the management of Moovy Magic could instigate to mitigate those business risks. (9 Marks)

(Total: 15 Marks)

SOLUTION 1

a) The International Standard on Auditing (ISA) 240 states that the primary responsibility for the prevention and detection of fraud rests with those charged with governance of an entity and with management. It is important that management with the oversight of those charged with governance, place a strong emphasis on fraud prevention, which may reduce opportunity for fraud to take place and fraud deterrence, which could persuade individuals not to commit fraud because of the likelihood of detection and punishment.

The ways the directors and management can discharge this responsibility include:

- ✓ Establishing and maintaining sound or strong systems and controls.

- ✓ Establishing a strong control environment, monitoring its effectiveness and taking corrective actions.

- ✓ Developing a code of conduct, monitoring compliance and taking action against non-compliance.

- ✓ Emphasising a strong commitment to fraud prevention by establishing a culture of honesty and ethical behaviour within the entity with clearly communicated policies on corporate attitude to fraud.

- ✓ Establishing an internal audit function

- ✓ Establishing a compliance function specifically charged with ensuring compliance with all relevant laws and regulations.

The auditor, however, does not have primary responsibility for the prevention and detection of fraud.

The responsibility of the auditor for the prevention and detection of fraud is to properly plan, perform and evaluate his audit work so as to have a reasonable expectation of detecting material misstatements in the financial statements whether they are caused by fraud or other irregularities.

- ✓ The auditor, according to ISA 240, is to identify and assess the risks of material misstatements and to obtain sufficient appropriate evidence about those risks through appropriate audit procedures.

The procedures to be performed by the auditor include making enquiries of management in respect of:

- Their assessment of the risks of material fraud
- Process for identifying and responding to risks of fraud
- Identified or likely specific risks of fraud
- Internal communication in respect of fraud

➢ Evaluate any unusual or unexpected relationship identified in performing analytical procedures.

➢ evaluation of information from other risk assessment procedures to confirm the existence of fraud risk factors

✓ The auditor should adopt the attitude of professional skepticism as required by ISA 200. The ISA also states that unless the auditor has reason to believe the contrary, he may accept records and documents as genuine and where responses to enquiries of management are inconsistent, the auditor shall investigate the inconsistencies.

b. Verification of the ownership of tangible non-current assets relates to the assertions of the directors that the entity has the rights to this class of assets disclosed in the financial statements.

i. Freehold Land and Buildings.

The auditor should:

- Check the legal right of ownership by inspecting appropriate documents like title deeds, deed of conveyance, land registration certificate and ensure that the documents are in the entity's name.
- Check invoices and agreements relating to sales and purchases of the properties.
- Ensure, where documents of title are held by a third party, that the said third party certifies possession in writing.

- Inspect the minutes of directors' meetings for proper authorisation of agreements, and signatures on relevant title documents properly approved

ii. Computers

Verification procedures to be applied to determine the ownership of computers would include the following:-

The auditor should

✓ Inspect the minutes authorising the purchase of the computers

✓ Examine suppliers invoices or other documents transferring title or ownership to the entity.

✓ Where relevant, confirm that the entity holds the proprietary license or authority to installed programs or software

✓ Inspect tangible non-current assets register.

iii. Motor Vehicles

To verify the ownership of motor vehicles, the auditor should:

✓ Inspect the minutes authorising the purchase or disposal of motor vehicles.

✓ Examine the suppliers' invoices and ensure they bear the entity's name.

✓ Examine vehicles registration documents or similar documentation giving evidence of title.

✓ Inspect the insurance policies and confirm that they relate to the entity's vehicle.

c. Appropriateness of the depreciation rates of the non-current assets and their respective effects on the Income Statement.

i. Freehold land and buildings - 2%

The rate applied here is considered adequate. On straight-line basis the life of the building is put at 50 years. The rate will ensure equitable presentation of the depreciated cost of the buildings in the income statement. It should be noted that land is not normally depreciated.

ii. Office Equipment (mainly computers) 20% on cost. The rate applied here is considered not okay. Five years is considered a bit longer lifespan for computers.

A period of four years should be more reasonable. Even at 25% annual depreciation rate, there may be need to review the rate chargeable at the end of each financial period in order to take account of technological change or "obsolescence". A rate of 20% will definitely reflect higher profit per the income statement.

iii. Motor Vehicles - 50% on cost
The rate being applied here is considered high. This puts the useful life of a vehicle at 2 years. The rate will translate to higher figures for depreciation in the first two years and as motor vehicles are not regularly purchased, this will distort the comparability of the income statement results post depreciation period. A rate range of 25% - $33^1/_3$ depending on the type of vehicles should be appropriate.

d. The contents of a non-current asset register include:

- ✓ Full description of the asset
- ✓ Identification number or mark
- ✓ Date of acquisition
- ✓ Supplier
- ✓ Original cost
- ✓ Current valuation of the asset, where appropriate
- ✓ Present location
- ✓ Expected useful life
- ✓ Expected date of disposal or scrapping and scrap value
- ✓ Depreciation or amortisation provided for the purpose of the financial statements
- ✓ Particulars and cost of repairs and renewals effected.

The usefulness of the non-current asset register to Keke Limited include

- ✓ Facilitating the periodic confirmation of existence of the assets
- ✓ Enabling the date of purchase and cost of the assets sold or scrapped to be obtained for tax and other purposes
- ✓ Forming an essential record of the property or assets of Keke Limited.
- ✓ Enabling the non-current assets accounts to be adjusted easily in the event of the assets being sold, scrapped or destroyed.
- ✓ Enabling periodic check on depreciation rate for appropriateness
- ✓ Providing statistical information on the composition of account balances periodically
- ✓ Uneconomic repairs being easily revealed

e. The buildings shall be carried at the revalued amount in the financial statements, being its fair value at the date of revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment loss. The increase in the buildings carrying amount as a result of the revaluation shall be credited directly to Other Comprehensive Income and accumulated in Equity unless it reverses a revaluation decrease for the same asset, previously recognised as an expense, in which case it must be recognised as income in the income statement.

The audit work that would be performed includes the following:

- ✓ Verify amounts in the financial statements with the independent and qualified valuer's report
- ✓ Consider the reasonableness of the valuation
- ✓ Check that valuation are regularly updated
- ✓ Check the accounting for the rise or fall, as the case may be, in the value of revaluation.

Marking Guide

		Marks	Marks
a	1 mark each for the responsibilities of management and the auditor	2	
	I mark each for the carrying out of the responsibilities (subject to a maximum of 2 each (respectively)	4	
			6
b(i)	1 mark for each verification point (subject to each maximum of 2 points)	2	
ii	1 mark for each verification point (subject to a maximum of 2 points)	2	
iii.	1 mark for each verification point (subject to each maximum of 2 points)	2	6
c.	2 points each for depreciation rate and the effect		6
d.	1 mark each for content of a non-current asset register and its usefulness (subject to a maximum of 6 points)		6
e.	3 marks for explanation on the accounting effect of the revaluation	3	
	(1 mark each for any three audit steps mentioned)	3	6
			30

Examiner's Report

The question is in five parts. Part (a) tests candidates' knowledge on the responsibilities of both management and the auditor on the prevention and detection of fraud while part (b) is on verification of ownership of non-current assets. Part (c) is on appropriateness of depreciation rates of non-current assets while part (d) is on candidates' knowledge of contents of non-current assets register and part (e) is on the effect of revaluation of building on the financial statements.

Almost all the candidates attempted the question because it is a compulsory question. Performance was good in parts, (a), (b), and (d) while candidates performed poorly in parts (c) and (e).
The commonest pitfall was the failure of candidates to understand the requirements of the question especially parts (c) and (e)

Candidates are advised to always read and understand the requirements ofa question before attempting it.

SOLUTION 2

A. The main objective of the planning stage of an audit is to assist the auditor to achieve the objective of performing the audit in an effective manner.

Other purposes of planning stage include:

- Helping the auditors to devote appropriate attention to important areas of the audit
- Helping the auditors to identify and resolve potential problems
- Assisting in the selection of staff with appropriate experience and the proper assignment of work to them.
- Allowing for the direction and supervision of staff and review of their work
- Helping the auditors to organise and manage the audit engagement so that it is performed in an effective and efficient manner.
- Understanding the entity and its environment.
- Understanding the accounting and internal control systems
- assisting to identify and assess the risk of material misstatement at both the financial statement and assertion levels respectively
- To obtain background information about the company since it is a new audit and the company's accounts have not been audited previously
- To get a clear understanding of the client's audit requirement and give an opportunity for auditors to clarify any ambiguous points in his terms of engagement
- To obtain information that will assist the auditors in the determination of materiality threshold
- To understand the transaction flows and balances to be reviewed.

B. The audit risks of Sweet Dreams Limited include:

- ✓ New audit client - As Sweet Dreams are undertaking the audit of their company records for the first time, there is a possibility of detection risk as the auditor will not be familiar with the business well enough. There will be no previous years results and financial statements for comparison. To bring down/reduce the level of detection risk; the auditor may need to carry out more audit work.

- ✓ No continuous inventory counting

There is inherent risk in that there is no adequate control over inventory and this may lead to misstatement and fraud- undetected for a long period of time. The auditor should maintain an attitude of professional skepticism and perform more substantive procedures on the inventory at counting and post counting dates.

✓ Valuation of finished products and work-in progress. There is risk of material misstatement of the inventory figures in the financial statements because Standard Cost may be reviewed periodically- even on two consecutive days- year end and commencement of the new year. The management can manipulate this to suit their purpose so the auditor needs to assign very experienced staff to deal with the situation.

✓ Conversion from Partnership
There is risk of management overriding controls due to the pedigree of the predecessor entity- partnership. The auditor would ensure that they obtain more "persuasive evidence".

✓ Increase in banks overdraft facility.
There is high risk of the management misstating the financial records in order to facilitate the increase in overdraft facility from the bank

MARKING GUIDE

		Marks	Marks
a	1 mark for each planning objective (subject to a maximum of points)	10	10
b.	I mark for each audit risk (subject to a maximum of 5 points)	5	
	I mark for each mitigate (subject to a maximum of 5 points)	5	10
			20

Examiner's Report

The question, in two parts, tests candidates understanding of objectives of audit planning and audit risks.

About 60% of the candidates attempted the question.

Performance of candidates was average in part (a) but poor in part (b). The commonest pitfall in part (b) was their inability to identify risks in a given scenario, explain them and proffer mitigates.

Candidates are advised to study hard and use their skills to interpret questions before attempting them.

SOLUTION 3

a. The professional and ethical issues that should have been identified by the firm of Chartered Accountants in relation to provision of services to a new client Spicer Plc include the following:

  i. Statutory audit of annual accounts:

  ✓ CLIENT ACCEPTANCE

  A Chartered Accountant in public practice should consider before accepting a new client relationship whether acceptance would create any threats to compliance with fundamental principles. Potential threats to integrity or professional behavior may be created from questionable issues associated with the client, like the client involvement in illegal activities, dishonesty or questionable financial reporting practices. If the threats identified are significant the safeguards to be put in place include:

  - Obtaining sound knowledge about the client and its business activities
  - Securing client's commitment to improve internal controls or corporate governance practices

  ✓ ENGAGEMENT ACCEPTANCE

  A Chartered Accountant in public practice should agree to provide only services that he is certified and competent to perform so that there may not be threats to compliance with fundamental principles. A self- interest threat to professional competence and due care is created if the engagement team does not possess or cannot acquire the competences necessary to carry out the engagement. The safeguards that should be in place to address the issues stated above include:

  - Acquiring an appropriate understanding of the clients business, the complexity of its operations and its position in the industry, the specific requirements of engagement, the purpose, nature and scope of the engagement and any legal or special reporting requirements

- Assigning of competent and sufficient staff on the engagement
- Agreeing on a realistic time frame for the performance of the engagement
- Complying with quality control practices
- Using experts where necessary.

✓ CHANGES IN PROFESSIONAL ACCEPTANCE
The Chartered Accountant in Public practice should communicate with the current auditors to establish if there are matters that he should be aware of before accepting the appointment. He should seek the client permission to communicate with the current auditor. If the management of Spicer Plc refuses to grant the permission, the prospective auditor should not accept the appointment. He should exercise appropriate professional and commercial judgment to decide to accept the appointment after assessing the information given by the current or existing auditors.

✓ UNPAID FEES
A Chartered Accountant in public practice should not accept the audit engagement of Spicer Plc if the company has not paid all outstanding fees after the proper removal of the current auditors.

✓ CONFLICTS BETWEEN COMPETING CLIENTS
The Chartered Accountant in public practice can act for two clients that are in direct competition with each other since he has a professional duty of confidentiality not to disclose information about Spicer Plc to the other client company, or vice versa.Where the acceptance of the audit engagement of Spicer Plc would materially prejudice the interest of any of the two clients, he should not accept the engagement, if not, the safeguards that could be in place include:

- Careful management of the clients, for example by ensuring that different members of staff are used for the engagements

- Full disclosure of the potential conflicts with the clients with suitable steps to be undertaken to manage the potential conflicts of interest.

- Creating "Chinese Walls" so that there would be physical separation of the teams and confidential and secure data filing

- Establishing clear guidelines on security and confidentiality and applying confidentiality agreement

- Regular review of safeguards in place

ii. Taxation Services
Assignments which include tax planning, tax compliance work, provision of advice and assistance in the resolution of tax disputes are not generally considered by the professional code of ethics to threaten independence.

iii. Consultancy Services in respect of the implementation of a new information technology system. If a Chartered Accountant in public service provides this service, a self threat may arise. The safeguards which may address the issue include the client:

- acknowledging its responsibility for the system of internal controls

- designating a competent and responsible member of senior management to be responsible for management decisions in respect of the design and implementation of the system.

- evaluating the adequacy and results of the design and implementation of the system.

- being responsible for the operation of the system and the data generated by it.

The five fundamental principles of ethics are

i. Integrity

Chartered Accountants should behave with integrity in all professional business and personal relationships. Integrity implies not just honesty, but also fair dealing, truthfulness, courage and confidentiality

ii. Objectivity

Chartered Accountants should not allow bias, conflicts of interest or undue influence of others to override their professional or business judgments. Objectivity is the state of mind which has regard to all consideration relevant to the task in hand but no other.

iii. Professional competence and due care

Chartered Accountants have a duty to maintain their professional knowledge and skill at such a level that a client or employer receives a competent service based on current developments in practice, legislation and techniques. They should act diligently and in accordance with applicable technical and professional standards.

iv. Confidentiality

Chartered Accountants should respect the confidentiality of information acquired during the course of their professional or business relationships and should not disclose such information to third parties, even after the determination of the professional and business relationships, without authority or unless there is a legal or professional right or duty to disclose . Information acquired during the professional or business relationship should not be used for the personal advantage of the member or third parties.

v. Professional behaviour

Chartered Accountants should behave with courtesy and consideration towards all they come in contact with in the course of performing their work. They should comply with relevant laws and regulations and should avoid any action that discredits the profession.

b. Disclosure of Clients Affairs

A fundamental principle of ethics is that a client's affairs should not be disclosed to a third party without the client's authority unless there is a legal or professional right or duty to disclose. Since the client has been found guilty of an unlawful act by a court or body of competent jurisdiction, the auditor is obliged to disclose information if forced to do so by the process of law to the body or the court, as the requirements of the law overrides the duty of confidentiality.

MARKING GUIDE

		Marks	Marks
a	5 marks for professional and ethical issues and the safeguards		
	- The statutory audit of annual accounts	5	
	3 marks for professional and ethical issues and safeguards		
	- Taxation services	3	
	3 marks for professional and ethical issues and safeguards		
	- Consultancy services - IT	3	11
b	1 mark each for explaining the five fundamental principles of ethics		5
c.	4 marks for explanation of to whom the auditor should report		4
			20

Examiner's Report

The question tests candidates' knowledge of professional and ethical issues.

About 80% of the candidates attempted the question.

Performance was above average in parts (a) and (b) but poor in part (c).

The commonest pitfall in part (c) was their inability to understand the requirements of the question.

Candidates are advised to interpret questions properly before attempting them. They should make use of the ICAN Study texts well for the examination.

SOLUTION 4

The weaknesses in the internal control in the sales system in Sofa Limited include

- The bookkeeper maintains all the accounting records and prepares the annual financial statements.

  There should be segregation of duties and the book keeper should not maintain all the accounting records and financial statements to prevent the risk of fraud or errors.

- Processing all of the accounting records by a stand alone computer thereby indicating weaknesses in the IT application controls and general IT controls.

  There should be input controls like autorisation controls and monitoring the work of the operating staff

- Orders are received by telephone and recorded by the sales clerk on a note pad. Incoming orders should be recorded on pre- numbered order forms, later matched with invoices to ascertain the outstanding orders.

- The sales clerk passes the sales order to the stores goods outwards department.

  There should be credit control whereby the credit limit of the customer will be circulated before processing.

- The sales clerk prepares the dispatch note (a two part) before sending the order to the sales department.

  Dispatch notes should be prepared at the point of supply of the goods from the stores.

- The dispatch of the goods is done on the strength of the sales order passed to the stores.

  Dispatch of goods should be done with evidenced proper authorization of a responsible officer

- Goods are delivered to the customer with only one copy of the dispatch note and the driver will come back only with the last copy announcing the success of the delivery.

Goods received by customers should be properly acknowledged on copy of the dispatch note with proof of delivery

- Sales invoice is prepared on weekly basis.

  Sales invoice should be prepared on dispatch of goods to the customers.

- Post is opened by the sales department.

  The post should be opened in the presence of two persons- independent of the sales department.

- The person opening the post does the banking.

  The sales department should not be involved in the banking of the cheques received by post.

b. The assertion one would pay more attention to the audit of receivables is “existence”.

c. Assets – including – receivables, are usually tested for overstatement hence the existence assertion is more relevant. The important audit technique that would be applied to test the suspicion is direct confirmation of balances with customers, also called circularisation. The existence assertion will confirm that the receivables do exist and there is no overstatement in the financial statements.

Direct confirmation of receivables should be more appropriate here since Andy and Sofi are not directly involved in the running of the business.

c. The co-operation of the debtors is needed for the circularisation process or technique to be a sufficient and appropriate source of audit evidence. Giving replies to confirmation requests is at the debtors' convenience but nonetheless a reliable source of third party evidence. Suppliers' statement reconciliation is considered an easier source because the client regularly receives the statement and the evidence is considered readily available. As much as the supplier's statement reconciliation is practicable, it is considered a better quality source of audit evidence than the receivables circularization technique.

	Marking guide	Marks	Marks
A	1 mark for each weakness (subject to a maximum of 6 points)	6	
	1 mark for each control (subject to a maximum of 6 points)	6	
			12

B	1 mark for "existence"	1
c.	3 marks for explanation on "existence" assertion and relevant test to be done	3
d.	4 marks for explanation on quality of evidence from 2 different third party sources	4
		20

Examiner's Report

The question is in four parts - (a) to (d)

Part (a) requests candidates to identify internal control weaknesses in a given case and the controls to address them. Parts (b) and (c) test candidates on the audit of current asset – receivables

Part (d) requires candidate to comment on evidence gathering techniques.
Candidates attempt at the question was about 50% and they reflected generally average understanding of the requirements of the question. Performance was average.

Their pitfall was inability to identify weaknesses in a given practical situation.

Candidates should learn to apply their knowledge to given practical situations.

SOLUTION 5

a.

- If Mike and Co are not willing to resign as auditors, the provisions of Section 362 to 364 of Companies and Allied Matters Act CAP C20 LFN 2004 (CAMA) state that Nasara Tech Limited (the Company) may by ordinary resolution remove Mike and Co before the expiration of his term in office, notwithstanding anything in any agreement between the company and Mike and Co.

- Nasara Tech Limited (The Company) is expected to give a special notice for the resolution for the removal, if the removal is before the expiration of the term of office of Mike &Co and also for the appointment of Adewuyi Adeyemi &Co- the proposed incoming auditors.

- The company would send a copy of the notice each to Mike and Co and Adewuyi Adeyemi & Co respectively

- Mike and Co are entitled to make representations to the members of the company in respect of the intended resolution and copies of the representation sent to each member or read at the general meeting at which the existing auditors, Mike & Co's appointment would be determined.

- Mike & Co are entitled also to attend the general meeting at which their term of office would otherwise have expired and at which it is proposed to fill the vacancy caused by their removal.

- Mike & Co may seek for damages or compensation for their removal.

- The company shall within 14 days of the passage of the resolution for the removal of Mike &Co give notice in the prescribed form to the Corporate Affairs Commission.

Other procedures

- It is a matter of professional expediency for Adewuyi Adeyemi &Co to obtain permission of the company to communicate with Mike &Co to enquire if there are any professional matters Adewuyi Adeyemi &Co should be made aware before deciding whether or not to accept the appointment.

b. If Mike & Co are willing to resign as auditors to Nasara Tech. Ltd (the company) Sections 365 and 366 of CAMA set out the procedures to be followed:

- The resignation should be made to the company at its registered office, in writing

- The notice of resignation shall not be effective unless Mike & Co includes a statement of the circumstances leading to their resignation, if Mike & Co believe they are relevant especially to the Shareholders and creditors. Mike & Co should make a statement also if no such circumstances exist.

- The company should send the statement to
  - The Corporate Affairs Commission (CAC) within 14 days of receipt

  - All persons entitled to receive a copy of the Company's financial statements- unless the CAC rules that Mike & Co is seeking to defame the company with needless publicity.

- Mike &co may require the directors to call an extra ordinary general meeting of the company in order to discuss the circumstances of the resignation.

Other issues

- Mike &Co should be communicated with by Adewuyi Adeyemi & Co to enquire if there are matters Adewuyi & Co should be aware of before or when deciding to accept the appointment

- If the Company refuses to give Adewuyi Adeyemi & Co approval to communicate with Mike & Co, Adewuyi Adeyemi & Co should decline the appointment.

c. Information that is recorded in the audit process is "audit documentation". As stated in International Standard on Auditing (ISA) 230, the objective of the auditor is to prepare documentation that provides:

- a sufficient and appropriate record of the basis for the auditor's report
- evidence that the audit was planned and performed in accordance with the ISAs and applicable legal and regulatory requirements.

Audit documentation is the record of

- audit procedures performed
- audit evidence obtained
- conclusions reached

The audit documentation is recorded in the audit file which may be in paper form or on electronic or other media. The contents of the audit file varies, depending on the size of the client or complexity of the audit process required to reach a conclusion or an opinion. The contents should include

- the audit program
- analyses and conclusion reached
- summaries of significant matters
- check lists
- relevant correspondence

The record is usually of two types:

- the permanent audit file
- The current audit file

The permanent audit file records information that is likely to be of continuing significance to every annual audit. Examples include:

- Legal constitution of an entity
- Important legal documents like agreements, title deeds and minutes of directors
- A summary of the history, development, ownership and activities of the entity
- Accounting systems and procedures
- Copies of previous years' financial statements with the relevant key ratios and trends
- Advisors like Lawyers, Bankers, Insurers and Stock brokers
- Any other relevant information

The auditor will need to regularly update the file as necessary.

Current audit file records information of relevance to the current year's audit. This is the evidence on which the conclusion of the current year's audit will be based. The contents include

- The financial statements: draft and final
- Audit planning materials
- Audit control materials like time budgets, review points
- Summary of audit adjustments and journals
- Reports and letters, like management letter, letter of representation, completion checklist.

- Minutes of the directors meetings and relevant committees of importance to the current audit for each audit are:
    - An audit program
    - Tests performed
    - Lead schedules

Other information on all the audit documentation records should have, where relevant, include:

- Name of client
- Accounting reference date
- File reference
- Name of the audit staff and date of preparation
- Name of the reviewer and date
- Key to audit ticks
- Findings and conclusions on the relevant areas of the working paper file

	Marking guide	Marks	Marks
a	6 marks for the explanation on the removal process of the auditors		6
b	4 marks on the voluntary resignation process of auditors		4
c.	½ mark for information recorded (subject to a maximum of 10)		5
			15

Examiner's Report

The question is in three parts. Parts (a) and (b) test candidates' on the appointment and removal of auditors while part (c) is on audit documentation.
About 70% of the candidates attempted the question and performance was poor.

Candidates are advised to cover the syllabus adequately and be able to apply their knowledge to practical issues.

SOLUTION 6

(a) The types of control activities are

- Performance Reviews:- These control activities include reviews and analyses of actual performance versus budgets, forecasts and prior period performance; relating different sets of data – operating or financial – to one another, together with analysis of the relationship and investigative and corrective action; comparing internal data with external sources of information; and review of functional or activity performance. These activities are also referred to as "Management controls".

  An example in the purchase and payables system is ensuring that orders are placed that are within budget limits and there should be frequent comparisons of actual purchases with budgets and investigation into variances.

- Information Processing - Application controls: Application controls apply to the processing of individual application such as revenue, purchases and payroll. These controls help to ensure that the transactions actually occurred, are authorised and are completely recorded and processed.
  For example, checking invoices from suppliers to ensure that the amount payable has been correctly calculated. Requisitioning of goods and services should be done by a responsible officer on specified forms within prescribed limit and performance acknowledged.

- Information Processing- General IT controls: - These controls are policies and procedures that relate to many different application like sales, inventory, payroll. They support the effective functioning of application controls by ensuring the continued proper operation of IT systems.
  An example is controls that restrict access to program and data to prevent unauthorised amendments to data files of suppliers so that wrong suppliers are not fraudulently paid.

- Physical Controls:- These types of controls concern the physical security of assets and records to prevent unauthorised use, theft or damage.
  All goods received should be inspected, agreed to orders and recorded on pre-numbered Goods Received Note.
- Segregation of Duties:- This relates to assigning different people the responsibilities of authorising and recording transactions and maintaining

custody of assets so as to reduce the likelihood of employee carrying out both functions and concealing errors or fraud.
For example, responsibilities for payable ledger entries should be vested in personnel separate from personnel responsible for ordering, receipt of goods and the invoice register.

b. The auditor will rely on the internal controls that are in operation in an entity with the understanding that the accounting systems and their related internal controls are sufficient to record transactions properly, in a system-based audit approach. However, all internal control systems have inherent limitations and controls can never be perfect and 100% certain to be effective.

This can be due to poor judgment in decision-making, human errors, collusion and management overriding controls.

The auditor consequently may have to perform some tests on the balances and transactions in the financial statements-which are referred to as substantive procedures. This of course is in addition to the tests of the underlying internal control systems of the entity using Tests of Controls.

	Marking guide	Marks	Marks
a	1 mark each for five control activities	5	
	1 mark each for five illustrations	5	10
b	4 marks for explaining why substantive procedures can never be completely eliminated		5
			15

Examiner's Report

The question tests candidates' knowledge on internal control.
About 80% of the candidates attempted the question. Performance was good in part (a) of the question while part (b) was poorly attempted.

The commonest pitfall in part (b) was the inability of the candidates to interpret the question well.

Candidates are advised to study well and develop their analytical skills to handle practical and real life scenarios.

SOLUTION 7

(a) Musky Fresh Limited

The Arabian manufacturers ceased supply of perfumes to the company.This is an indication of going concern threat and the auditor needs to require the following information before reaching his audit opinion.

i. Detailed information about the nature of the financial difficulties of the Arabian supplier - whether it is temporary or a permanent one.

ii. An assurance from the foreign supplier as to the probable time the financial difficulties will be resolved.

iii. Evidence of any financial assistance to the foreign suppliers

iv. Information from the management on possible alternative sources of supply of the perfume from other manufacturers

v. Whether the company has collected advance payment from customers for perfumes that may not be supplied.

vi. A written representation from the management on the ability of the company to continue on a going concern basis

vii. Legal advice taken with regards to the possibility of negotiating a break clause in the agreement with the store.

viii. Any costs/penalties arising from the above

ix. The nature and extent of Musky Fresh in other activities and its ability to expand or diversify into other areas

x. Willingness of Musky Fresh bankers to extend /grant any overdraft facility.

(b) Potential business risks of Moovy Magic Limited

	Potential business risk	**Suggested controls and strategies**
i	Procurement decisions are made locally. This could lead to too few copies being purchased, leading to lost revenue, or too many copies, incurring unnecessary costs.	Bulk discounts for purchase may not be obtained. Head office should consider cinema viewing rating to improve predictions of the likely level of rentals
ii.	Procurement decisions are made locally. Bulk discounts for purchase may therefore not be obtained	Centralised purchasing of all videos should be carried out by head office to ensure that the maximum discounts are obtained.
iii.	A guarantee is offered in respect of non-availability. This could lead to over-purchasing locally, as local managers purchase excessively to try and avoid the guarantee coming into force (assuming they are not penalised for over-purchasing).	Consideration should be given to abandoning this guarantee system, although a cost/benefit analysis would need to be undertaken. OR A policy of a guarantee whereby the video is made available within, say, two days, could be implemented. This could be made more feasible by introducing a system of transfers between stores.
iv.	There is no pre-booking system in operation so stores cannot predict demand. This makes it more likely that the current guarantee will come into force.	A (possibly discounted) pre-booking system could be introduced.
v.	No central budget is produced.	A central budget should be introduced, establishing criteria by which the performance of individual stores is measured.

	Marking guide	Marks	Marks
a	1 mark for each information (subject to maximum of 6 points)		6
b	2 marks for each business risk (subject to maximum of 3 points)	6	
	1 mark for each control (subject to a maximum of 3 points)	3	9
			15

EXAMINER'S REPORT

The question is in two parts. Part (a) tests candidates on a situation affecting the going concern of an entity in a post – audit reference date period and part (b) tests candidates on business risks.

About 40% of the candidates attempted the question and performance was poor.

The commonest pitfall was candidate's inability to apply their theoretical knowledge to practical scenarios. Candidates are advised to learn to apply their skills to practical situations.

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION - MAY 2016

TAXATION

Time Allowed: 3hours

ANSWER FIVE OUT OF SEVEN QUESTIONS IN All

SECTIONA: COMPULSORY QUESTION (30 MARKS)

QUESTION1

Mr. Okpobo Emmanuel was born in Kaduna in January 1954. He was employed by XYZ Limited on an annual gross salary of ₦60,000,000. He resigned from the company, effective May 31, 2014, to join the employment of Ultimate Nigeria limited as Chief Accountant, effective June 1, 2014.

The details of his salary per annum are as follows:

	₦
Basic salary	36,000,000
Housing allowance	15,000,000
Transport allowance	2,400,000
Utility allowance	960,000
Meal allowance	600,000
Leave allowance	3,600,000
Clothing allowance	1,800,000

In addition to his salary, Mr. Okpobo Emmanuel was also entitled to other perquisites which include an official car costing ₦9,600,000, a driver and a Personal Assistant who were paid ₦420,000 and ₦600,000 per annum respectively.

Additional information about Mr. Okpobo Emmanuel are as follows:

(i) He is married with four children, all of school age;

(ii) He paid life insurance premium of ₦2,960,000 in 2013 and ₦3,600,000 in 2014 on his life assurance policy;

(iii) In 2014, his employer-Ultimate Nigeria Limited, deducted and remitted on his behalf the following mandatory deductions of ₦4,800,000 and ₦2,400,00 for National Housing Fund and Pension Contributions respectively; and

(iii) He paid a premium of ₦420,000 on his National Health Insurance Scheme in 2014 to a health service provider to provide medical cover for himself and his family.

Required:

Compute the income tax liability of Mr. Okpobo Emmanuel for the relevant Year of Assessment. (30 Marks)

SECTION B: ANSWER ANY TWO OUT OF THREE QUESTIONS IN THIS SECTION (40 MARKS)

Akpabio Abdulahi Nigeria Limited was incorporated on February 1, 2010 and commenced business on June 1, 2010.

The Adjusted Profits of the company based on the audited accounts are give below:

	₦'000
Period ended March 31, 2011 (10 months)	11,000
Year ended March 31, 2012	14,500
Year ended March 31, 2013	22,000

The capital expenditure are as follows:

			₦'000
Machinery	-	February 21, 2010	3,600
Factory building	-	February 28, 2010	4,200
Furniture	-	June 1, 2010	720
Delivery van	-	January 17, 2011	900
Motor car	-	June 9, 2011	1,300
Office equipment	-	February 21, 2012	530

You are required to:

a. Determine the basis period for computing Adjusted Profits and Capital Allowances for the first THREE Years of Assessment. (6 Marks)

b. Compute the Capital allowances claimable for the first THREE Years of Assessment in respect of the qualify in capital expenditure of the company.

(Ignore any option available to the taxpayer) (14 Marks)

(Total 20 Marks)

QUESTION3

Wealth Capital Limited is a stock broking firm registered to operate in the capital market in Nigeria. It commenced business on July 1, 2009. The company's audited accounts have revealed the following:

			Profits ₦
Period ended	December 31, 2010	(18 months)	8,400,000
Year ended	December 31, 2011	-	9,270,000
Year ended	December 31, 2012	-	10,150,000

The company did not file any tax returns with the Federal Inland Revenue Service (FIRS) in respect of its accounts for year ended December 31, 2010 until March 31, 2012.

You are required to:

a. State the documents required to be filed for tax returns with Federal Inland Revenue Service by all registered companies in Nigeria. (6 Marks)

b. State the information that should be included in Companies Income Tax returns filed by a stock broking firm relating to transactions involving an offer in the primary and secondary markets. (8 Marks)

c. Calculate the penalty payable by Wealth Capital limited for late filing of its tax returns based on its accounts for year ended December 31, 2010.

(6 Marks)
(Total 20 Marks)

QUESTION 4

Audu Enterprises Limited commenced business on June 1, 2009. The following are the adjusted Profit/(Losses) for the relevant Assessment Years:

	Profit/(Losses) N'000	**Capital Allowances N'000**
Period to December 31, 2009 (7 months)	(200,000)	30,000
Year ended December 31, 2010	(140,000)	Nil
Year ended December 31, 2011	140,000	50,000

You are required to:

a. State any FOUR rules governing the claim for loss relief. (4 Marks)

b. Compute the Adjusted Profit/Losses and unrecouped Capital Allowances of the business at end of the relevant years of assessments. (16 Marks)
(Total 20 Marks)

SECTION C: ANSWER ANY TWO OUT OF THREE QUESTIONS IN THIS SECTION (30 MARKS)

QUESTION 5

Oloro Nigeria limited, a company engaged in the manufacture of home utensils, is based in Onitsha. The company commenced business on June 1, 2010.

Although, the company has been in business for some time, it is yet to register and file returns with the Federal Inland Revenue Service (FIRS) incompliance with the Value Added Tax Act Cap VIL FN 2004 (as amended). FIR VA inspectors visited the company recently and enquired why the company has not complied with the VAT law since it commenced business.

The Managing Director of the company feigned ignorance of the existence of the VAT Act and immediately approached your tax advisory firm to ascertain the company's VAT liability for the current month.

You are given the following information relating to the previous month:

Sales (VAT inclusive)	
Raw Material A (Vat inclusive)	270,000
Raw Material B	400,000
Raw Material C	360,000
Assets purchased	570,000
Cleaning	150,000
Labour	427,000
Penalty for tax offence	36,000
Sales returns	540,000
Purchase returns (Material)	
A	42,000
B	70,000
C	50,000
VAT remitted in the month	66,000

Required:

a. Calculate the VAT remittable to the Revenue at the end of the month.

(10 Marks)

b. Oloro Nigeria Limited acquired a property for N30m in the current year and the sale and purchase agreement for the transaction was sent to the Stamp Duties Office. The Managing Director is confused as to why the agreement should be sent to the Stamp Duties Office. You are required to:

i. State any THREE implications of non-stamping of Instruments. (3 Marks)

ii. Explain any TWO forms of Stamp Duties. (2 Marks)
(Total 15 Marks)

QUESTION 6

a. Tax, Fee, Fine and Penalty are one way or the other similar but are not entirely the same.

Required: Explain the following terminologies:

i.	Tax	(2 Marks)
ii.	Fee	(2 Marks)
iii.	Fine and Penalty	(2 Marks)

b. i. What are the distinguishing features between tax and other public charges? (2 Marks)

ii. State any THREE objectives of taxation. (3 Marks)

c. Explain briefly Direct and Indirect Taxes and highlight their differences.

(4 Marks)
(Total 15 Marks)

QUESTION 7

a. Where an employee in respect o whom a Tax Deduction card has been issued cease to be in employment the employer shall send to the relevant tax authority a Certificate on the prescribed form containing the particulars of the employee.

Required:

Describe any FIVE particulars which should be contained in the Certificate on the prescribed form of an employee who is no longer in employment.

(10 Marks)

b. You have been approached by the Managing Director of XYZ Nigeria Limited for an advice in respect of an assessment received by him from the Federal Inland Revenue Service. He indicated his interest to appeal against the assessment because he believes it is arbitrary and excessive.

You are required to:

State the contents of a valid Notice of Objection. (5 Marks)

(Total 15 Marks)

6

NIGERIANTAXRATES

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 EDUCATIONTAX (2% of Assessable Profit)

6. CAPITALGAINSTAX 10%

7. VALUEADDEDTAX 5%

SOLUTION 1

MR OKPOBO EMMANUEL
COMPUTATION OF INCOME TAX LIABILITY
FOR 2014 ASSESSMENT YEAR

	₦	₦	₦
Income for the period ended May 31, 2014			
(5 months)			
Salary ($\frac{5}{12}$ x ₦60,000,000)			25,000,000
Income for the period, 1/6/14 – 31/12/14			
(7 months)			
Basic salary		21,000,000	
Housing allowance		8,750,000	
Transport allowance		1,400,000	
Utility allowance		560,000	
Meal allowance		350,000	
Leave allowance		2,100,000	
Clothing allowance		1,050,000	35,210,000
Benefits-in-Kind:			
Car (5% x N9,600,000)		280,000	
Driver		245,000	
Personal Assistant		350,000	875,000
Gross Income			61,085,000
Deduct: Reliefs and Allowances, and Tax Exempt Deductions:			
Consolidated Relief Allowance			
Higher of: -	200,000		
OR			
1% of Gross Income	610,850		
Plus: 20% of Gross Income	12,217,000	12,827,850	
Life Insurance Premium		3,600,000	
National Housing Fund Contributions		4,800,000	
National Pension Contributions		2,400,000	
National Health Insurance Scheme		420,000	
			(24,047,850)
Chargeable income			**37,037,150**

Tax Computation:

		Amount (₦)
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
Next ₦33,837,150	@24%	8,120,916
₦37,037,150		
Tax payable		**8,680,916**

MARKING GUIDE

Heading		1
Income (1/1/14 –31/5/14)	½	
Income (1/6/14 – 31/12/14)	½	1
Basic Salary	1	
Housing Allowance	1	
Transport Allowance	1	
Utility Allowance	1	
Meal Allowance	1	
Leave Allowance	1	
Clothing Allowance	1	
Total of allowances	½	7½
Benefits-in-Kind (BIK)		
Car	1	
Driver	1	
Personal Assistant	1	
Total of BIKs	½	3½
Gross Income		1
Deductions		
Consolidated Relief Allowance	3	
Life Insurance Premium	1	
National Housing Fund Contribution	1	
National Pension Fund Contribution	1	
National Health Insurance Scheme	1	
Total Reliefs	1	8
Chargeable Income		1
Tax Computation:		
Core point for each band (1 mark for each of the six points)		6
Tax payable		1
		30

EXAMINERS' REPORT

The question tests candidates' knowledge of the computation of tax liability of individuals in employment.

Most of the candidates attempted the question and performance was above average. The commonest pitfall was the inability of the candidates to present their solutions in a proper format.

Candidates are advised to pay attention to the standard form of presentation.

SOLUTION 2

a.

AKPABIO ABDULAHI NIGERIA LIMITED

DETERMINATION OF BASIS PERIOD FOR COMPUTING ADJUSTED PROFITS AND CAPITAL ALLOWANCES FOR THE FIRST THREE YEARS OF ASSESSMENT

Assessment Year	Basis Period for Assessment	Basis Period for Capital Allowances
2010	1/6/2010 – 31/12/2010	1/6/2010 – 31/12/2010
2011	1/6/2010 – 31/5/2011	1/1/2011 – 31/5/2011
2012	1/6/2010 – 31/5/2011	NIL

b. COMPUTATION OF CAPITAL ALLOWANCES CLAIMABLE FOR THE FIRST THREE YEARS OF ASSESSMENT

	Machinery	Factory/ Building	F & F	Delivery Van	Equip	Total
Rate	%	%	%	%	%	
Initial	50	15	25	50	50	
Annual Allowance	25	10	20	25	25	
Investment Allowance	10	-	-	-	-	
	₦'000	₦'000	₦'000	₦'000	₦'000	₦'000
2010 Assessment Year						
Cost	3,600	4,200	720	-	-	8,520
Allowances:						
Investment	360					360
Initial	(1,800)	(630)	(180)	-	-	2,610
Annual (w1)	(263)	(208)	(63)	-	-	534
						3,504

W.D.V c/f to A. Y. 2011	1,537	3,362	477	-	-	
2011 Assessment Year						
(1/6/2010 – 31/12/2010)						
Cost	-	-	-	900	-	900
Allowances:						
Initial	-	-	-	(450)	-	450
Annual (W2)	(450)	(357)	(108)	(113)	-	1,028
						1,478
W.D.V c/f to A. Y. 2012	1,087	3,005	369	337		
2012Assessment Year						
Deduct: Annual Allowance	(450)	(357)	(108)	(113)	-	1,028
W.D.V c/f to A. Y. 2013	637	2,648	261	224		

Workings

1. Annual Allowance - 2010 (7 months)

Machinery - $\frac{\text{₦}3,600,000 - \text{₦}1,800,000}{4}$ = $\frac{\text{₦}1,800,000}{4}$ = ₦450,000

Annual allowance for 7 months = $\frac{7}{12} \times \text{₦} \frac{450,000}{1}$ = ₦262,500

Factory building - $\frac{\text{₦}4,200,000 - \text{₦}630,000}{10}$ = ₦357,000

Annual allowance for 7 months = $\frac{7}{12} \times \text{₦} \frac{357,000}{1}$ = ₦208,250

Furniture & Fittings - $\frac{\text{₦}720,000 - \text{₦}180,000}{5}$ = ₦108,000

7months - $\frac{7}{12} \times \text{₦} \frac{108,000}{1}$ = ₦63,000

Investment Allowance at 10%

₦3,600,000 @10% = ₦360,000

Plant - ₦3,600,000 @ 10% = ₦360,000

2. Annual allowance - 2011 & 2012 Assessment Years

Machinery	FB	FF	MV
₦3,600,000 – ₦1,800,000	₦4,200,000 –₦630,000	₦900,000 –₦180,000	₦900,000 –₦450,000
4	10	5	4
= ₦450,000	= ₦357,000	= ₦108,000	= ₦112,500

MARKING GUIDE

a. Heading	1	
Years of Assessment (½mark for each year)	1½	
Basis Period (½mark for each year)	1½	
Basis Period for Capital Allowances for A. Ys 2010 and 2011	1	
Basis Period for Capital Allowance for A. Y. 2012	1	6
b. 2010 Assessment Year		
Cost (½mark for each asset)	1½	
Total Cost	½	
Investment Allowance (Total)	½	
Investment Allowance	½	
Initial Allowance (½mark for each asset)	1½	
Total Initial Allowance	½	
Annual Allowance (½ for each asset)	1½	
Written Down Values (½ for each asset)	1½	
		8
c. 2011 Assessment Year		
Cost	½	
Total Cost	½	
Initial Allowance	½	
Total Initial Allowance	½	
Annual Allowance (½mark for each asset)	2	4
2012 Assessment Year		
Annual Allowance (½mark for each asset)		2
		20

EXAMINER'S REPORT

The question tests candidates' knowledge of the computation of capital allowances in an abnormal basis period situation.

Many candidates attempted the question and performance was below average. The commonest pitfall was the inability of the candidates to identify the relevant Years of Assessment for the assets.

Candidates are advised to pay attention to the treatment of capital allowances in abnormal basis situations.

SOLUTION 3

a. Documents required to be filed for tax returns with Federal Inland Revenue Service by all registered companies in Nigeria include:

   i. Duly completed self assessment income tax form (IR3C-4COY);
   ii. Audited financial statements together with the relevant schedules showing assets, trade receivables, trade payables etc;
   iii. A declaration which shall be signed by the Managing Director, a Director, or Statutory Secretary of the company indicating that the returns contain a true and correct statement of the amount of its profits computed in respect of all sources and that the particulars in such returns are true and complete;
   iv. Capital allowance computations;
   v. Tax computations for the Year of Assessment; and
   vi. Evidence of direct payment of the tax due into a bank designated for the payment of tax.

b. Information that should be included in Companies Income Tax Returns filed by a stockbroking firm relating to transactions involving an offer in the primary and secondary markets are as follows:

   Primary Market:

   These information include:

   i. Types of offer;
   ii. Services rendered;
   iii. Amount of tax deducted at source; and
   iv. Amount of Value Added Tax payable.

Secondary Market:

These information include:

i. Number and value of transactions carried out for the relevant calendar month;
ii. Commission received or paid;
iii. Amount of tax deducted at source; and
iv. Amount of Value Added Tax payable.

c. **WEALTH CAPITAL LIMITED**

Calculation of Late Returns Penalty

Based on the Audited Accounts for the Year Ended December 31, 2010

Description	**Month/ Period**	**Penalty (₦)**	**Remarks**
First month of default	July 2011	25,000	
Subsequent months	Aug 2011 - Dec 2011	25,000	₦5,000 per month
Subsequent months	Jan 2012 - Feb 2012	10,000	₦5,000 per month
		60,000	

MARKING GUIDE

a. Completed Assessment Form	1	
Audited Financial Statements	1	
A declaration	1	
Capital Allowance Computations	1	
Tax Computations	1	
Evidence of direct payment	1	6
bi. Types of Offer	1	
Services rendered	1	
Amount of Tax deducted	1	
Amount of Value Added Tax Payable	1	
ii. Number and value of transactions	1	
Commission received	1	
Tax deducted at source	1	
Value Added Tax payable	1	8
c. Heading	1	
Identification of the first month of default	1	
Penalty for first month	2	
Subsequent months (Aug 2011 – Dec 2011)	1	
Subsequent months (Jan 2012 – Feb 2012)	1	6
Total		20

EXAMINER'S REPORT

The question tests candidates' knowledge of the filing of returns in a stockbroking firm.

Many candidates attempted the question and performance was above average. The commonest pitfall was the inability of the candidates to calculate the penalty payable by the taxpayer.

Candidates are advised to be conversant with the filing of tax returns.

SOLUTION 4

a. Four rules governing the claim for loss relief

The following points are to be noted in the application of the rules on loss relief for companies:

i. Trading loss to be deducted from Assessable Profits of an Assessment Year shall not exceed the actual loss incurred by the company in the previous Assessment Years;

ii. Losses are not aggregated with Assessable Profits in the computation of a company's Total Profits. In strict compliance with the provision of Section 31 (1) of CITA, a trading loss from one of the company's sources of profits cannot be set-off against profits from another source. A loss incurred from a particular line of business can only be relieved in future years from Assessable Profits derived from the same source or line of business;

iii. When losses incurred in two different Assessment Years are being carried forward against future profits, the first loss incurred will be relieved in priority to the subsequent loss, subject to the four (4) year loss relief period for insurance companies; and

iv. When trade ceases, any terminal loss resulting there from which could not be relieved in that year of cessation due to insufficiency or non availability of profit, is deemed lost.

There is no provision under the Nigerian tax system for carrying back of terminal loss.

b. AUDU ENTERPRISES

COMPUTATION OF ADJUSTED PROFIT AND UN-RECOUPED CAPITAL ALLOWANCES

YOA	Basis Period	₦'000	₦'000
2009	**1/6/2009 - 31/12/2009**		
	Loss for the period		(200,000)
	Capital allowances		(30,000)
	Loss and Capital allowances c/f to A. Y. 2010		(230,000)
2010	**1/6/2009 - 31/5/2010**		
	Loss brought forward	(200,000)	
	Loss - 1/6/2009 – 31/12/2009	(200,000)	
	Loss - 1/6/2010 – 31/5/2010(5/12 x ₦140,000)	(58,333)	
		(458,333)	
	Unrelieved loss restricted to actual loss		(258,333)
	Capital allowance for the year	-	(30,000)
	Losses and Capital allowances c/f to A. Y. 2011		(288,333)
2011	**1/1/2010 – 31/12/2010**		
	Loss for the year	(140,000)	
	Unrelieved loss b/f	(258,333)	
			(398,333)
	Unrelieved loss c/f restricted to actual loss		(340,000)
	Capital allowances brought forward	30,000	
	Capital allowance for the year	-	(30,000)
	Losses and Capital allowances c/f to A. Y. 2012		**(370,000)**
2012	**1/1/2011 - 31/12/2011**		
	Assessable Profit		140,000
	Unrelieved Loss b/f		(340,000)
	Unrelieved Loss c/f		(200,000)
	Capital allowances b/f	30,000	
	Capital allowance for the year	50,000	(80,000)
	Losses and Capital allowances c/f to A. Y. 2013		(280,000)

MARKING GUIDE

a. Trading loss to be deducted	1	
Losses are not aggregated	1	
Relief of earlier loss	1	
Terminal loss cannot be relieved	1	4
b.		
2009 Assessment Year		
Loss for the period	1	
Capital Allowance	1	2
2010 Assessment Year		
Loss brought forward	1	
Loss (1/6/2009 – 31/12/2009)	1	
Loss (1/6/2010 – 31/5/2010)	1	
Unrelieved loss restricted	1	
Capital Allowance for the year	1	5
2011 Assessment Year		
Loss for the year	1	
Unrelieved Loss b/f	1	
Capital Allowance b/f	1	
Capital Allowance for the year	1	
Losses and Capital Allowance c/f	1	5
2012 Assessment Year		
Assessable Profit	1	
Unrelieved Loss b/f	1	
Capital Allowances b/f	1	
Capital Allowance for the year	1	4
		20

EXAMINER'S REPORT

The question tests candidates' knowledge of the rules governing loss relief and carry forward of capital allowances on commencement of business.

Not many candidates attempted the question but performance was fair. The commonest pitfall was the inability of the candidates to compute loss relief and capital allowances in arriving at assessable income.

Candidates are advised to pay attention to the treatment of losses and capital allowances.

SOLUTION 5

a.

OUTPUT VAT		₦	₦
Sales		3,600,000	
Returns		(540,000)	
Net Sales		3,060,000	
VAT ($^{5}/_{105}$ x ₦3,060,000)			141,714
Less:			
INPUT VAT (Raw Materials)			
(A)	₦		
Purchases	270,000		
Less Returns	42,000		
Net Purchases	228,000		
(B)			
Purchases	400,000		
Less Returns	70,000		
Net Purchases	330,000		
(C)			
Purchases	360,000		
Less Returns	50,000		
Net Purchases	310,000		
Total Purchases	868,000		
Total Input VAT		($^{5}/_{105}$ x ₦868,000)	(41,333)
			100,381
Less VAT already remitted			66,000
Final VAT remittable			34,381

bi. Three implications of non-stamping of Instruments are:

- Such an instrument shall not be given as evidence in court;

- Such an instrument is not admissible whether directly or for collateral purpose. The secondary evidence of the instrument is not admissible either; and

- Cross examination upon an unstamped instrument is not allowed.

ii. **Two forms of Stamp Duties are:**

Fixed duties: These are duties which do not vary with the consideration for the document.

Examples of Fixed Duties are:

- Admission as a Barrister or Solicitor;
- Admission as a Notary public;
- Affidavit, affirmation and statutory declaration;
- Instrument of apprenticeship;
- Letter of power of attorney;
- Policy of insurance against accident;
- Receipt; and
- Bills of Exchange payable on demand or at sight or on presentation or within three days after date or sight.

Ad Valorem duties: These are duties which vary with the amount or value of the consideration for the document, in accordance with scale of rates provided in the schedule to the Act.

Examples of such duties include:

- Valuation of any property;
- Bills of Exchange of any other kind and promissory note;
- Share Capital;
- Loan Capital;

- Contract notes for or relating to the sale or purchase of any stock or marketable Security;
- Conveyance of transfer on sale or purchase of any stock or marketable security;
- Debenture;
- Mortgage; and
- Policy of life insurance.

MARKING GUIDE

a.		
OUTPUT VAT		
Sales	½	
Returns	½	
Net sales	½	
VAT calculation	1	2½
INPUT VAT		
Material A		
Purchases	½	
Less Returns	½	
Net Purchases	½	1½
Material B		
Purchases	½	
Less Returns	½	
Net Purchases	½	1½
Material C		
Purchases	½	
Less Returns	½	
Net Purchases	½	1½
Total Purchases	½	
Output VAT less Input VAT	½	
VAT already remitted	1	
Final VAT remittance	1	3
		10
bi. Instrument shall not be given as evidence	1	
Instrument shall not be admissible	1	
Cross examination is not allowed	1	3
ii. Fixed duties	1	
Ad-Valorem	1	2
		15

EXAMINER'S REPORT

The question tests candidates' knowledge of the calculation of VAT remittable to the Federal Inland Revenue Service (FIRS) and the basic rules of Stamp Duties.

Majority of the students attempted the question and performance was above average. The commonest pitfall was the inability of the candidates to offset Input VAT against Output VAT.

Candidates are advised to learn how to compute the Input VAT and Output VAT.

SOLUTION 6

a.

i. **Tax**
This is a compulsory extraction of money by a public authority for public purposes from her citizens.

ii. **Fee**
This is a payment to defray the cost of each recurrent service undertaken by the government, primarily in the public interest, but conferring a measurable special advantage on the fee payer. Examples are court fee, registration fee of a property and marriage fee.

iii. **Fines and Penalties**
These are levies not imposed to collect revenue but to punish a person for infringement of state law, such as traffic offenders.

b. **Distinguishing features between tax and other public charges**

i. A tax is a compulsory payment. It is not a voluntary payment or donation. Bannock, Baxter and Davis (1998, p:405) define taxation as 'a compulsory transfer of money from private individuals, institutions or groups to the government'.

Not all compulsory payments are taxes e.g. penalties, fines imposed on people for committing crimes.

- A tax is usually backed up by law e.g Companies Income Tax Act, Personal Income Tax Act, Value Added Tax, Capital Gains Tax Act, etc.
- Tax is levied according to predetermined criteria – It is openly done and verifiable
- Taxes are paid to the government and not individuals. For a tax to exist, some interaction with central government (or one of its agencies) must take place. (Pritchard and Murphy, 1988, p.2)
- Unlike a charge, tax is not a price paid by the taxpayer for services rendered or commodity supplied by the government like Electricity bill, Water bill.

i. Objectives of Taxation

The objectives of taxation include the following:

- **Revenue Generation:** The primary objective of a modern tax system is generation of revenue to help the government to finance ever-increasing public sector expenditure;

- **Provision of 'Merit Goods':** An important objective of tax system is the promotion of social, economic and good governance through provision of merit goods. Examples of merit goods are health and education. These must not be left entirely to private hands though private participation should be encouraged. Private enterprises will push the cost of providing education and health services beyond the reach of common people if left entirely in their hands;

- **Provision of 'Public Goods':** Provision of commonly consumed goods and services the cost of which cannot be levied to taxpayers is one of the functions of government. Examples of public goods include:

    - ❖ Internal security through maintenance of law and order by police and other security agencies;
    - ❖ External security through defense against external aggression by Army, Navy and Air forces; and
    - ❖ Provision of street lights and roads.

- **Discouraging Consumption of 'Demerit Goods':** Tax can be used to discourage consumption of demerit or harmful goods like alcohol and cigarettes. This is done to reduce external costs to the society. These external costs include health risks and pollution;

- **Redistribution of Income and Wealth:** Tax system is a means of ensuring the redistribution of income and wealth in order to reduce poverty and promote social welfare. For example, taxation can be used as economic regulator for promotion of economic stability and sustainable growth through fiscal policy. Government also has responsibility for fighting inflation, unemployment and creating a sound infrastructure for businesses. A tax system is one of the means of achieving this; and

- **Harmonization of Economic Objectives:** Harmonization of diverse trade or economic objectives of different countries is one of the modern objectives of tax systems. For example, a tax system can be used to achieve the philosophy of the single market in ECOWAS or Africa so as to provide for the free movement of goods/services, capital and people between member states.

c. **Direct Tax** is levied directly on the person who is expected to pay the tax. The taxpayer is not only advised by notification (called assessment notice) but he is duly receipted. The purpose of these formalities is to bring to the taxpayers' notice the incidence of such tax. Companies Income Tax, Pay-As-You-Earn and Capital Gains Tax are common examples of direct taxes.

Indirect Tax is borne by a person other than the one from whom the tax is collected. It is levied on the manufacturer but paid by the consumer. The taxpayer in case of indirect tax is never notified nor have knowledge of such levy. A very good example of this is the excise tax on manufactured products. The manufacturers normally charge this tax as an additional cost after arriving at the manufacturing cost. It is charged per unit of output. The consumer who pays the shelf price for a unit of product must have met an inputed tax, the exact amount and basis of which he has no information about. In indirect tax, the tax burden of tax payment is shifted to another person. Another popular example of indirect tax is Value Added Tax (VAT).

MARKING GUIDE

a. Explanation of:		
Tax	2	
Fee	2	
Fine and Penalties	2	6
bi. Tax is a compulsory payment	½	
Tax levied according to criteria	½	
Tax paid to government	½	
Tax not payment for services	½	2
ii. Revenue generation	1	
Provision of merit goods	1	
Provision of public good	1	
Discouraging consumption of demerit goods	1	
Redistribution of Income and Wealth	1	
Harmonisation of Economic Objectives	1	
(Any Three of the six points)	——	3
c. Explanation of:		
Direct Tax	2	
Indirect Tax	2	4
		15

EXAMINER'S REPORT

The question tests candidates' knowledge of the basic principles of taxation.

Majority of the candidates attempted the question and performance was good. The commonest pitfall was the inability of the candidates to present their answers in concise and good grammar.

Candidates are advised to pay attention to the use of grammar in the presentation of their answers.

SOLUTION 7

a. Particulars that should be contained in the transfer certificate of an employee leaving an employer are as follows:

   i. The name of the employee;
   ii. Address of the employee;
   iii. Any identification number assigned to the employee;
   iv. Date of commencement of employment;
   v. Date of resignation/termination
   vi. Reliefs from Income tax granted to the employee;
   vii. Cumulative emoluments at the date of leaving employment;

   viii. Cumulative corresponding tax (tax to date); and
   ix. A declaration confirming that the information on the certificate is a detailed and accurate information for the best of the employer's knowledge.

b. A Notice of Appeal must state:

   i. The name and address of the applicant;

   ii. The official number and the date of the relevant Notice of Assessment;

   iii. The amount of the Assessable, Total or Chargeable income and of the tax charged/payable, as shown by that notice and the Year of Assessment concerned;

   iv. The precise grounds of appeal against the assessment;

   v. The address for service of any notices or other documents to be given to the applicant; and

   vi. The date on which the applicant was served with the notice in accordance with the decision of the Appeal Commissioners.

MARKING GUIDE

a. Name of employee	2	
Address of the employee	2	
Any identification number	2	
Date of commencement of employment	2	
Date of resignation/termination	2	
Reliefs	2	
Cumulative corresponding tax to date	2	
A declaration	2	**10**
(2 marks for each of the maximum five points)		
b. Name and address of the applicant	1	
Official number	½	
The amount of Assessable Income	1	
Precise grounds of appeal	1	
The address for service of notices	1	
The date the application was served	½	5
		15

EXAMINER'S REPORT

The question tests candidates' knowledge of the documents in respect of individuals leaving employment and contents of a valid Notice of Objection.

Many candidates attempted the question and performance was good.

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION - MAY 2015

PERFOMANCE MANAGEMENT

Time Allowed – 3 hours

YOU ARE REQUIRED TO ANSWER FIVE OUT OF SEVEN QUESTIONS IN THIS PAPER

SECTION A: COMPULSORY QUESTION (30 MARKS)

QUESTION 1

Orlu Holding Plc prepares its accounts to December 31 each year. It is considering investing in a new computer controlled production facility on January 1. 2016 at a cost of ₦50 million. This will enable Orlu Holding Plc to produce a new product which it expects to be able to sell for four years. At the end of this time it been agreed to sell the new production facility for ₦1 million cash.

Sales of the product during the year ended December 31. 2016 and the next three years are expected to be as follows:

Year ended December 31	2016	2017	2018	2019
Sales in units (000)	100	105	110	108

Selling price, unit variable cost and fixed overhead cost (excluding depreciation) are expected to be as follows during the year ended December 31. 2016.

	₦
Selling price per unit	1,200
Variable production cost per unit	750
Variable selling and distribution cost per unit	100
Fixed production cost for the year	4,000.000
Fixed selling and distribution cost for the year	2,000.000
Fixed administration cost for the year	1,000.000

The following rates of annual inflation are expected for each of the years during 2017-2019.

	%
Selling prices	5
Production costs	8
Selling and distribution costs	6
Administration costs	5

The company pays taxation on its profits at the rate of 30% with half of this being payable in the year in which the profit is earned and the remainder being payable in the following year. Investments of this type qualify for tax depreciation at the rate of 25% per annum on a reducing balance basis.

The Board of Director of Orlu Holding Plc. has agreed to use a 12% post-tax discount rate to evaluate the investment.

Required:

a. Advise Orlu Holding Plc. Whether the investment is financially worthwhile. (17 Marks)

b. Calculate the internal rate of return of the investment. (8 Marks)

c. Define the following terms
   i. Real rate of returns (1 mark)
   ii. Money rate of return (1 mark)

d. Explain briefly how real rate of return and money rate of return would be applied in calculating the net present value of a project's cash flows. (3 Marks)

(Total 30 Marks)

SECTION B: ANSWER ANY TWO OUT OF THREE QUESTIONS IN THIS SECTION

(40 MARKS)

QUESTION 2

You have recently been appointed as the management accountant to Abax Limited, a small company manufacturing two products. Dab and CAB both products use the same type of material and labour but in different proportions In the past. The company has had poor control over its working capital. To remedy this, you have recommended to the directors that a budgetary control system be introduced. This proposal has been approved by the board.

Because Abax Limited's production and sales are spread evenly over the years, it was agreed that the annual budget should be broken down into four periods, each of 13 weeks, commencing with the 13 weeks ending April 4. To help you in this task, the sales and production directors have provided you with the following information:

(i) **Marketing and production data:**

	DAB	CAB
Budgeted sales for 13 weeks (units)	845	1,235
Material content per unit (kilograms)	7	8
Labour per unit (standard hour)	8	5

(ii) **Production Labour:**
Each of the 24 production employees work a 37-hour, five day week at ₦80 per hour. Any hours in excess of these will require Abax Limited to pay an overtime premium of 25%. Because of technical problems, which will continue over the next 13 weeks, employees are only able to work at 95% efficiency compared to standard.

(iii) **Purchasing and Opening Inventory:**
The production director estimates that raw material will cost ₦120 per kilogram over the budget period. He also plans to revise the quantity of raw materials inventory held in stock. He estimates that the raw materials inventory levels at commencement of the budget period will be as follows:

Raw material	DAB	CAB
2,328 kilograms	163 units	361 units

(iv) **Closing Inventory**: At the end of the 13- week period, closing inventories are planned to change on the assumption that production and sales volumes for the second budget period will be similar to those in the first period:

- raw material inventory should be sufficient 13 days production:
- finished inventory of DAB should be equivalent to 6 days sales volume:
- finished inventory of CAB should be equivalent to 14 days sales volume:

Required

a. Prepare in the form of a statement the following information for the 13- week period ended April 4:

   i. the production budget in units for DAB and CAB; (3 Marks)
   ii. the purchasing budget for Abax Limited in units: (4 Marks)

iii. the production labour budget for Abax Limited in hours: (5 Marks)
iv. the cost of production labour for the period. (2 Marks)

b. Discuss briefly **TWO** different circumstances where participation in setting budgets are likely to contribute to poor performance by managers.

(6 Marks)

(Total 20 Marks)

QUESTION 3

a. TK, a telecommunications company, has recently been privatised by the government after legislation was passed which removed the state monopoly and opened up the communications market to competition from both Nigeria and foreign companies.

Prior to the deregulation, TK was the sole, protected and monopolistic supplier of telecommunications services and was required to provide the best telecommunications services the nation can afford. At that time the government was responsible for setting TK's expected levels of performance and the level of resources the company would require to meet its objectives.

Required

i. State **TWO** long-term strategic objectives that TK should plan to achieve following its privatization and deregulation of the telecommunication market and give **ONE** example of each. (3 Marks)

ii. Advise the Board of Directors on the stages they should follow in developing appropriate strategic planning process for TK in the light of its privatisation and deregulation of the telecommunication market. (12 Marks)

c. Discuss the limitations of the Boston Consulting Group (BCG) portfolio matrix.

(5 Marks)

(Total 20 Marks)

QUESTION 4

The management of Gbengus Agro Limited is planning for next season's cultivation, and has asked you as a management accountant, to recommend the optimal mix of vegetable production for the coming year. The current year data is as follows:

	Cabbage	**Spinach**	**Tomatoes**	**Carrots**
Area occupied (acres)	30	24	36	30
Yields per acre (tonnes)	17.5	14	15.75	21
Selling price per tonnes (₦)	60,000	75,000	90,000	81,000
Variable cost per acre (₦)				
Fertilizer	24,000	20,000	36,000	32,000
Seeds	12,000	16,000	24,000	20,000
Pesticides	20,000	12,000	16,000	20,000
Direct wages	320,000	360,000	400,000	456,000

Fixed overhead per annum ₦62 Million

The land area used for the production of carrots and tomatoes can be used for either crops, but not for cabbage or spinach. The land area used for cabbage and spinach can be used for either crops, but not for carrots or tomatoes. In order to provide an adequate market service, the management must produce each year at lease 70 tonnes each of cabbage and spinach and 63 tonnes each of tomatoes and carrots.

Required:

a. i. Present the profit statement for the current year. (6 Marks)

ii. Calculate the profit for the production mix that you would recommend to Gbengus Agro Limited (4 Marks)

b. i. Advice the management on which of the vegetables they should concentrate their production on, assuming that the land could be cultivated in such a way that any of the four vegetable could be produced and that there was no market constraints. (4 Marks)

ii. Calculate the profit assuming the management accepts your advice in b(i) above. (2 Marks)

c. Calculate break-even point of sales for the most profitable product. (4 Marks)

(Total 20 Marks)

SECTION C: ANSWER ANY TWO OUT OF THREE QUESTION IN THIS SECTION

(30 MARKS)

QUESTION 5

Your manager has asked you to prepare a report entitle 'How to design an effective management information system'. The report should incorporate references to specific types of environments/organisations and give examples of the management accounting tools that could be useful for each type.

Required:

Prepare a draft report as requested by your manager. (15 marks)

QUESTION 6

Niger Power Electricity Authority has two divisions: Generation and Distribution. The Generation Division has enough market even at full capacity of 5,000 megawatts of electricity.

The Distribution Division requires 2,500 megawatts to meet the demands of the customers on its network.

The Power Generation Division has the following selling price and cost data:

	₦
Market price per megawatt	200,000
Variable cost per megawatt	(160,000)
Contribution	40,000

Fixed manufacturing cost is ₦200,000

Each megawatts distributed sells for ₦250,000. Variable costs include cost of network support₦50,000 and selling 2% of sales. Capital investment by the head office in Generation Division amounted to ₦100 million.

You are required to:

a. i. Advise the management whether to buy from Generation Division. If transfer price is based on full cost basis.

ii. Advice whether the company as a whole would benefit if the Distribution Divisional Manager decides to buy from Generation Division at full cost basis. (5 Marks)

b. Calculate:

i. Return on investment of Generation Division

ii. Residual income of generation division if imputed interest rate is 15% per annum. (5 Marks)

c. How can divisional performance be measured in a decentralised organisation? (5 marks)

(Total 15 Marks)

QUESTION 7

Daily Company Limited has developed a new product. Details are as follows:

Selling price and product life cycle

The product will have a life cycle of 10,000 units. It is estimated that the first 9,000 units will be sold for ₦3,100 each and then the product will enter the 'decline' stage of its life cycle. It is difficult to forecast the selling price for the 1,000 units that will be sold during this stage.

Costs

Labour will be paid at ₦300 per hour. Other variable costs will be₦950 per unit. Fixed costs over the life cycle of the product will be₦2,000,000. The labour rate and other costs will not change throughout the product's life cycle.

Learning curve

The first batch of 100 units will take 1,500 labour hours to produce. There will be an 85% learning curve that will continue until 6,400 units have been produced. Any batch produced after this level will each take the same amount of time as the 64th batch. The batch size is constant at 100 units.

Required:

a. Calculate

i. The cumulative average time per batch for the first 64 batches (2 Marks)

ii. The time taken for the 64th batch (2 Marks)

iii. The average selling price of the final 1,000 units that will allow Daily Company Limited to earn a total profit of ₦2,500.000 from the product. (6 Marks)

Note: The learning index for an 85% learning curve is – 0.2345.
Ignore time value of money.

b. Discuss briefly **FOUR** key barriers to e-business. (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

$MR = a - 2bQ$

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

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

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

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

$$\sum Y = na + b\sum X$$

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

Annuity Table

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

Where r = discount rate

n = number of periods

Discount rate (r)

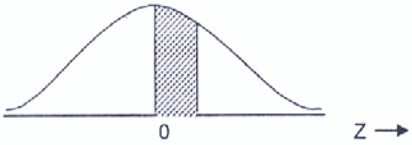
Periods

(n)	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%	
1	0·990	0·980	0·971	0·962	0·952	0·943	0·935	0·926	0·917	0·909	1
2	1·970	1·942	1·913	1·886	1·859	1·833	1·808	1·783	1·759	1·736	2
3	2·941	2·884	2·829	2·775	2·723	2·673	2·624	2·577	2·531	2.487	3
4	3·902	3·808	3.717	3·630	3.546	3.465	3·387	3·312	3·240	3·170	4
5	4·853	4·713	4·580	4·452	4·329	4·212	4·100	3·993	3.890	3·791	5
6	5·795	5·601	5·417	5·242	5·076	4·917	4·767	4·623	4.486	4·355	6
7	6·728	6.472	6·230	6·002	5·786	5·582	5·389	5·206	5·033	4·868	7
8	7·652	7·325	7·020	6·733	6·463	6·210	5·971	5·747	5·535	5·335	8
9	8·566	8·162	7·786	7.435	7·108	6·802	6·515	6·247	5·995	5·759	9
1	9·471	8·983	8·530	8·111	7·722	7·360	7·024	6·710	6.418	6·145	10
1	10·368	9·787	9·253	8·760	8·306	7·887	7.499	7·139	6·805	6.495	11
1	11·255	10·575	9·954	9·385	8·863	8·384	7·943	7·536	7'161	6·814	12
1	12·134	11·348	10·635	9·986	9·394	8·853	8·358	7·904	7·487	7·103	13
1	13·004	12·106	11·296	10·563	9·899	9·295	8·745	8·244	7·786	7·367	14
1	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
1	5·889	5·650	5.426	5·216	5·019	4·833	4·659	4.494	4·339	4·192	10
1	6·207	5·938	5·687	5.453	5·234	5·029	4·836	4·656	4.486	4·327	11
1	6·492	6·194	5·918	5·660	5·421	5·197	4·988	4·793	4·611	4.439	12
1	6·750	6.424	6·122	5·842	5·583	5·342	5·118	4·910	4·715	4·533	13
1	6·982	6·628	6·302	6·002	5·724	5.468	5·229	5·008	4·802	4·611	14
1	7·191	6·811	6.462	6·142	5·847	5·575	5·324	5·092	4·876	4·675	15

NORMAL DISTRIBUTION

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



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

SOLUTION 1

ORLU HOLDINGS PLC

(a) Profitability of the investment using Net Present Value (NPV)

	Cash outflow			Cash inflow			Net Cash flow	12% Discount Factor	Present Value (PV)
	Initial Cost	Tax paid	Total	Inflow before Tax	Cash Proceed	Total			
Year	**₦'000**	**₦'000**	**₦'000**	**₦'000**	**₦'000**	**₦'000**	**₦'000**		**₦'000**
2016 (Jan) 0	(50,000)		(50,000)	-	-	-	(50,000)	1.000	(50,000)
2016 (Dec) 1	-	(2,325)	(2,325)	28,000	-	28,000	25,675	0.893	22,928
2017 (Dec) 2	-	(5,214)	(5,214)	28,630	-	28,630	23,416	0.797	18,663
2018 (Dec) 3	-	(6,173)	(6,173)	28,926	-	28926	22,753	0.712	16,200
2019 (Dec) 4	-	(6,476)	(6,476)	26,551	1,000	29,551	21,075	0.636	13,404
2020 (Dec) 5	-	(3,284)	(3,284)	-			(3,284)	0.567	(1,862)
					Net Present Value (NPV)				19,333

The investment is financially worthwhile in view of the fact that it generated a positive NPV of ₦19, 333,000

(b) Internal Rate of Return on Investment (IRR)

$$IRR = R_a + \frac{NPV_a}{NPV_a - NPV_b}\left(R_b - R_q\right)$$

Where R_a = Low discount factor
R_b = High discount factor
NPV_a = NPV of low discount factor
NPV_b = NPV of high discount factor

By Interpolations of NPV of 30% and 31%

	Net Cash Flow	**Discount factor (30%)**	**Present Value (PV)**
Year	**₦'000**		**₦'000**
2016 0	(50,000)	1,000	(50,000)
2016 1	25,675	0.769	19,744
2017 2	23,416	0.592	13,862
2018 3	22,753	0.455	10,353
2019 4	21,075	0.350	7,376
2020 5	(3,284)	0.269	(883)
		NPVa =	+452

	Net Cash Flow	**Discount factor (31%)**	**Present Value (PV)**
Year	**₦'000**		**₦'000**
2016 0	(50,000)	1,000	(50,000)
2016 1	25,675	0.763	19,590
2017 2	23,416	0.583	13,652
2018 3	22,753	0.445	10,125
2019 4	21,075	0.340	7,166
2020 5	(3,284)	0.259	(851)
		NPVb=	(318)

Using IRR = $R_a + \frac{NPV_a}{NPV_a - NPV_b}\left(R_b - R_q\right)$ where R_a = 30% R_b = 31%

30 + $\frac{452{,}000}{452{,}000 - \left(-318{,}000\right)}\left(31 - 30\right))$ =

$$30 + \frac{452{,}000}{770{,}000}$$

IRR = 30.59%

(c) (i) Real Rate of Return - A real rate of return is the annual percentage return on an investment which is adjusted for in inflation.

(ii) Money Rate of Return - This is also known as normal rate of return which is annual percentage return that compensates for depreciation in purchasing power of the currency due to inflation.

In a situation where the expected rate of inflation is 5% an Investor seeking a money rate of return of 10% must find an investment that yields a rate of return of 15%.

(d) How Real Rate Of Return and Money Rate of Return can be applied in calculating NPV of Project Cash Flow:

There are two ways of calculating NPV under inflationary condition.

The two methods are situations where a real rate of return is used whereby cash flow is estimated and discounted using the real discount factors as follows:

$$\frac{1 + \text{Money rate}}{(1 \text{ Inflaation rate})} - 1$$

$$\frac{(1 + \text{m})}{(1 \ + \text{f})} - 1$$

The second method is where a normal or money rate of return is used whereby Cash flow is estimated thus:

(1 + m)(1+f) = Normal rate

Where m= Money rate

f = Inflation rate.

WORKINGS

(i)

Profit Statement					
		2016	**2017**	**2018**	**2019**
		₦'000	**₦'000**	**₦'000**	**₦'000**
Sales	(a)	120,000	132,300	145,000	150,000
Less Costs:					
Production costs:					
Variable		75,000	85,000	96,228	102,037
Fixed		4,000	4,320	4,666	5,039
Selling and Distribution					

costs:					
Variable		10,000	11,130	12,360	12,863
Fixed cost		2,000	2,120	2,247	2,382
Administration cost:					
Fixed		1,000	1,050	1,103	1,158
	(b)	92,000	103,670	116,604	123,479
Net Profit (a-b)		28,000	28,630	28,926	26,551

(ii)

Tax Computation					
	2016	**2017**	**2018**	**2019**	**2020**
	₦'000	**₦'000**	**₦'000**	**₦'000**	**₦'000**
Net Profit	28,000	28,630	28,926	26,551	-
Less Depreciation allowance	12,500	9,375	7,030	5,270	-
Taxable Income	15,500	19,255	21,896	21,281	-
Tax Liability (30%)	4,650	5,777	6,569	6,384	
50% Paid in the current Year	2,325	2,889	3,284	3,192	
50% Paid in the next Year	-	2,325	3,889	3,284	3,192
	2,325	5,214	6,173	6,476	3,192

(iii) Computation of Depreciation Allowance

	2016	**2017**	**2018**	**2019**
	₦'000	**₦'000**	**₦'000**	**₦'000**
Cost Written Down Value b/f	50,000	37,500	28,125	21,094
Depreciation allowance (25%)	12,500	9,375	7,031	
		5,274		
WDV C/F	37,500	28,125	21,094	15,820

(iv) **2016** **2017** **2018** **2019**

<u>Computation for items of profit statement</u>

Sales Price factor		1.00	$(1.05)^1$	$(1.05)^2$	$(1.05)^3$
	=	1.00	1.05	1.1025	1.1576
Selling Price adjusted		₦1, 200	₦1, 260	₦1, 323	₦1, 389.15
Total Sales Value (₦'000)		120,000	132,300	145,530	150,028.20
Production Costs factor		1.00	$(1.08)^1$	$(1.08)^2$	$(1.08)^3$
	=	1.00	1.08	1.1664	1.2597
Variable Production Cost Adjusted	=	₦750	₦810	₦874.80	₦944.78
Total Variable Production Cost (₦'000)	=	75,000	85,050	96,228	102,036.67

Fixed Production Cost Adjusted	=	₦4,000,000	₦4,320,000	₦4,665,600	₦5,038,848
Selling and Distribution Cost factor		1.00	$(1.06)^1$	$(1.06)^2$	$(1.06)^3$
	=	1.00	1.06	1.1236	1.191016
Variable Selling/Distribution Cost Adj.	=	₦100	₦106	₦112.36	₦119.1016
Total Variable Selling/Distr. Cost (₦'000)	=	10,000	11,130	12,359.60	12,862.97
Fixed Selling/Distribution Cost Adjusted	=	₦2,000,000	₦2, 120,000	₦2,247,200	₦2,382,032
Administrative Cost factor		1.00	$(1.05)^1$	$(1.05)^2$	$(1.05)^3$
	=	1.00	1.05	1.1025	1.157625
Fixed Administration Cost Adjusted	=	₦1,000,000	₦1,050,000	₦1,102,500	1,157,625

Marking Guide

ORLU HOLDING Plc.			**Mark**	**Mark**
a (i)	Computation of NPV 40 TICKS	= 4 marks		
(ii)	NPV value	= 1 mark		
(iii)	Advice	= 2 marks	7	
(iv)	Workings - 120 ticks		10	**17**
b (i)	IRR Formula	= 1 mark		
(ii)	IRR Computation 36 ticks	= 4 marks		
(iii)	IRR for the 2 schedules	= 1 mark		
(iv)	IRR formula computation	= 1 mark		
(v)	IRR final rate	= 1 mark	8	8
c (i)	Definition of Real rate of return	= 1 mark		
(ii)	Definition Money rate of return	= 1 mark	2	2
d (i)	Application Explanation	= 1 mark		
(ii)	Formula for Money rate of return	= 1 mark		
(iii)	Formula for Real rate of return	= 1 mark	3	3
				30

EXAMINER'S REPORT

The question tests the candidates' knowledge and ability to evaluate capital investment project. Candidates were required to use the Net Present Value (NPV) model to appraise the financial worth of the investment. It also tested the computation of appropriate breakeven discount factor for an investment using the Internal Rate of Return (IRR) model under inflationary condition and consideration of tax implication on the company's Net Cash Flow.

The candidates' performance in this question was below average as virtually all students failed to achieve 50% pass mark in the question.

The commonest pitfalls are:
(i) Poor understanding of the requirements of the question.
(ii) Wrong application of the inflation factor to adjust the cash inflows and outflows.
(iii) Wrong application of depreciation allowance variable.

Candidates are advised to ensure adequate preparation and clear understanding of the questions before attempting them. The effect of inflation as introduced in the question and treatment of depreciation allowance i.e. (capital allowance) with tax adjustments effect in arriving at Net Cash Flows to determine NPV for decision making should be mastered.

SOLUTION 2

ABAX LIMITED

a (i) Production Budget (units) for DAB and CAB

	DAB	CAB
Sales	845	1,235
Closing Stock	78	266
	923	1,501
Less Opening Stock	163	361
Production (units)	760	1,140

(ii) Purchase budget for Abax Limited in units

Purchase Budget (kg)	DAB	CAB	Total
Closing Stock (kg)	1,064	1,824	2,888
Material Usage (kg)	,320	9,120	14,440
	6,384	10,944	17,328
Less: Opening Stock			2,328
Purchases (kg)			15,000

(iii) Production Labour Budget for Abax Limited (hours)

	DAB	CAB	Total
Production in units	760	1,140	(hours)
Labour per unit (Standard Hours)	8	5	
Production Hours	6,080	5,700	11,780

Grossing production hours as 95% efficiency (W.3)	12,400
Available manpower in hours (W.4)	11,544
Overtime	856

(iv) Cost of production labour for the period

		₦
Production hours	12,400	
Labour rate per hour (₦)	80	
		992,000
Add overtime premium (W.5)		17,120
		1,009,120

WORKINGS

(i) Calculation of closing inventory (Units) DAB CAB

6/65 x 845/1 = 78 14/65 x 1,235/1 = 266

(ii) Closing Raw Materials 13/65 x 5,320/1 = 1,064 13/65x 9,120/1= 1,824 =2,888kg

Raw materials consumed DAB 7kg x 760 units of production = 5,320kg

For production CAB 8kg x 1,140Unit of Production =9,120kg

=14,440kg

(iii) Grossing production hours at 95% efficiency = 11,780/0.95 = 12,400 Hours

(iv) Available manpower in hour = 24 x 37 x 13
Employee x hours/weeks x weeks per quarter = 11,544 Hours

(v) Overtime premium = 25% x ₦80 x 856 hours = ₦17,120

(c) Circumstances where participation in setting budgets are likely to contribute to poor performance by managers:

i) Strong evidence suggests that some personality types do not perform well in participatory systems and for these types, being given a budget may produce higher effort levels. For example "Externals" as defined on the basis of the "locus of control" variable will actually respond well to imposed budgets.

(ii) Whereas in conditions of uncertainty, participation has been shown to improve results, under conditions of stability participation may result in few or no benefits. It may result in more time and cost being expanded for no benefits. This may be particularly relevant for cost centres within large organisations that have no direct link to market conditions.

(iv) "Pseudo-participation"- where there is a semblance of participation but no real participation - has been shown to produce very poor results. Individuals react strongly against this pretence at participation, and effort levels are significantly reduced.

(iv) Participation may increase "budget slack" and thus lead to lower targets and performance. Budget slack is where the budget is deliberately set at a level that is easier than could be achieved. There may be an increased incentive to build in budget slack if a bonus will be paid for meeting the budget.

MARKING GUIDE

ABAX LIMITED

a (i) Determination of production budget in units	DAB	CAB	**Mark**	**Mark**
• Total units available for sale	½	½	1	
• Closing Stock	½	½	1	
• Opening Stock	½	½	1	
• Production			1	
Any 6 ticks at ½ mark per tick				3

(ii) Production Budget in kilograms				
• Closing Stock	½	½	1	
• Consumed for production	½	½	1	
• Opening Stock			1	
• Total kilograms available for production			1	4
(iii) Production Labour Budget				
• Production in units	½	½	1	
• Standard Labour Hours	½	½	1	
• Production Hours	½	½	1	
• Grossing to 95% efficiency		½		
• Available manpower in Hours		½		
• Working of 95% efficiency		½		
• Working of available manpower		½	5	
(iv) Cost of Production - Labour				
• Cost of actual hours worked		½		
• Its working		½		
• Overtime premium		½		
• Its working		½		
• Total cost of production – Labour		½	2	
Any 4 ticks at ½ mark =2 marks		14		
(b) Any 3 points on where participation in budgets setting is likely to Contribute to poor performance by managers at 2marks each.			6	
		20		

EXAMINER'S REPORT

The question tests the candidates' knowledge of calculating production budgets from given data of a multi-product company. About 80% of the candidates attempted the question and the general performance was below average.

Candidates' commonest pitfalls are:

(i) Lack of understanding of the question and their inability to determine the opening and closing inventories and the production purchase budget.

(ii) Inability of most candidates to factor in lower working efficiency of labour due to technical problems as well as overtime premium payment.

(iii) Inadequate preparation for such question where they need to work from known to unknown variables in arriving at appropriate figures to use in the preparation of the budget.

Candidates are advised to study in-depth and not to limit their knowledge on simple budget preparation but also on budgeting application and techniques in deriving important variables not given but useful in the preparation of overall budget. They should not neglect this aspect of the syllabus and practice with more worked examples.

SOLUTION 3

i. Long Term Strategic Objectives available to TK:

- **Market leadership**: obtaining a leadership of the market by market penetration or market development strategy
- Obtaining large market share through cost leadership. By having lower cost than competitors thus succeeding by providing services at lower cost, selling at lower prices and therefore winning a bigger share of the market
- **Differentiation**: making products or services that are considered by customers to be better and different from those of competitors. This will make the customers to pay higher prices.

ii. Stages to follow in developing appropriate strategic planning process

- State mission and objectives
  The entity exists for a purpose, formally expressed in a mission statement. The entity must develop clear objectives, consistent with the mission statement, e.g. maximisation of shareholders' wealth.

- Strategic (SWOT) analysis to include;
  Position audit: Internal analysis considering strength and weaknesses within the organisation –its products, customers, management, employees, technical skills etc. The strategy should make use of any strengths within the organisation and reduce or remove significant weaknesses.

  Corporate appraisal: This involves making use of the mission statement and objectives of the company, together with environmental analysis and position audit, to formally appraise what the entity might be capable of doing.

  Environmental analysis: This involves an analysis of developments outside the organisation that are already affecting the organisation or could affect the organisation in the future. They could affect the achievement of organisational objectives and strategy selection. An external analysis might consider political situation, changes in law, and changes in economic situations, social factors, technology changes and competitive environment. External analysis identifies opportunities and threats that face the organisation. Strategies are developed to exploit opportunities and deal with threats.

- Strategic choice to include:
  Bases of strategy: This is about how to compete. The work of Michael Porter is influential here. According to Porter, a successful competitive strategy must be based on either Cost Leadership or Differentiation. Cost leadership means becoming the lowest- cost producer in the market, leading to ability to sell at lower prices and therefore winning the biggest share of the market. Differentiation means making products or services that are considered by customers to be different from those of competitors and therefore considered better.

Strategic direction: This concerns which products should be sold to the markets. A useful model here is the Ansoff's Grid which identifies four possible alternatives: Market Penetration, Market Development, Product Development and Diversification Strategies.

Strategic method: This concerns the question of how to grow. Growth can be achieved through: Internal (Organic) Growth, Acquisitions and Mergers and Joint Ventures or Strategic Alliance.

- **Evaluation of strategic options**: Strategies are evaluated to decide whether they might be appropriate. Johnson and Scholes suggested that strategies be assessed for suitability, feasibility and acceptability.
- **Strategic implementation**: The selected strategies should be implemented and monitored. Changes and adjustments should be made where necessary. Of particular importance are change management and project management.
- **Review and control**: A management information system is necessary to monitor the progress of the business, particularly introduction of a new strategy where timing and achievement of progress points might be vital to success.

(b) Limitations of BCG portfolio matrix

- It assumes that competitive strength of a product in its market depends on its market share. This may not necessary be so. A product can have strong competitive position in its market even with low market share if it has high product quality, brand name or low cost.
- BCG matrix is better for analysing Strategic Business Units (SBUs) and market segments and not for the entire market which might consist of many different market segments.

- It might be difficult to define “high rate” and “low rate” of growth in the market and also be difficult to define what is meant by “high” market share or “low” market share.
- Market growth is an inadequate description of overall industry attractiveness. Factors such as entry barriers, capital intensity and strong buyers can make even high-growth markets oversupplied, price oriented and unprofitable.
- Market share is an inadequate proxy for relative competitive strength. Other factors such as location, degree of vertical integration and capacity utilization also affect relative costs. Price and margins are also influenced by product positioning and shared marketing, distribution and branch franchises.
- The analysis is highly sensitive to how the market is defined. Do market share and growth refer to the total market or to the segments served?
- The model assumes that business units are independent. If two SBUs share facilities, divesting in the dog might weaken the star. The additional cash that the competitor generates may allow it to attack the company's own star in another market.
- The model incorrectly assumes that capital is rationed and has to be allocated among the SBUs, but there may not be such rationing - the capital markets are quite willing to fund all projects that promise to produce returns above the cost of capital

MARKING GUIDE

		Mark		**Mark**
3 (a)				
(i)	Market Leadership	1.5		
	Market Share	1.5		
	Differentiation	1.5	3	3
	(Any two points @ 1.5 marks per point)			
(ii)				
•	State mission and objectives	2		
•	Strategic (SWOT) analysis to include;	2		
	Position audit	2		
	Corporate appraisal	2		
	Environmental analysis	2		
•	Strategic choice to include	2		
	Bases of strategy	2		
	Strategic direction	2		
	Strategic method	2		

• Evaluation of strategic options	2		
• Strategic implementation	2		
• Review and control	2	12	12

(Any six points listed @ 1 mark per point= 6 marks;
The six points explained @ 1 mark per point= 6 marks)

(b) Limitations of BCG Portfolio Matrix

❖ Assumes competitive strength depends on mkt share	1		
❖ Difficulty of defining market	1		
❖ Better for analyzing SBUs, not entire market	1		
❖ Difficult to define high or low rate of growth	1		
❖ Difficult to define high or low market share	1		5
		20	

EXAMINER'S REPORT

The question tests candidates' knowledge and understanding of strategic objectives and plans of achieving them in a deregulated market. They are also to advise Board of Directors on stages to take in developing appropriate strategic planning process. The part (b) of the question also tests their knowledge on Boston Consulting Group (BCG) portfolio matrix. About 90% of the candidates attempted the question and the performance was average.

Most of the candidate were not familiar with the BCG portfolio matrix and thus lose substantial mark in the (b) part of the question.

Candidates are advised to read more textbook and journals on contemporary issues on strategic planning process and new developments in Performance Management.

SOLUTION 4

Preliminary calculations:

Variable costs are quoted per acre, but selling prices are quoted per tonne: Therefore, it is necessary to calculate the planned sales revenue per acre. The calculation of the selling price and contribution per acre is as follows:

		Cabbage	**Spinach.**	**Tomato**	**Carrots**
a.	Yield per acre(tonne)	17.5	14	15.75	21
b.	Selling price per tone	₦60,000	75,000	90,000	81,000
c.	Sales revenue per acre (a×b)	₦1,050,000	₦1,050,000	₦1,417,500	₦1,701,000
d.	Variable cost per acre	₦376,000	₦408,000	₦476,000	₦528,000
e.	Contribution per acre	₦674,000	₦642,000	₦941,500	₦1,173,000

a. i. Profit statement for current year

		Cabbage	**Spinach**	**Tomato**	**Carrots**	**Total**
a.	Acres	30	24	36	30	
b.	Contribution per acre	₦674,000	₦642,000	₦941,500	₦1,173,000	
c.	Total contribution (a×b) ₦	20,220,000	15,408,000	33,894,000	35,190,000	104,712,000
	Less fixed costs					62,000,000
	Profit					42,712,000

ii. Profit statement for recommended mix

Area A (45 acres) Area B (55 acres)

		Cabbage	**Spinach**	**Tomato**	**Carrots**	**Total**
a.	Contribution per acre	**₦674,000**	**₦642,000**	**₦941,500**	**₦1,173,000**	
b.	Ranking	1	2	2	1	
c.	Minimum sales requirements in acres		5	4		
d.	Acres allocated	40			51	
e.	Recommended mix (acres)	40	5	4	51	
f.	Total contributions (a)× (e) (₦)	26,960,0000	3,210,000	3,766,000	59,823,000	93,759,000
	Less: fixed costs					62,000,000
	Profit					31,759,000

NOTE

The minimum sales requirement for spinach is 70 tonnes, and this will require the allocation of 5 acres (70) tonnes/14tonnes yield per acre).The minimum sales requirement for tomato is 63 tonnes, requiring the allocation of 4 acres (63tonnes/15.75tonnes yield per acre). Allocation of available acres to products on basis of ranking and assumes that acre is the key factor.

b.

i. Contribution in sales values for carrots:
= ₦89,914,860 (52.86 acres at ₦1,701,000 sales revenue per acre)
Production should be concentrated on carrots, which have the highest contribution per acre as shown above.

ii. Contribution from 120 acres of carrots:

	₦
(120×₦ 1,173)	140,760,000
Fixed overhead	62,000,000
Profit from carrots	78,760,000

c. Break-even point in acres for carrots = $\frac{\text{Fixed costs}}{\text{Contribution per acre}} = \frac{\text{₦62,000,000}}{\text{₦1, 173,000}}$

= 52.8559 = 52.86 acres

OR

b.

ii. Total acre: 54 + 66 = 120 for Carrot

		₦
Revenue = 120 x ₦170100	=	204,120,000
VC 120 x 528,000	=	63,36,0000
		140,760,000
Less FC		62,000,000
		78,760,000

c. Break-even point in Naira (₦)

$$\text{BEP} = \frac{FC}{P/V}$$

$$^{\text{P}}/_{\text{V}} = \frac{\text{s}-\text{v}}{s} \qquad = \frac{204{,}120{,}000-63{,}360{,}000}{204{,}120{,}000}$$

$$= \frac{140{,}760{,}000}{204{,}120{,}000}$$

$$\text{BEP} = \frac{FC}{P/V} \qquad = \frac{62{,}000{,}000}{\text{PV}}$$

$$= \frac{62{,}000{,}000 \text{ x } 204{,}120{,}000}{140{,}760{,}000}$$

= ₦89,907,928

ALTERNATIVE SOLUTION

a (i) Profit Statement for the Current Year

	Cabbage	**Spinach**	**Tomatoes**	**Carrot**	**Total**
	₦'000	**₦'000**	**₦'000**	**₦'000**	**₦'000**
Sales	31,500	25,200	51,030	51,030	158,760
Less Variable Cost	11,280	9,792	17,136	15,840	54,048
	20,220	15,408	33,894	35,790	104,712
Less Fixed Cost					62,000
Net Profit					42,712

WORKINGS

	Cabbage	**Spinach**	**Tomatoes**	**Carrot**	**Total**
Area in Acres	30	24	36	30	120
Yield/Acre (tones)	17.5	14	15.75	21	
Total Yield (tones)	525	336	567	630	
Selling Price Per Tonne	₦60,000	₦75,000	₦90,000	₦81,000	
Total Sales Revenue (₦'000)	31,500	25,200	51,030	51,030	158,760

Variable Cost/Acre

Fertilizer	24,000	20,000	36,000	32,000	
Seeds	12,000	16,000	24,000	20,000	
Pesticides	20,000	12,000	16,000	20,000	
Direct Wages	320,000	360,000	400,000	456,000	
Total	376,000	408,000	476,000	528,000	
Total variable cost (₦'000)	11,280	9,792	17,136	15,840	54,048
Contribution					104,712
Less fixed cost					62,000
Net Profit					42,712
Contribution (₦'000)	20,220	15,408	33,894	35,190	-
Average Land	30	24	36	30	
				120Acres	
Contribution /acre	₦674,000	₦642,000	₦941,500	₦1,173,000	
	3rd	4th	2nd	1st	

MARKING GUIDE

		Mark	Mark
a(i)	Computation of Profit Statement Any 36 ticks at 1/6 or any 60 ticks at 1/6 alternative solution		6
(ii)	Computation of Profit of Production mix 16 ticks at ¼		4
b(i)	Giving correct advice on the production and sales of carrot		4
(ii)	Calculation of Profit from advice in b(i) 4 ticks at ½ mark		2
c	Computation of break-even point of sales in Naira (₦) or acres correctly		4
			20

EXAMINER'S REPORT

The question tests candidates' knowledge and understanding of preparation of profitability Statement of multiple products where the application of limiting factor is required. They are also expected to advise the management on the most profitable vegetables and the calculation of break-even sale. About 60% of the candidates attempted the question and the performance was poor as they scored below 50% of the pass mark allocated to the question.

The commonest pitfalls are:

- **(i) Inability of the candidates to correctly apply the yield per acre in the determination of contribution and profit per acre;**
- **(ii) Wrong apportionment of Land (acres) in calculating the required product mix; and**
- **(iv) Those that attempted the question could now calculate the break-even point of saleshaving forgotten the Break-Even Point (BEP) formula.**

Candidates are advised to practice more with worked examples as this is a very important topic in the syllabus which should not pose problem to good students of performance management.

SOLUTION 5

18th May, 2016

To: Manager

From: Management Accountant

REPORT ON HOW TO DESIGN AN EFFECTIVE MANAGEMENT INFORMATION SYSTEM

Management Information System (MIS) provides information to management, of a routine or non-routine nature, by analysing data and converting it into organised information. MIS provides management information in regular or routine reports, which management uses for planning and controlling activities. In short MIS provides management with information for decision making.

a) **Introduction**

This brief report summarises how an effective management information system can be designed.

b) **The objectives of management accounting information systems**

- i) aid to short-term planning and strategic planning
- ii) to facilitate control and decision making
- iii) to provide the base for the effective use of management accounting techniques.

These planning, controlling and decision-making activities are essential if the organisation is to achieve its objectives. These objectives may encompass a wide range of issues from high-level strategic plans to the control of detailed operating activities, such as the labour hours worked during the month. There is therefore a need to identify the information needs for a broad range of business activities.

c) **The range of information**

Given a spectrum from long-term strategic to short-term operational information needs, the data sources will probably exhibit the following characteristics:

- Strategic information needs will tend towards long-term, external and global data, which is obtainable from customers, suppliers, trade associations and government.
- Detailed operational information needs are likely to come from within the business.

d) **Recording and reporting issues**

The recording and processing methods adopted need to consider:

- Collecting and recording monetary and non-monetary information
- The influence and needs of management accounting techniques
- The influence of IT systems; and;
- The type of business entity.

In deciding on the format of the reports generated, consideration should be given to:

- Analysis and dissemination to relevant individuals and groups;
- Management culture, structure and style;

- The appropriate accuracy, detail and speed, and any trade-off between them
- Security, access and controllability issues;
- The need for systems compatibility and other organisation's system; and
- The needs, skills and systems knowledge of the potential users.

e) **Other issues**

Other general issues that need to be considered are:

- Expected planned life of the system;
- Developments in MIS; and
- Available resources and time constraints in terms of commissioning dates.

The above discussion should include reference to a specific organisation of which the candidate has experience/knowledge.

The design of the systems should consider the management accounting tools that are likely to be utilised e.g. budgeting, costing, TQM, benchmarking, etc. Can the system deliver the information needs of these techniques?

SIGNED
(MANAGEMENT ACCOUNTANT)

MARKING GUIDE		**Mark**	**Mark**
Address of the report with correct heading of the subject matter		2	2
Introduction, definition and explanation of Management Information System		3	3
Process of Management Information System (MIS):			
The range of information	-	1½	
Recording issues	-	1½	
Reporting issues	-	1½	
Development	-	1½	
Other issues	-	1½	7½
Conclusion of the report taking into consideration types of organisation and the Management Accounting tools.		2½	
			15

EXAMINER'S REPORT

The question tests the candidates' knowledge of Management Information System (MIS), its design and examples of Management accounting tools that apply to specific types of environments/organisations. About 80% of the candidates attempted the question and the performance was average as most of them scored above 50% of the mark allocated.

Candidates' major pitfall was their inability to provide relevant Management Accounting tools to support the Management Information System given in their report.

Candidates are advised not to neglect the Management Information System (MIS) area of the syllabus as it could be tested in different forms, as it is also an important tool in Performance Management.

SOLUTION 6

Niger Power Electricity Authority

(a) (i) **Distribution Division**

	₦	₦
Selling Price per Unit		250,000
Less: Transfer Cost	200,000	
2% of Sales	5,000	
Variable Network Support	50,000	
	255,000	
		(255,000)
Total Loss		= (5,000)

- Advice : Do not buy

(a) (ii) **Generation Division**

	₦
5,000 Units x ₦40,000 (contribution)	
	200,000,000
Less: Fixed Manufacturing Cost	(200,000)
Total Profit	=199,800,000

- Advice: The Company as a whole will benefit if the Distribution Division buys from the Generation Division.

(b) (i) Return on Investment - ROI

$$\boldsymbol{ROI} = \frac{Profit}{Capital\ Employed}\ x\ 100$$

$$= \frac{₦199{,}800{,}000}{₦100{,}000{,}000}\ x\ 100$$

=199.8% or 200%

(ii) Residual Income

= ₦199,800,000 - (15% of ₦100,000,000)

= ₦199,800,000 - ₦15,000,000

= ₦184,800,000

(c) Divisional performance in the decentralized organization can be measured using the following:

(i) Return on Investment (ROI);
(ii) Assets Growth;
(iii) Sales Growth;
(iv) Increased Profitability;
(v) Cost of Reduction;
(vi) Improved Stock Control;
(vii) Bureaucratic efficiency; and
(viii) Residual Income etc.

ALTERNATIVE TO a(i) and a(ii)

a (i) Distribution Division:

Selling Price	₦	₦
(250,000 x 2,500)	625,000,000	
Less: -Transfer Cost (200,000 x 2,500)	500,000,000	
-2% of Sales	15,625,000	
-Variable Network Support (50,000 x 2,500)	125,000,000	
	640,625,000	(640,625,000)
Loss		(15,625,000)

- Advice: Do not buy

(ii) General Division

	₦
Contribution - (5,000 x 40,000)	200,000,000
Less: fixed Manufacturing Cost	(200,000)
Profit:	199,800,000

- Advice: The Company as a whole will benefit if the Distribution Division buys from the Generation Division.

MARKING GUIDE		Mark	Mark
a			
(i)	Selling Price	½	
	Costs	½	
	2% of Sales	½	
	Network Support	½	
	Loss Generated (Total)	½	
	Advised (Decision)	½	
(ii)	Contribution	½	
	Fixed Cost Profit	½	
	Profit (Total)	½	
	Advise (Decision)	½	5
b.			
	ROI – Formula	½	
	Computation		1
	Answer		1
	Profit	½	
	Computation		1
	Answer		1
			5
c. One mark for each tick or each tick carries one mark to maximum of 5 marks			5
			15

EXAMINER'S REPORT

The question tests the candidates' knowledge of transfer pricing in an organisation from one division to the other and the computation of Return on Investment (ROI) and Residual Income. About 90% of the candidates attempted the question and less than 40% of the candidates scored above 50% of the marks allocated.

The commonest pitfall is the candidates' inability to calculate the benefit to the whole company if Distribution Division buys from the Generation Division using contribution (Marginal Costing) approach. Also, majority of them could not calculate the Return on Investment using the appropriate formula.

Candidates are advised to pay more attention to this aspect of the syllabus and make use of modern texts and to patronise the Pathfinder.

SOLUTION 7

i. The average time for 64 batches (i.e. 6,400 units)is:

$Y = ax^b = 1,500 \text{ x } 64^{-0.2345} = 565.64$ hours.

ii. The total time for 64 batches is 64 x 565.64hours = 36,200.96 hours.
The average time for 63 batches is:
$Y = ax^b = 1,500 \text{ x } 63^{-0.2345} = 567.735$ hours = 35,767.31 hours
Thus the time for the 64th and subsequent batches is 36,200.96 – 35,767.36 = 433.65 hours

		₦'000	₦'000
iii.	Revenue from 9,000 units (9,000 units @ ₦ 3,100)		27,900
	Cost of 10,000 units:		
	Variable costs:		
	Non-labour (10,000 units @ ₦950)	9,500	
	Direct labour (see below)	15,544	
		25,044	
	Fixed costs	2,000	27,044
			856
	Profit Target		2,500
			1,644

Revenue required from final 1,000 units:
(₦2,500,000 – ₦856,000) = ₦1,644,000 i.e. ₦ 1,644,000 ÷ 1,000 = ₦1,644 per unit

Direct labour cost:
Total time = 36,200.96 hours + (36, batches x 433.65 hours) = 51,812.36 hours
The direct labour rate is ₦300 per hour so this gives a cost 0f ₦15,543,708.
The 1,000 units being sold in the decline stage need to be sold at an average selling price of ₦1,644 (₦1,644,000/1,000) in order to meet the profit target of ₦2,500,000

7b. The major barriers to e-business include:

(i) **Set-up costs.** It can be fairly expensive for a small company to establish a website for selling its products and taking payment by credit card, debit card, Inter-switch or PayPal. For example, it will be expensive for a small company to set up a website showing an online catalogue with photograph, keeping records of inventory balances, and with a facility to debit customer credit cards.

(ii) **Type of business.** Some products and services are easier to sell on the internet than others. For example, computer firms sell products very successfully over the internet as their products can be perfectly specified in writing. However, it is much more difficult to sell items of clothing. No matter how much detail about clothing items that is provided on the website or how many photographs that are provided, there are difficulties with selling such goods 'by catalogue'. Companies that do sell clothing by internet have to budget for large amount of sales returns.

(iii) **On-going operating cost.** A website has to be updated frequently to keep it interesting (and accurate), and it might be necessary to keep making special offers to encourage customers to keep revisit the site.

(iv) **Time to establish the system.** It takes time to establish a website that customers know about and wants to visit.

(v) **No in-house skills.** A company might not employ individuals with the knowledge or skills to maintain a website. However, this should not be a serious barrier to e-business, especially if the employer is prepared to give suitable training to staff.

	MARKING GUIDE	**Mark**	**Mark**
a)	Average time per batch for the first 64 batches:		
	Stating the formula	1	
	Interpreting the formula (current figures)	1	
	Correct answer (no of hours)	1	3
(ii)	time taken for 64th batch:		
	Interpreting formula (for 63rd batch)	1	
	Correct answer (no. of hours)	1	
	Subtraction and answers (64th – 63rd batches)	2	4
(iii)	Average SP for final 1,000 units @ ₦2,500,000 profit:		
	Revenue for 9,000 units @ ₦3,100	½	
	Variable cost: Non – labour (for 10,000 units)	½	
	Direct labour	½	
	Fixed Cost (all 10,000 units)	½	
	Revenue less total Costs	½	

	Revenue From last 1,000 units (profit target less sale revenue)	½	3
(b)	Key barriers to e business		
	1 ¼, mark for any correctly discussed barrier x maximum of 4		5
		15	

EXAMINER'S REPORT

The question tests candidates' knowledge of Learning Curve and key barriers to e-business. The Learning Curve portion that accounts for almost 75% of the overall mark demands for applying learning curve formula to n^{th} batch, determination of incremental analysis to cost and selling price.

About 40% of the candidates attempted the question and the overall performance was below average with few candidates showing brilliant performance. Over 60% of the candidates that attempted the question scored below 45% of the allocated marks. The performance in the e-business portion was above average of allocated mark.

The major pitfall was the inability of the candidates to understand incremental analysis to both production hours in the n^{th}batch and selling price at decline stage.

Students are advised to read beyond applying learning curve formula to n^{th} batch only and be more conversant with new developments in Performance Management.

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – MAY 2016

PUBLIC SECTOR ACCOUNTING & FINANCE

Time allowed: 3hours

YOU ARE REQUIRED TO ANSWER FIVE OUT OF SEVEN QUESTIONS IN THIS PAPER

SECTION A COMPULSORY QUESTION (30 MARKS) QUESTION

QUESTION 1

In order to promote transparency, accountability and probity in public sector governance, the Federal Government of Nigeria introduced many public finance management reform initiatives.

Required:

a. Discuss the rationale, expected outcomes and modes of operation of the following public sector financial management reform initiatives embarked upon by the Federal Government of Nigeria giving one recommendation each on how these initiatives can be effectively utilized to support the current "war against corruption".

   i. Government Integrated Financial Management Information System

   (GIFMIS) (8 marks)

   ii. Integrated Payroll and Personal Information System{IPPIS) (8 marks)

   iii. Treasury Single Account(TSA) (8 marks)

b. Justify the need for the establishment of a Budget Implementation Committee by the Federal Government. (6 marks)

(Total 30 Marks)

SECTION B: ANSWER ANY TWO OUT OF THREE QUESTIONS IN THIS SECTION (40 MARKS)

QUESTION 2

a. Identify **FIVE** functions of the Officer Controlling Expenditures as prescribed in Government Financial Regulations (2009 Edition) (5 Marks)

b. Records from the Office of the Accountant General of the Federal Democratic Republic of Naija for the year ended December 31, 2015 stated the following:

REVENUE/EXPENDITURE	2015	2014
	(₦ Million)	(₦ Million)
Value Added Tax receipts	1,721,250	1,647,000
Miscellaneous Revenue	281,250	318,750
Personal Income Tax – Direct Tax	7,875,000	5,400,000
Allocation of Collection Costs (FIRS and Customs)	2,306,250	2,478,750
Personnel Costs	5,400,000	7,200,000
Share of Statutory Allocation	10,125,000	6,337,500
CRF Charges	1,687,500	2,812,500
Grants and Subvention from Foreign donors	56,250	65,250
Rent from Government Properties	213,750	221,250
Overhead charges	1,125,000	900,000
MDAs Subvention	1,350,000	1,425,000
Sales of Government Properties	281,250	363,750
Loans Repayments	652,500	182,250
Purchases and reconstruction of Non-Current Assets	1,875,000	2,025,000
Proceeds from sales of Federal Government Properties	787,500	-
Purchase of Market securities	375,000	225,000
Cash and Cash equivalent (January 1, 2015	2,812,500	-
Proceeds from Loans and other borrowings	2,250,000	750,000
Cash and Cash equivalent (December 31, 2015)	16,245,000	2,812,500

Required:

Prepare a Cash Flow Statement for year ended December 31, 2015 using Direct Method (Show Comparative Figures). (15 Marks)

(Total 20 Marks)

QUESTION 3

The Local Development Authorities (LDAs) of Ifedun Council agreed to transfer its Cultural and Social Centre for the purpose of adequate maintenance, to the State Government. The State Government accepted to take over the Centres and therefore requested for its 2017 budget. The following were supplied by the Cultural and Social Centre to Government through the Cultural Officer of the Accounts Department of the Ministry.

Actual Salaries and Wages and Overhead Expenses (2016)

	₦million	**₦million**
Salaries	9.75	
Wages	8.42	
		18.17
Rates	8.73	
Power/Electricity	2.70	
Rent	2.60	
Artifacts for sale	2.80	
Security services	1.00	
Other supplies	2.51	
Service level agreement	2.85	
Promotion Expenses	2.01	25.20
Total Expenditure		**43.37**
Actual Income (2016)		
Admissions	9.01	
Sales in the Centre	4.78	
Other incomes	1.48	
Grant	1.00	
Total Income		**16.27**
Net Expenditure		**27.10**

Other details provided include:

i. Salaries are made up as follows	Cultural Officer	Social Officer	Total
	₦million	₦million	₦million
Salaries	4.80	3.00	7.80
National insurance	0.48	0.30	0.78
Pension	0.72	0.45	1.17
Total	6.00	3.75	9.75

ii. The wages were for 5 employees (known as Cultural Assistants) paid on hourly basis with maximum of 20 hours per week at ₦1,260 per hour, plus over time bonus as follows:

	Salary ₦'Million	Insurance ₦'Million	Pension: ₦'Million	Total ₦'Million
Cultural Assistant 20 hours				
Per week " N1.260 per hour (52 weeks)	1.31	0.131	0.20	1.641
For 5 Cultural Assistant Overtime				8.205
Overtime				0.230
				8.435

The guideline for the budget has been given as follows:

i. Expenses: Rent to remain as at last year since lease would still be running for two years but Security Service providers would charge only ₦0.6m next year.

ii. No festival would be planned for the following year and as a result there would be no promotion expenses and grant in the following year.

iii. Though same number of visitors would come to the centre, the rate of admission fees will go up by 10 percent for the following year.

iv. There will be an Increase of 5% on other income. The budget for Artifact for sale would increase by same proportion as the Sales in the Centre budget which would increase by 20%.

v. Power/Electricity and rates will increase by 8% and 2%, respectively while Other Supplies will increase by 2.5%.

vi. Salaries and Wages:

   a. There would b 2.60% increase wages, while the National Insurance contributions will increase to 12% of salaries instead of the current 10%, and Pension Contribution will be 15% of salaries.

   b. Cultural Officer would not be due for salary increment but Social Officer will earn annual increment of ₦0.088m

   c. There would be no over time payment

   d. Service level agreement is fixed at ₦2.948m

You are required to prepare the Budget for lfedun Local Development Authority Cultural and Social Centre for the year ended December 31, 2017 (use same format as in the question) (20 Marks)

QUESTION 4

IPSAS 26 on Impairment of Cash Generating Assets prescribes the procedures to determine if a cash-generating asset has been impair and when to recognise or reverse impairment:-

Required:

a. Explain the term 'Cash-Generating Unit'. (4 Marks)

b. Distinguish between 'Depreciation' and 'Impairment' (4 Marks)

c. Identify **SIX** types of assets that are explicitly excluded from the procedure. (6 Marks)

d. How can assets that may be impaired be identified? (4 Marks)

e. Identify **TWO** internal indicators of impairment. (2 Marks)

(Total 20 Marks)

SECTION C: ANSWER ANY TWO OUT OF THREE QUESTIONS IN THIS SECTION (30MARKS)

QUESTION 5

Fiscal federalism provides guidance on how expenditure assignment could be designed to enhance the public sector's contribution to economic growth and development.

(a) Explain what is meant by the term 'expenditure assignment'. (5 Marks)

(b) Identify and explain the main guidelines upon which expenditure assignment is based, especially in a multilevel federal system of government. (10 Marks)

(Total 15 Marks)

QUESTION 6

"In the real world, every economy has both the private sector and the public sector".

(a) What is meant by this statement? Explain your answer with particular reference to Nigeria. (5 Marks)

(b) Discuss the income redistribution and economic stabilisation functions of government from the perspective of a developing economy like Nigeria.

(10 Marks)

(Total 15 Marks)

QUESTION 7

(a) Distinguish carefully between the following pairs of concepts in inter-governmental fiscal relations:

i. Matching grants and Non-matching grants.

ii. Vertical revenue allocation and Horizontal revenue allocation.

(6 Marks)

(b) Discuss any **THREE** main problems associated with intergovernmental fiscal relations in Nigeria. (9 Marks)

(TOTAL 15 MARKS)

SOLUTION 1

1a.

i. **Rationale for Government Integrated Financial Management Information System (GIFMIS)**

GIFMIS is a sub component of the Economic Reform Governance Project (ERGP) which supports the public resources management and anti-corruption initiatives through modernisation of fiscal process using better methods, techniques and information technology.

The GIFMIS is aimed at improving the acquisition, allocation, utilisation and conservation of public financial resources using automated, integrated, effective, efficient and economic information systems. The GIFMIS aids strategic management of public financial resources to enhance accountability, transparency, cost effective public service delivery, economic growth and poverty reduction efforts.

Expected Outcomes of GIFMIS are:

a. The implementation of a computerised financial management information system for the Federal Government of Nigeria (FGN) which is efficient, effective and user friendly.
b. Increasing the ability to access information on financial and operational performance.
c. Increasingthe internal controls to prevent and detect potential and actual fraud.
d. Increasing the ability of FGN to undertake central control monitoring and receipts in the Ministries, Departments and Agencies (MDAs).
e. Improving the medium term planning through a Medium Term Expenditure Framework.
f. Providing the ability to understand the cost of group activities.
g. Increasing the ability to access information on financial and operating activities.

Mode of Operation

GIFMIS operation is being handled by Ministry of Finance and Office of Accountant General. It is expected to be operated by all MDA's.

Recommendation

a. Training of staff
b. provision of adequate number of computer hardware, software
c. internet facilities

ii. Integrated Payroll and Personnel Information System (IPPIS) Rationale

The IPPIS was introduced by Federal Government in its bid to "entrench transparency and accountability in the public service human resources and payroll administration"

It is a centralised computer based payroll and management system, aimed at eliminating payroll fraud.

In 2004 the Federal Government of Nigeria, supported by the World Bank embarked on a wide ranging Public Service Reform Programs starting with Civil Service Reform Agencies.

A key recommendation from initial diagnostic work undertaken in preparation for the World Bank support mechanism was the need for the Federal Government to quickly deploy an integrated personnel and payroll solution.

The IPPIS reduces the issue of "ghost worker" syndrome, the fraud in pension's management and other forms of payroll fraud in the public and civil services.

The Federal Government reduced the personnel costs of some Ministries, Departments and Agencies between 2007 and 2010by ₦12billion, while the Federal Government has saved about ₦160billion as at the end of December, 2013.

Expected Outcomes are to:

a. Facilitate human resources planning by providing information for decision making.
b. Provide a platform for accurate budgeting and annual recurrent expenditure on staff emoluments.
c. Monitor monthly payment of staff emoluments against FGN's annual budget to ensure minimal wastage and leakage.
d. Eliminate payroll fraud such as multiple payment of emoluments to single employee or payment of monthly salary to a non-existent employee (ghost workers).
e. Facilitate easy storage, updating and retrieval of personnel records.
f. Ensure database integrity so that once data is entered it cannot be manipulated by unauthorised users.

Mode of Operation of IPPIS

The operation of IPPIS is handled by Office of Accountant General, Head of Service, Federal Civil Service Commission, Federal Budget Office, and Central Bank of Nigeria

Recommendation

a. Training of staff
b. provision of adequate number of computer hardware, software
c. internet facilities

iii. Treasury Single Account (TSA)

Rationale

Treasury Single Account (TSA) is an essential tool for consolidating and managing government's cash resources.

According to the International Monetary Fund (IMF), the primary objective of a TSA is to ensure effective aggregate control over government cash balances.

TSA is a unified structure of government bank accounts that gives a consolidated view of government cash resources, based on the unity of cash and treasury. It is a centralised cash position of the treasury, where the revenues of all MDAs are consolidated and all cash outflows (payment and transfers) are executed in a single account within the custody of the CBN.

Expected Outcomes of TSA are to:

a. Help government unify banking arrangements;
b. Assist the federal government in the efficient utilisation of government funds for approved projects;
c. Promote transparency and accountability in government operations;
d. Reduce the amount, and cost of government borrowing by maximising the use of available government resources to deliver projects.
e. Ensure centralized control over revenue through effective cash management.
f. Enhance accountability and enables government to know how much is accruing to it on a daily basis.
g. Reduce fiscal criminality and help tame the tide of corruption.

Mode of Operation of TSA

a. The Central Bank of Nigeria (CBN) opened and activated the Consolidated Revenue Fund or (TSA) to receive all government revenue and make payments through it.

b. All Ministries Department and Agencies (MDAs) remit their revenue collections into this account through their individual Commercial banks who now act as collecting agents for a fee.

c. Remittances are made into the TSA at end of every banking day.

d. The revenue accounts of those Commercial banks should be zero at the end of every working day.

Recommendation

a. MDAs should be strictly monitored for proper compliance and ensure that, there is no leakage on lodgement of all their deposits into the TSA Account.
b. States and local governments should be persuaded to adopt the policy.

1b. Justification of Budget implementation Committee:

The justifications for the establishment of a Budget Implementation Committee are to:

i. Keep track of progress in the implementation of the budget.
ii. Provide feedback to government on the progress of the programme or project as it relates to performance, costs and time schedule in comparison to the original plan.
iii. Identify the problems affecting the implementation of the budget, if any.
iv. Suggest solutions as to how any identified implementation problem can be resolved not only in the present but also in the future.
v. Enable government to review or modify programs or projects on the basis of report received.
vi. Serve as a basis for further resource allocation.
vii. Serve as a basis for punitive measures like termination of contract or refund of money in the case of unsatisfactory performance.

MARKING GUIDE

		Marks
i.	Government Integrated Financial Management information System (GIFMIS)	
	Explanation	1
	Rationale: Any 2 points @ 1 mark each	2
	Expected outcomes	
	Any 4 points @ ½ mark each	2
	Mode of operation	
	Any 2 points @ 1 mark each	2
	Any 2 recommendations @ ½ mark each	1
		8
ii.	Integrated Payroll and Personal Information System (IPPIS)	
	Explanation	1
	Rationale: Any 2 points @ 1 mark each	2
	Expected outcomes	
	Any 4 points @ ½ mark each	2

	Mode of operation	
	Any 2 points @ 1 mark each	2
	Any 2 recommendations @½	1
		8
	Treasury Single Accounts (TSA)	
	Explanation	1
	Rationale: Any 2 points @ 1 mark each	2
	Expected outcomes:	
	Any 4 points @ ½ mark each	2
	Mode of operation	
	Any 2 points @ 1 mark each	2
	Any 2 recommendations @ ½ mark each	1
		8
b.	Justifications for the establishment of a Budget implementation committee	
	Any 4 points @ 1½ marks each	**6**
	Total Marks	**30**

EXAMINER'S REPORT

The question tests candidates' knowledge on recent Public Finance Management Strategies put in place to promote transparency, accountability and probity in public sector governance through reform initiatives.

They all attempted the question and the performance was very poor. Candidates' major pitfall was their very poor knowledge of the various government reform initiatives, such as Government Integrated Financial Management Information System (GIFMIS), Integrated Payroll and Personal Information System (IPPIS) and Treasury Single Account (TSA). In addition, they could not justify the need for the constitution of a budget implementation committee by the Federal Government.

Candidates are advised to keep themselves abreast of contemporary issues relating to Public Finance Management reform initiatives.

SOLUTION 2

Officer Controlling Expenditure is the officer to whom the control of a sub-head, or specified amount of a sub-head, has been delegated by the appropriate Accounting Officer.

a) Functions of the officer controlling expenditures prescribed in government financial regulations (2009 edition) are:

- Supervision of government expenditure and ensuring that no payment is made without proper authority.
- Promptly charging his account under proper heads and sub-heads of all disbursements
- Ensuring that all books are correctly posted and kept up to date.
- Producing when required by the Accountant General and the Auditor General, all cash, stamps etc. in his custody.
- Ensuring that funds are available under the appropriate head and sub-heads to meet payments of specific vouchers.
- Effective monitoring of government expenditure.
- Ensuring that there is no extra budgetary spending.
- Ensuring that there is adequate security over the custody of public funds.
- Maintenance of the vote book.

Cash Flow Statement for the Year Ended December 31 2015 - Direct Method

Receipts:	**2015** **₦ Million**	**2014** **₦ Million**
Value Added Tax	1,721,250	1,647,000
Share of Statutory Allowance	10,125,000	6,337,500
Personal Income Tax – Direct	7,875,000	5,400,000
Allocation of Collection Costs:		
-FIRS and Customs	2,306,250	2,478,750
Grants and subventions from foreign donors	56,250	65,250
Miscellaneous Revenue	281,250	318,750
Total Receipts	**22,365,000**	**16,247,250**
Payments		
Personnel Costs	5,400,000	7,200,000
CRF Charges	1,687,500	2,812,500
Overhead Charges	1,125,000	900,000
MDAs Subventions	1,350,000	1,425,000
Total Payments	**9,562,500**	**12,337,500**
Net Cash Flow from Operating Activities	**12,802,500**	**3,909,750**

Cash Flow from Investing Activities		
Sale of Government Properties	281,250	363,750
Purchases and reconstruction of Non- current assets	(1,875,000)	(2,025,000)
Purchase of Marketable securities	(375,000)	(225,000)
Sales of Government property proceeds	787,500	-
Rent from government properties	213,750	221,250
Net cash outflow from investing activities	**(967,500)**	**(1,665,000)**
Cash flow from financing activities		
Proceeds from Loans and other borrowing	2,250,000	750,000
Loans Repayment	(652,500)	(182,250)
Net cash inflow from financing activities	1,597,500	567,750
Net cash generated for the year	13,432,500	2,812,500
Cash and cash equivalent at 1-1-2015	2,812,500	-
Cash and Cash equivalent at 31 December	16,245,000	2,812,500

MARKING GUIDE

		Marks
a.	List 5 functions @ 1 mark each	5
b.	Heading	½
c.	Receipts/inflows	
	12 ticks @ ½ mark each	6
	Payments/Outflows	
	9 ticks @ ½ mark each	4½
	Investment Activities	
	9 ticks @ $^1/_3$	3
	Total Marks	**15**

EXAMINER'S REPORT

The question tests candidates' knowledge of the functions of the officer controlling expenditures as prescribed in government financial regulation and on how to prepare Cash flow statement using direct method.

Most candidates attempted the question and their performance was fair.

Candidates' major pitfall was that most of them could not prepare the cash flow statement correctly.

Candidates are advised to prepare very well for the future examination.

SOLUTION 3

The Annual Budget for Ifelodun Local Development Authority Cultural and Social Centre for the year ended December 31, 2017

Expenditure:	**₦'million**	**₦'million**
Salaries **(W I)**	10,018	
Wages **(WII)**	8,418	18,436
Rates (102% of ₦8.73 million)		8,905
Power/Electricity (108% of ₦2.70 million)		2,916
Rent		2,600
Artifacts for sale (120% of ₦2.60 million)		3,120
Security Services		0,600
Other Supplies (1.25% of ₦2.51 million)		3,138
Service Level Agreement		2,948
Total Expenditure		**42,663**
Income:		
Admissions (110% of ₦9.01m)	9,911	
Sales in the Centre (120% of ₦4.78 m)	5,736	
Other Incomes (105% of ₦1.48m)	1,554	
Total Income		**17,201**
Net Expenditure		**25,462**

Working I

Details of Salaries	**Cultural Officer ₦'million**	**Social Officer ₦'million**	**Total ₦'million**
2016 Salaries	4,800	3,000	7,800
2017 increment	0	0,088	0.088
2017 Salaries	**4.800**	**3.088**	**7.888**
National Insurance (12% of Salaries)	0.576	0.371	0.947
Pension Contribution (15% of Salaries)	0.720	0.463	1.183
Total	**6,096**	**3.922**	**10.018**

Working II **Details of Wages**	**Cultural Assistants ₦'million**
2016 Wages for the 5 Cultural Assistants	8,205
2017 increment (2.60% of ₦8.205 million)	0,213
2017 Wages	**8,418**
Overtime	0
Total	8,418

MARKING GUIDE

Headings	1
Expenditure budget	
12 items @ ½	6
Income budget	
4 items @ ½	2
Workings:	
Salaries 6 workings ½	3
Wages 4 items @ ½	2
Other expenses	
12 items ½	6
Total Marks	20

EXAMINER'S REPORT

The question tests Candidates' knowledge on how to prepare personnel Budget.

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

Candidates' major pitfall was their inability to understand the question requirements very well.

Candidates are advised to prepare very well for future examinations and comply with the examination questions' requirements.

SOLUTION 4

(a) A 'Cash- Generating Unit' is the smallest identifiable group of assets held with the primary objective of generating a commercial return that generates cash inflows from continuing use that are largely independent of the cash inflows from other assets or groups of assets'.

(b) 'Depreciation' and 'amortisation' are the systematic allocation of the depreciable amount of an asset over its useful life. In the case of an intangible asset, the term "amortisation" is generally used instead of "depreciation." Both terms have the same meaning.

'Impairment' is definedas a loss in the future economicbenefits or service potential of an asset, over and above the systematicrecognition of the loss of the asset's future economic benefits. Impairment of a cash-generating asset,therefore, reflects a decline in the future economic benefits or service potentialembodied in an asset to the entity that controls it.

(c) Assets that are explicitly excluded from the procedures are as follows:

- i) Inventories (see IPSAS 12*, Inventories*);
- ii) Assets arising from construction contracts (see IPSAS 11,*Construction Contracts*);
- iii) Financial assets that are within the scope of IPSAS 29*, Financial Instruments: Recognition and Measurement*;
- iv) Investment property that is measured at fair value (see IPSAS 16, *Investment Property*);
- v) Cash-generating property, plant, and equipment that is measured at revalued amounts (see IPSAS 17, *Property, Plant, and Equipment*);
- vi) Deferred tax assets (see the relevant International or National Accounting Standard dealing with deferred tax assets);
- vii) Assets arising from employee benefits (see IPSAS 25, *Employee Benefits*);
- viii) Cash-generating intangible assets that are measured at revalued amounts (see IPSAS 31, *Intangible Assets*);
- ix) Goodwill;
- x) Biological assets related to agricultural activity that are measured at fair value less costs to sell (see IPSAS 27, *Agriculture*);
- xi) Deferred acquisition costs, and intangible assets, arising from an insurer's contractual rights under insurance contracts within the scope of the relevant international or national accounting standard dealing with insurance contracts;
- xii) Non-current assets (or disposal groups) classified as held for sale that are measured at the lower of carrying amount and fair value, less costs to sell, in accordance with the relevant International or National accounting standard dealing with non-current assets held for sale and discontinued operations; and
- xiii) Other cash-generating assets in respect of which accounting requirements for impairment are included in another Standard.

(d) The assets that may be impaired can be identified when its carrying amount exceeds its recoverable amount. This may occur when there are some indications inform of external or internal sources of information that mayindicate that the asset has suffered impairment. If any of those indications is present, an entity is required to make a formal estimate of recoverable amount. An entity shall assess at each reporting date whether there is any indication that an asset may be impaired. If any such indication exists, the entity shall estimate the recoverable amount of the asset.

Irrespective of whether there is any indication of impairment, an entity shall also test an intangible asset with an indefinite useful life or an intangible asset not yet available for use for impairment annually by comparing its carrying amount with its recoverable amount. This impairment test may be performed at any time during the reporting period, provided it is performed at the same time every year. Different intangible assets may be tested for impairment at different times. However, if such an intangible asset was initially recognised during the current reporting period, that intangible asset shall be tested for impairment before the end of the current reporting period.

e) Internal indicators of impairment are as follows:

   i) Evidence is available of obsolescence or physical damage of an asset;

   ii) Significant changes with an adverse effect on the entity have taken place during the period, or are expected to take place in the near future, in the extent to which, or the manner in which, an asset is used or is expected to be used. These changes include the asset becoming idle, plans to discontinue or restructure the operation to which an asset belongs, plans to dispose of an asset before the previously expected date, and reassessing the useful life of an asset as finite rather than indefinite;

   iii) A decision to halt the construction of the asset before it is complete or in a usable condition; and

   iv) Evidence is available from internal reporting that indicates that the economic performance of an asset is, or will be, worse than expected. This evidence may include the existence of
      - Cash flows for acquiring the asset, or subsequent cash needs for operating or maintaining it, that are significantly higher than those originally budgeted;
      - Actual net cash flows or surplus or deficit flowing from the asset that are significantly worse than those budgeted;
      - A significant decline in budgeted net cash flows or surplus, or a significant increase in budgeted loss, flowing from the asset; or
      - Deficits or net cash outflows for the asset, when current period amounts are aggregated with budgeted amounts for the future.

MARKING GUIDE

			Marks
a.	Definition of Cash-Generating Unit	2	
	Examples of CGU	2	4
b.	Distinction between Depreciation and impairment	2	
	Example of each concept (Any 2 @ 1 mark each)	2	4
c.	Any six(6) types of assets that are explicitly excluded from the procedures- 6 @ 1 mark each		6

d.	Basis of Identifying impaired assets Any 2 points @ 2 marks each	4
e.	Any two internal indicators of impairment: 2 @1 mark each:	2
	Total marks	**20**

EXAMINER'S REPORT

The question tests candidates' knowledge on the contents of IPSAS 26 and specifically certain concepts in the IPSAS 26.

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

Major pitfall of the candidates was their inability to explain the concepts examined correctly.

Candidates are advised to make sure that all the subject syllabus are covered before writing future examination.

SOLUTION 5

(a) Expenditure assignment refers to the allocation of spending powers and responsibilities to different levels of government, especially with respect to the provision and delivery of public goods and services. For various reasons, such as executive capacity, avoidance of unnecessary duplication, locational advantages like proximity to consumers, economies of scale etc. The central government should engage in certain forms of expenditures and activities while lower levels of government should engage in others.

(b) The main guidelines upon which expenditure assignment is based include:

i. **Efficient provision of public services:-** This could be achieved by using the jurisdiction that controls the minimum geographical area that would bear the costs and benefits of the provision of such services.

ii. **Equitable provision of public services:-** This involves equal treatment of all citizens, irrespective of place of residence or employment. To avoid wasteful tax and expenditure competition among jurisdictions, redistribution programmes are best handled nationally in pursuit of equity, but specific programmes that are tailored to the peculiar circumstances of individual jurisdictions can be implemented by the sub-national governments.

iii. **Preservation of a single internal common market**- The regulation of trade and investment is best assigned to the central government to prevent a sub-national government from erecting local incentives that would become barriers to free flow of goods and inputs across governmental jurisdictions.

c. **Economic Stabilisation:-** Economic stabilisation policy is usually designed to promote full-employment, price stability, economic growth and external balances. It is difficult for a sub-national government to implement successful stabilisation policy, like monetary and exchange rate policies, that require coordination by a Central Bank.

d. **Efficient provision of quasi-public goods**:- Technically, services like health, education, social welfare and social insurance are private goods but they are provided by the public sector on equity grounds. They are provided by the central government in order to satisfy minimum standards across jurisdictions.

MARKING GUIDE

			Marks Allotted
(a)	Explanation of the term 'expenditure assignment'		5
(b)	Identification of any four guidelines at 1 mark each	4	
	Explanation of any 4 guidelines @ 1½ Marks each	6	10
	Total Marks		**15**

EXAMINER'S REPORT

The question tests candidates' understanding of government's expenditure profile in the context of Fiscal Federalism. Candidates are required to explain the term expenditure assignment and its main guidelines in a multilevel Federal System of Government.

Only few of the candidates attempted the question and their performance was poor. The candidates lacked familiarity with this aspect of the syllabus which has been copiously treated in the Institute's Study Text.

Hence, Candidates are advised to have an indepth study of this aspect of the syllabus by consulting the relevant and standard texts on Public Finance, including the Study Text of the Institute.

SOLUTION 6

(a) The statement implies that there is no economy that is fully private/free enterprise or fully public, exclusively controlled by government. Rather, it is a system of interaction of both private and public sectors that operate in an integrated pattern. Thus, every nation is said to operate a "mixed economy" albeit in varying proportion of the two sectors; private and public sectors.

i. **The Private Sector**: It is that part of the economy under the control and directions of non-governmental economic units such as private individuals, organisations and firms. Each economic unit in the private sector owns its resources and uses them mainly to promote its own well-being. In Nigeria, for instance, each business unit in the form of sole proprietorship, partnership, private or public limited company allocate its resources with the objective of profit-maximisation.

ii. **The Public Sector:** This is the part of the economy that is publicly owned – that is, the government sector of the economy. Thus, the public sector includes all government departments and agencies, public enterprises, and all other activities through which local, state and federal governments exert influence on the economy to promote social and economic welfare of the people.

(b) (i) Income redistribution function of government

Granting differences in natural and acquired abilities, distribution of income determined exclusively by the market will produce high inequality whereby some people are very wealthy, while others are very poor. To redistribute income, government uses taxes and transfer payments. To achieve a rich-to-poor redistribution, tax revenue is used to finance transfer payments in the forms of free education, scholarship grants, subsidised public health care services, and other pro-poor welfare programmes.

(ii) **Economic stabilisation function of government**

Economic stabilisation refers to general stability of prices of goods and services, exchange rate of local currency and interest rate on loanable fund, which is vital prerequisite for economic growth and development. Economic stabilisation policies are therefore policies designed to promote price stability, full employment and economic growth. If the economy is encountering inflation, government will use a combination of restrictive monetary and fiscal policies and price control to stabilise prices. On the other hand, during economic depression or economic recession, government will need to reflate the economy through expansionary fiscal and monetary policies to increase aggregate demand and money stock.

MARKING GUIDE

(a)	Explanation of Statement	2	
	Identification & Explanation of the Private and Public Section (1½ Marks each)	3	5
(b)	Explanation of:		
	• Income redistribution function	5	
	• Economic stabilisation function	5	
			10
	Total Marks		**15**

EXAMINER'S REPORT

The focus of the question is on the economic environment that defines the role and activities of the public sector in a developing economy. The requirements of the question include the identification of a mixed economy in terms of broad components: private sector and public sector. Candidates are also expected to demonstrate their understanding of the income redistribution and economic stabilisation functions of government in such economy.

Majority of the candidates attempted the question, but the general performance was below average. Not many of them could identify the mixed economic system as required in the question, so also the economic stabilisation role of government.

Candidates are advised to have familiarity with this aspect of the syllabus, namely the appreciation of the economic environment and the role of the public sector. The Institute's Study Text is a good teaching material on this.

SOLUTION 7

(a) Inter-governmental transfers from higher to lower level governments fall into two broad categories; namely, matching and non-matching grants.

(i) **Matching or Conditional Grants**:- These require that the recipient uses the grant for a specific purpose as well as provide a specific proportion of the total programme cost to supplement the amount granted.

Non-matching Grants:- This category of grants do not require the recipient to provide a matching or supplementary amount. Such grants are usually spent where it may be necessary to subsidise programmes considered to be of high priority by a higher level of government, but lower priority by a lower level of government.

(ii) **Vertical revenue allocation:-** This refers to the sharing of national revenue among the various tiers of government, such as among the federal, state and local government in Nigeria. It is guided by a pre-determined revenue allocation formula.

Horizontal revenue allocation on the other hand, refers to the distribution of revenues among units of government at the same level. That is, the sharing of the percentage of national revenue among the states (local governments).

(b) The main problems associated with intergovernmental fiscal relations in Nigeria include the following:

(i) Over-dependence on oil revenue: The exploration of crude oil in Nigeria and its high yielding revenue has continued to undermine the development of the hitherto buoyant agricultural, industrial and mining sectors. Consequently, oil revenue has become the major source on which the country critically depends. Heavy dependence by the states and local governments on statutory allocation from the Federation Account makes them an economic appendage of the federal government, while the sharing formula encourages laziness and idleness by stifling development.

(ii) **Conflicts over revenue sharing formula:** Revenue sharing among the component units of Nigerian federation has, from the inception, been replete with agitations, controversies and outright rejections due to the nature of politics that is involved in it. The reasons for this include lack of consensus on the criteria for distribution, the absence of reliable socio-economic data (especially population), and the rapid rate of constitutional change and the extent to which constitutional change is tied to perceptions of regional and ethnic dominance.

(iii) **Centralising tendency of fiscal relations:** The revenue-generation and spending powers are concentrated in the centre. The Federal Government in Nigeria, in most cases, unilaterally spends or decides the modes and methods of spending. A case in point is the excess crude oil account which some states challenged as unconstitutional. This concentration of powers in the centre reduces the ability of the states to generate revenue internally.

(iv) **Agitation of resource control:** The major fallout of the down play of the principle of derivation, is the agitation for resource control that has taken criminal dimensions in most of the oil producing communities and states of the Niger Delta. There have been multifarious cases of kidnapping, vandalism of oil pipelines and installation, and other high scale violence.

MARKING GUIDE

(a)	(i)	Types of Grants:		
		Matching Grants:	1½	
		Non-Matching Grants:	1½	
				3
ii)	Types of Revenue Allocation:			
		Vertical Revenue Allocation	1½	
		Horizontal Revenue Allocation	1½	
				3

(b) Problem of Intergovernmental Fiscal relations in Nigeria
(3 Marks each for 3 points) 9
Total Marks **15**

EXAMINER'S REPORT

The question tests candidates' understanding of intergovernmental fiscal relations with respect to the issues of grants and revenue allocation. Apart from explaining the concepts: types of grants and revenue allocation, candidates are expected to identify and explain problems of intergovernmental fiscal relations in Nigeria.

It was a popular question as many of the candidates attempted the question. The general performance in the question was above average. However, many of them could only identify the problems of intergovernmental fiscal relations without copious explanation of the points raised.

Candidates are advised to always provide copious explanations of their points and be more reflective in their presentation at this skills level of professional examination.

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – MAY 2016

MANAGEMENT, GOVERNANCE AND ETHICS

Time Allowed: 3 hours

YOU ARE REQUIRED TO ANSWER FIVE OUT OF SEVEN QUESTIONS IN THIS PAPER

SECTION A: COMPULSORY QUESTION (30 MARKS)

QUESTION 1

Zaat Pharmaceutical Company Limited was incorporated in 2001 and has grown rapidly. As part of its expansion programme, the company recently employed seven management trainees and has embarked on strengthening its strategic management capabilities. As a member of the top management team of the company, you have been assigned the responsibility of training the new employees on the basics of strategic management.

a. With the aid of Johnson, Scholes and Whittington's analytical model of strategic management, write a seminar paper, to be presented at a seminar for the management trainees, highlighting the essential elements of strategic management. (18 marks)

b. As part of the training of the newly employed trainee managers, outline briefly how you will explain an organisation's mission statement. Also provide FOUR factors indicating the relevance of a mission statement to the new employees. (7 marks)

c. You are required to explain to the management trainees

   i. The meaning of Risk in business
   ii. The essence of Pure Risk (5 Marks)

(Total 30 Marks)

SECTION B: (40 MARKS)

INSTRUCTION: ANSWER ANY TWO OUT OF THREE QUESTIONS IN THIS SECTION

QUESTION 2

In recent times, there is an increasing demand on corporate entities to be socially responsible.

a. Define the idea of CSR in a way that highlights its essence. (3 Marks)

b. Present TWO fundamental factors underpinning the idea of Corporate Social Responsibility (CSR). (4 marks)

c. Discuss the main aspects of CSR. (10 Marks)

d. Discuss briefly CSR reporting. (3 Marks)

(Total 20 Marks)

QUESTION 3

Explain broadly the following terms:

a. Risk Appetite (5 marks)

b. Risk-based Approach (5 marks)

c. Narrow and Wide Stakeholder (5 marks)

d. Primary and Secondary Stakeholders (5 marks)

(Total 20 marks)

QUESTION 4

The accounting profession has both technical and ethical dimensions that are of equal importance.

a. Outline the FOUR basic steps that an accountant should take into consideration in the course of making a moral judgment relating to his work as a professional accountant. (8 Marks)

b. Discuss briefly the THREE basic moral perceptions of the nature of the relationship between a professional accountant and a client. (6 marks)

c. Highlight SIX specific requirements of professional behaviour that professional accountants must consider in carrying out their professional responsibilities. (6 mark)

(Total 20 Marks)

SECTION C (30 MARKS)

INSTRUCTION: ANSWER ANY TWO OUT OF THREE QUESTIONS IN THIS SECTION

QUESTION 5

Mr. Chijioke Okereke, an experienced banker and three of his friends are considering resigning from their plum jobs in a Deposit Money Bank and starting a Micro Finance Bank.

Mr Okeke and his friends have approached you, having had some training in Management, Governance and Ethics, to review their business proposal and advise them on the nature and strength of competition in any market or industry.

You are required to:

Prepare a presentation using Porter's Five Forces Model as a tool for analysing the nature and strength of competition in any market or industry so that Mr. Okereke and his friends can objectively evaluate their proposal. **(Total 15 marks)**

QUESTION 6

As part of an intensive training programme on risk management, you have been invited to facilitate a session on categories of risk that may confront a business entity.

Discuss FIVE categories of risk . **(Total: 15 marks)**

QUESTION 7

Professional accountants need to take ethical decisions from time to time. This requires that professional accountants are sufficiently familiar with ethical decision-making models to enable their effective application in practical situations.

a. State the purpose of ethical decision models.
b. Present logically the seven-step (AAA) approach to ethical decision–making.

(Total 15 Marks)

Solution 1

a.

Strategic management consists of three elements:

- Strategic position
- Strategic choices
- Strategy into action.

i. **Strategic position**

In strategic management, the element of 'strategic position' involves an analysis or assessment of the strategic position of a business entity in relation to, for example, the market. Questions to consider in this regard include:

- in what ways does the company perform better than its competitors?
- in what ways are competitors more successful or how do rival companies compare with each other in terms of 'competitive advantage'?

It also requires an understanding of the core factors in the 'business environment' that affect a company, and how the company will be affected by changes that are likely to happen in the environment in the future. Here, relevant questions to ask include:

- Could the company be affected by changes in technology, or changes in the state of the economy, or new laws?
- How could changes in what customers want to buy, because of changes in society or life style, affect what the company produces and sells?

Analysing or determining the strategic position of a company also involves making a decision about what it should be doing in relation to what the company is trying to achieve.

OR

Johnson, Scholes and Whittington suggest that there are three important aspects to strategic position:

- The environment
- Strategic capability of the entity

- Expectations and purposes.

Environment (threats and opportunities)

An analysis of the business environment involves an analysis of the threats and opportunities that seem to exist, and an assessment of their significance.

- Threats are developments in the environment that could threaten the ability of a business entity to achieve its objectives.
- Opportunities are developments that might be exploited, to improve the ability of a business entity to achieve its objectives.

Strategic capability of the entity (strengths and weaknesses)

The management of an entity should also make an assessment of the strategic capability of the entity. This means reaching an understanding of what the entity is capable of achieving. An assessment of strategic capability involves an analysis of the strengths and weaknesses of the entity.

- What is the business good at doing? Why is it good in this regard? What can be done to further improve these strengths?
- What is the entity weak at doing that its rivals can do better? Why is it weak in this regard? What can be done to reduce or eliminate these weaknesses?

Expectations and purposes

An analysis of strategic position also requires management to make decisions about the purpose of the entity and what it is trying to achieve. Business entities often make a formal statement of their purpose and reason for existence in the form of a **mission statement**. Business purpose may include maximising or increasing shareholder's wealth, protecting the interest of stakeholder groups, such as employees and customers or protecting the environment and achieving a 'sustainable business'.

ii. Strategic choices

The second element in the Johnson, Scholes and Whittington's model for strategic management is strategic choices. This involves identifying different possible strategies that the entity might adopt, and making a choice of the preferred strategies from the different alternatives that are available. There are three aspects to identifying alternative strategies and making strategic choices:

- Corporate level and international
- Business level strategies
- Development directions and methods

Corporate level and international

Strategic choices have to be made at the corporate level. In particular, decisions have to be made about what the entity should be doing. For companies, this means making decisions about which products or services it should be selling, and in what markets it should be selling them.

There could also be an international aspect to strategic choices at this level. A company needs to decide whether it will operate internationally, and if so in what countries.

Business level strategies

Strategic choices must also be made at the business strategy level. For companies, a major strategic choice is between a strategy of cost leadership and a strategy of differentiation. If, for instance, a company chooses a strategy of differentiation, it has to decide how it intends to make its products or services different from those of its competitors, so that the company will have a competitive advantage over rival companies and can succeed with its chosen strategy.

Development directions and methods

A strategic choice must be made about the direction or directions in which the business should be directed. Decisions must be made on strategy for growth, how to penetrate and maintain a good position in the market.

iii. Strategy into action

The third element in the Johnson, Scholes and Whittington's model of strategic management is how to translate 'strategy into action'. This means implementing the chosen strategies. There are three aspects to strategy implementation:

- Organising
- Enabling

- Managing change.

Organising

A structure must be established that will help a business entity to implement its strategies effectively in order to achieve its strategic targets. 'Organising' involves putting in place a management structure and delegating authority. Individuals should be made responsible and accountable for different aspects of the chosen strategies. Decision-making processes must be established.

Enabling

A business organisation must be enabled to achieve success through the effective use of its resources.

- Each resource must be used to support the achievement of strategic objectives. This calls for efficient management of resources such as people (and labour skills), information, finance and technology.
- Strategies should be based on making full use of the resource strengths of the entity, to achieve competitive advantage.

Managing change

Most business entities exist in a rapidly-changing environment and they need to adapt and change in order to survive and succeed. Implementing strategy always means having to make changes. Managing change successfully is therefore an important aspect of strategic management.

b.

(i) A mission statement articulates the purpose of an organisation and the reason for its existence.

- A mission statement describes an organisation's basic function in society, in terms of the products and services it produces for its customers.
- A mission statement defines the present state or purpose of an organisation.

(ii) The following are the relevance or importance of a mission statement:

- provide a basis for consistent strategic planning decisions;
- assist with translating broad intentions and purposes into corporate objectives;

- provide a common purpose for all groups and individuals within the organisation;
- inspire employees;
- help to establish the goals and ethics for the organisation; and
- improve the understanding and support for the organisation from external stakeholder groups and the public in general.

c.

i. **Definition of risk**

- Risk is usually associated with the possibility that things might go wrong, that events might turn out worse than expected or that something bad might happen.
- Risk exists whenever a future outcome or future event cannot be predicted with certainty, and a range of different possible outcomes or events might occur.

ii. **Pure risk, also called downside risk**, is a risk where there is a possibility that an adverse event will occur. Events might turn out to be worse than expected, but they cannot be better than expected. Pure risks can often be controlled either by means of internal controls or by insurance. These risks might also be called **internal control risks** or **operational risks.**

Marking Guide

1a.	**Marks**	**Marks**
Johnson, Scholes and Whittington's analysis of strategic management		
Identification of the THREE elements of strategic management	1x3	
Explanation of each of the identified elements	5x3	
		18
1b.		
Explanation of what a mission statement is	1x1	
Explanation of any FOUR of the relevance/ importance of a mission statement	1½ x 4	
		7
1c.		
Explanation of risk in business	2x1	
Explanation of Pure Risk	3x1	
		5
Total		**30**

EXAMINERS' REPORT

The question tests candidates' practical understanding of Johnson, Scholes, and Whittington's analytical model for strategic management. It also tests their understanding of the relevance of a mission statement as well as the nature and types of risk in business.

Being a compulsory question, all candidates attempted the question and general performance was average. However, many of them were unable to provide a detailed, coherent and systematic analysis of the model of strategic management in question.

Candidates are advised to endeavour to understand the contents of the syllabus and also improve their skill of writing in detailed, coherent and systematic manner.

SOLUTION 2

a. Definition of CSR

i. CSR refers to the responsibilities that a company has towards society. It requires business to take decisions and act in ways that would reflect adherence to appropriate ethical values and respect for individuals, society and the environment, as well as compliance with legal requirements.

ii. It is related to the idea that just as companies have responsibilities to their shareholders, they are also responsible to the general public and other stakeholder groups.

b. **Two fundamental reasons underpinning CSR**

i. As a corporate citizen of a society, a corporation owes the same sort of responsibilities to society at large that other citizens owe.

ii. There is a social contract between a company and the society in which it operates. As the owner or user of large amounts of property and other resources, companies as corporate citizens also owe a duty to society to use its property and resources in a responsible way. In return, society allows the company to operate and remain in existence.

c. **Aspects/demands of CSR**

Corporate social responsibility has five main aspects in form of demands.

i. A company should operate in an ethical way, and with integrity. A company should have a recognised code of ethical behaviour and should expect everyone in the company to act in accordance with the ethical guidelines in that code.

ii. A company should treat its employees fairly and with respect. The fair treatment of employees can be assessed by the company's employment policies, such as providing good working conditions and providing education and training to employees.

iii. A company should demonstrate respect for basic human rights. For example, it should not tolerate child labour.

iv. A company should be a responsible citizen in its community. Responsibility to the community might be shown in the form of investing in local communities, such as local schools or hospitals. This can be an important aspect of CSR for companies that operate in under-developed countries or regions of the world.

v. A company should do what it can to sustain the environment for future generations. This could take the form of:

- reducing pollution of the air, land or rivers and seas;
- developing a sustainable business, whereby all the resources used by the company are replaced;
- cutting down on the use of non-renewable (and polluting) energy resources such as oil and coal and increasing the use of renewable energy resources (water, wind); and
- re-cycling of waste materials.

d. CSR reporting

CSR reporting is the practice of companies publishing annual reports on their corporate social responsibility. These reports have been voluntary and were originally published as part of annual reports, but subsequently produced as separate reports. It is currently joined to the financial reports in the process of **Integrated Reporting**.

CSR reports are also called **social and environmental reports**, while CSR reporting is sometimes referred to as **sustainability reporting**, when its main focus is on environmental issues and needs of future generation.

The purpose of CSR reports is to inform key stakeholders about the CSR policy objectives of the company and how successful it has been in achieving them.

CSR reports, for instance in the UK, originally developed out of Health, Safety and Environmental Reports, which reported on health and safety at work, accident rates, volumes of waste and pollution, and so on, and actions taken by the company to deal with these problems.

CSR reporting is broader in scope than health, safety and environmental reporting, because it includes other social issues and more employee issues, such as ethical employment practices, education and training and investments by the company in community projects.

Marking Guide

	Marks	Marks
a.		
Definition of CSR	1x3	3
b.		
TWO fundamental reasoning for CS	2x2	
Main aspects/demands of CSR		
Identification and discussion of the FIVE main aspects/demands of CSR	2x5	
		14
c.		
Explanation of CSR reporting		3
Total		**20**

EXAMINER'S REPORT

The question tests the depth of the understanding that candidates have of the essence and underpinning of Corporate Social Responsibility (CSR). It also tests their understanding of CSR reporting.

Many candidates attempted the question, but performance was barely average. While many of them had a fair understanding of the concept and essence of CSR, most of them could not give a good account of the main aspects of CSR and its reporting.

Candidates are encouraged to pay attention to the details of the topics covered in ICAN study text.

SOLUTION 3

a. **Risk Appetite**

Risk appetite is concerned with how much risk the management of an entity is willing to take. Management might be willing to accept the risk of loss up to a certain maximum limit if the chance of making profits is sufficiently attractive to them. For a market trader in the financial markets, risk appetite has been defined as 'the amount of capital that a trader is willing to lose in order to generate a potential profit.'

Risk appetite is used to describe how willing a board is to take on risk – on a scale from willing to take on risk through willing to take some risks down to aversion to taking a risk.

A board of directors might also have an appetite for one type of risk but an aversion to a different type of risk. The risk appetite of a board or management in any particular situation will depend on:

i. the importance of the decision and the nature of the decision;

ii. the amount and nature of the potential gains or losses; and

iii. the reliability of the information available to help the Board or management to make their decision.

b. **A risk-based approach**

The term 'risk-based approach' is used to describe risk management processes. It is an approach to decision-making based on a detailed evaluation of risks and exposures, and policy guidelines on the level of risk that is acceptable (risk appetite).

The risk-based approach takes the view that some risk must be accepted, but risk exposures should be kept within acceptable limits. Decisions should therefore be based on a consideration of both expected benefit and the associated risk.

c. **Narrow and wide stakeholders**

Evans and Freeman made a distinction between narrow and wide stakeholders.

i. Narrow stakeholders are those that are most affected by the actions and decisions of the organisation. Narrow stakeholder groups for a company usually include shareholders, directors, other management, employees, suppliers and those customers who depend on the goods produced by the company.

ii. Wide stakeholders are those groups that are less dependent on the organisation. Wide stakeholders for a company may include customers who are not particularly dependent on the company's goods or services, the government and the wider community (as distinct from local communities in which the company operates, which may be narrow stakeholders).

Evans and Freeman suggested that a company has much more responsibility and accountability to narrow stakeholders than to wide stakeholders.

d. Primary and secondary stakeholders

Clarkson made a distinction between primary and secondary stakeholders. A primary stakeholder group for a company is a group that is essential for the continuation of the company as a going concern. Customers, suppliers and employees may be primary stakeholders. Secondary stakeholders are those that the organisation does not directly rely on for its continued survival, at least in the short term.

According to Clarkson, primary stakeholders have strong influence over a company's decisions and actions.

Marking Guide

	Marks
a. Risk Appetite	
Explanation	5
b. Risk-based Approach	
	5
c. Narrow and Wide Stakeholders	
Explanation	5
d. Primary and Secondary Stakeholders	
Explanation	5
Total	**20**

EXAMINER'S REPORT

The question tests candidates' understanding of and their ability to clarify the distinctions between some of the basic and interrelated concepts in Risk Management and Governance.

About half of the candidates attempted the question but general performance was below average. The obvious pitfall was the inability of many of them to identify the important distinctions between the related concepts. This suggests a shallow understanding of the concepts in question.

Candidates are advised to endeavour to understand the main claims of important concepts in ways that would enable them to distinguish them from other related concepts.

Solution 4

a. FOUR basic steps to take in making a moral decision/action inthe accounting profession.

i. **Step 1.** The individual must be able to recognise the moral issue or moral dilemma, whenever there is an ethical aspect to a situation. He or she must be able to recognise that a moral decision has to be taken.

ii. **Step 2.** The decision-maker must be able to recognise and select the course of action that is morally correct.

iii. **Step 3.** The decision-maker must give priority to the moral issue above all other considerations (for example, self-interest).

iv. **Step 4.** The decision-maker must have enough moral strength to implement the decision that he selects in Steps 2 and 3.

b. The relationship between professionals and their clients is based on THREE perceptions of the nature of a professional person.

i. **Relationship of trust**. The client can trust the professional to act in a proper way, in accordance with a professional code of conduct. In return, the professional expects the client to place its trust in him (or her). For example, a client should not withhold relevant information from a professional that would affect his decisions or judgements.

ii. **Assurance of Expertise and Competence**. There is an assurance that the professional has attained a minimum level of expertise and competence. This assurance is provided, in accountancy, by the requirements to (1) pass formal examinations in order to obtain a qualification, (2) have relevant work experience and (3) continue with professional development and training throughout the accountant's professional career.

iii. **The professional must put the client before himself**. There is also an implication in the professional-client relationship that the professional should have more concern for the client than for his own self-interest.

c. **Professional behaviour is commonly associated with:**

i. acting with integrity, being honest and straight-dealing;
ii. providing objective opinions and advice, free from bias, influence or conflicts of interest;
iii. using specialist knowledge and skill at an appropriate level for the work;
iv. respecting the confidentiality of information provided by clients;
v. avoiding any action that brings disrepute to one's profession; and
vi. compliance with all relevant laws and regulations.

Marking Guide

		Marks
4a. FOUR basic steps to take in making a moral decision/action in the accounting profession.		
• Brief outline of each of the four steps	2x4	**8**
b. THREE basic moral perceptions of the nature of the relationship between a professional (accountant) and hisor her client.		
• Identification of each of the THREE moral perspectives	1x3	
• Explanation of each of the identified perspectives	1x3	**6**
c. SIX specific requirements of professional behaviour		
• Identification of each of the SIX requirements	1x6	6
Total		**20**

EXAMINER'S REPORT

The question tests candidates' understanding of core moral issues that are relevant to professional accountants with particular reference to their relationship with clients and the steps that should be taken in making ethical decisions.

Many of the candidates did not attempt the question and those who did performed below average. This is largely due to their inability to address the demands of the question.

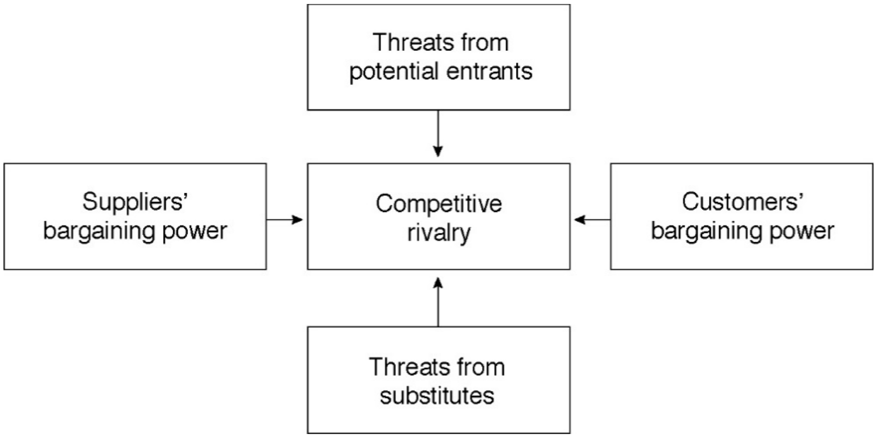
Candidates are advised to study basic ethical concepts, principles and theories and also seek to understand how to apply them in professional practice.

Solution 5

Michael Porter's FIVE factors or 'forces'

a. Threats from potential entrants
b. Threats from substitute products or services
c. The bargaining power of suppliers
d. The bargaining power of customers
e. Competitive rivalry within the industry or market.

The Five Forces model is set out in the diagram below:



When any of the five forces are strong, competition in the market is likely to be strong and profitability will therefore be low. Analysing and understanding the five forces in a market would help strategic managers to choose the markets and industries for their firm to operate in.

a. Threat from potential entrants

One of the Five Forces is the threat that new competitors will enter the market and add to the competition. New entrants might be attracted by the high profits earned by existing competitors into the market, or by the potential for making high profits. When they enter the market, new entrants will try to establish a share of the market that is large enough to be profitable. One way of gaining market share would be to compete on price and charge lower prices than existing competitors.

The significance of this threat depends on how easy or how difficult it would be for new competitors to enter the market. In some markets, the cost of entering a new market can be high, with new entrants having to invest in assets and establish production facilities and distribution facilities. In other markets, the cost of entering the market can be fairly low.

The costs and practical difficulties of entering a market are called 'barriers to entry'.

b. Threat from substitute products

There is a threat from substitute products when customers can switch fairly easily to buying alternative products (substitute products).

The threat from substitutes varies between markets and industries, but a few examples of substitutes are listed below:

i. Transport. Customers might switch between air, rail and road transport services.
ii. Food and drink products. Consumers might switch between similar products, such as coffee and tea.

When there are substitute products that customers might buy, firms must make their products more attractive than the substitutes. Competition within a market or industry will therefore be higher when the threat from substitute products is high.

Threats from substitute products may vary over time. There are many examples in the past of industries that have been significantly affected by the emergence of new substitute products.

i. Plastic containers and bottles became a significant substitute for glass containers and bottles.
ii. Synthetic fibres became a substitute for natural fibres such as wool and cotton.
iii. Word processors and personal computers became a substitute for typewriters, and the market for typewriters was destroyed.

c. Bargaining power of suppliers

In some industries, suppliers have considerable power. When this occurs, they might charge high prices that firms buying from them are unable to pass costs on to their own customers. As a result, profitability in the industry is low, and the market is competitive.

d. Bargaining power of customers

Buyers can reduce the profitability of an industry when they have considerable buying power. Powerful buyers are able to demand lower prices, or improved product specifications, as a condition for buying. Strong buyers also make rival firms compete to supply them with their products.

A notable example of buyer power is the power of supermarkets as buyers in the market for many consumer goods. They are able to force down the prices from suppliers of products for re-sale, using the threat of refusing to buy and switching to other suppliers. As a result, profit margins in the manufacturing industries for many consumer goods are very low.

Porter suggested that buyers might be particularly powerful when the:

i. volume of their purchases is high relative to the size of the supplier;
ii. products of rival suppliers are largely the same ('undifferentiated');
iii. costs of switching from one supplier to another are low;
iv. cost of purchased item is a significant proportion of the buyer's total costs;
v. profits of the buyer are low;
vi. buyer's product is not affected significantly by the quality of the goods that it buys; and
vii. buyer has full information about suppliers and prices.

e. Competitive rivalry

Competition within an industry is also determined by the rivalry between competitors. Strong competition forces rival firms to offer their products to customers at a low price (relative to the product quality) and this keeps profitability fairly low.

Porter suggested that competitor rivalry might be strong when:

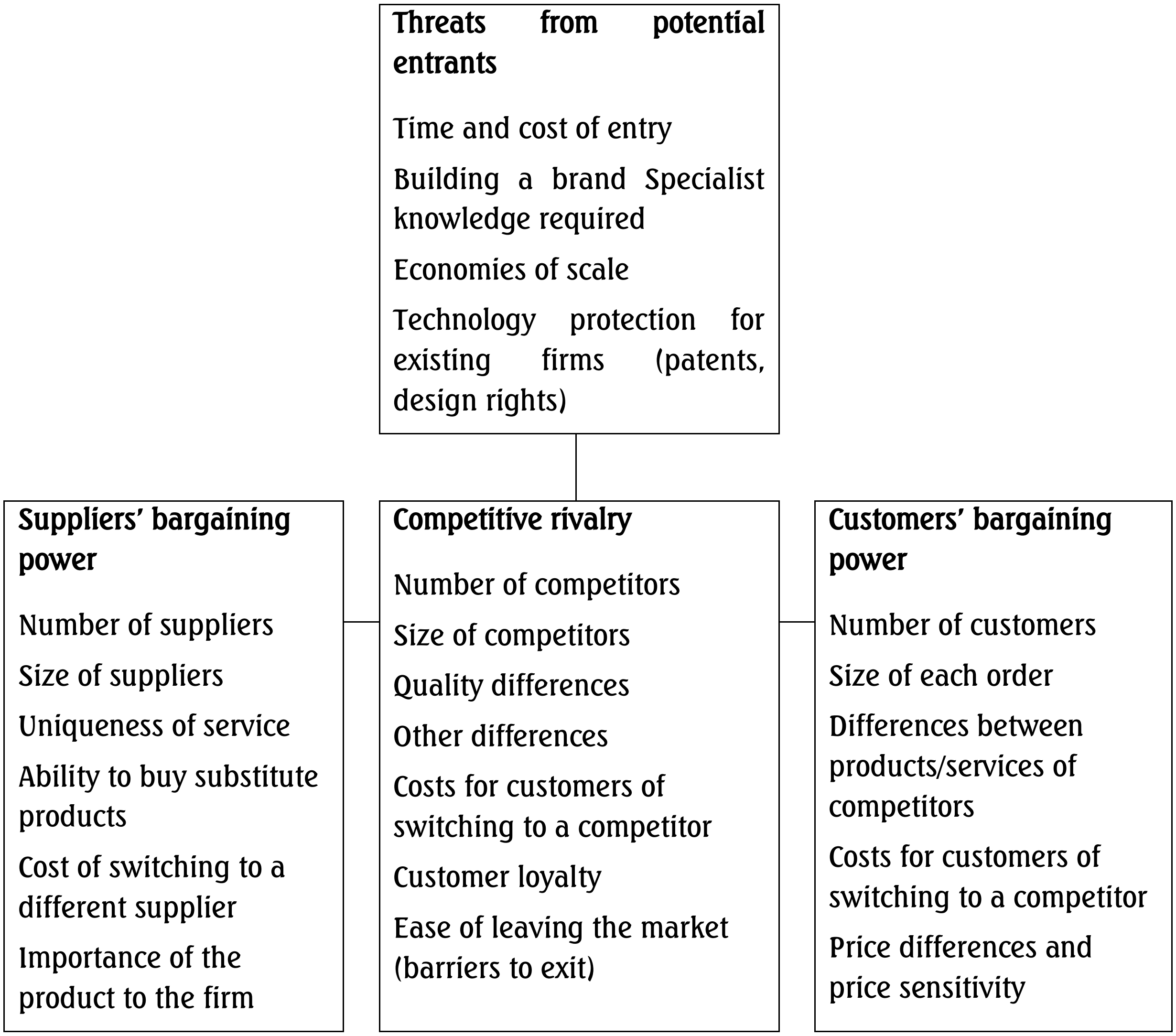
i. rival firms are of roughly the same size and economic strength;
ii. there are many competitors;
iii. there is slow growth in sales demand in the market;
iv. the products of rival firms are largely the same ('undifferentiated');
v. fixed costs in the industry are high, so that firms still make some contribution to profit even when they cut prices;

vi. supply capacity can only be increased in large incremental amounts (for example, in electricity supply industry, where increasing total supply to the market might only be possible by opening another power generation unit); and

vii. the costs of withdrawing from the industry are high, so that even unprofitable companies are reluctant to leave the market.

Summary of the Five Forces model in diagram

The Five Forces model is summarised below, showing some of the key factors that help to determine the strength of each of the forces in the industry or market.



Threats from potential entrants

Time and cost of entry

Building a brand Specialist knowledge required

Economies of scale

Technology protection for existing firms (patents, design rights)

Suppliers' bargaining power

Number of suppliers

Size of suppliers

Uniqueness of service

Ability to buy substitute products

Cost of switching to a different supplier

Importance of the product to the firm

Competitive rivalry

Number of competitors

Size of competitors

Quality differences

Other differences

Costs for customers of switching to a competitor

Customer loyalty

Ease of leaving the market (barriers to exit)

Customers' bargaining power

Number of customers

Size of each order

Differences between products/services of competitors

Costs for customers of switching to a competitor

Price differences and price sensitivity

Threats from substitutes

The existence of substitutes

The performance of substitute products

Costs of switching to a substitute product

Relative prices,

Fashion trends

Question 5 Marking Scheme

		Marks
• Identification of Michael Porter's FIVE factors or 'forces' that determine the nature and strength of competition inan industry or market	1x5	**5**
• Explanation of each of the FIVE factors or forces	2x5	**10**
Total		**15**

EXAMINER'S REPORT

The question is testing candidates' knowledge of Porter's Five Forces Model for analysing market competition and their ability to present this in a systematic order that would help a prospective business assess market competition.

Many candidates attempted the question, but performance was below average. The major pitfall is their inability to accurately present the model.

Candidates are advised to pay close attention to all the concepts, theories and principles discussed in the syllabus and also endeavour to have a full grasp of their practical relevance.

Solution 6

Identification of categories of risk

The following are the categories of risk that a business entity may confront:

a. market risk
b. credit risk
c. liquidity risk
d. technological risk

e. legal risk
f. health, safety and environmental risk
g. reputation risk
h. business probity risk.
i. Derivative risk

Discussion of categories of risk

Market risk

Market risk is the risk from changes in the market price of key items, such as the price of key commodities. Market prices can go up or down, and a company can benefit from a fall in raw material prices or incur a loss from a rise in prices.

A company might be able to pass on higher prices of raw materials to the customer, by raising the prices for its own goods or services. However, if it puts its price up, there might be a fall in total demand from customers. Higher prices, leading to falling sales volume could result in lower profits.

Credit risk

Credit risk is the risk of losses from bad debts or delays by customers in the settlement of their debts. All companies that give credit to customers are exposed to credit risk. The size of the credit risk depends on the amount of receivables owed to the company, and the 'credit quality' of the customers.

Credit risk is a major risk for commercial banks, because lending is a major part of their business operations.

Liquidity risk

Liquidity risk is the risk that the company will be unable to make payments to settle liabilities when payment is due. It can occur when a company has no money in the bank, is unable to borrow more money quickly, and has no assets that it can sell quickly in the market to obtain cash.

Companies can be profitable but still at risk from a liquidity shortage.

Technological risk

Technological risk is the risk that could arise from changes in technology (or inadequacy of technological systems in use). When a major technological change occurs, companies might have to make a decision about whether or not to adopt the new technology.

i. If they adopt the new technology too soon, they might incur higher costs than if they waited until later.

ii. If they delay in adopting the new technology, there is the risk that a competitor will take advantage, and use the technology to gain market share.

Legal risk

Legal risk, which includes **regulatory risk**, is the risk of losses arising from failure to comply with laws and regulations, and also the risk of losses from legal actions and lawsuits.

Health, safety and environmental risk

Health and safety risks are risks to the health and safety of employees, customers and the general public. Environment risks are risks of losses arising, in the short term or long term, from damage to the environment - such as pollution or the destruction of non-renewable raw materials.

The risks faced by companies vary according to the nature of the business.

i. Companies are required to comply with health and safety regulations. This has a cost. If they fail to comply with regulations, they could be liable to a fine if government inspectors discover the failure to comply. If there is an incident in which employees or customers suffer injury or ill health as a consequence of a failing in health and safety control measures, the company could be exposed to large fines from government and lawsuits from the individuals affected.

ii. If a company fails to deal with environmental risks in a satisfactory way, it could suffer losses in various ways. For example, it might:

  - be fined for a breach of anti-pollution regulations.
  - suffer a loss of customers, for example, if its reputation suffers as a result of an incident in which severe damage is done to the environment, such as a major oil spillage.

Reputation risk

Reputation risk is difficult to measure quantitatively. It is the risk that a company's reputation with the general public (and customers), or the reputation of its product 'brand', will suffer damage. Damage to reputation can arise in many different ways.Incidents that damage reputation are often reported by the media leading to financial losses due to loss of customers.

Companies that might suffer losses from damage to their reputation need to be vigilant and alert for any incident that could create adverse publicity. Public relations consultants might be used to assist with this task.

Business probity risk

Probity means honesty and integrity. Business probity risk is the risk of losses from a failure to act in an honest way. Companies in some industries might be exposed to this type of risk.

i. For some products, there might be a large trade in smuggled goods, such as cigarettes and alcohol products. Companies might be tempted to deal with smugglers in order to increase sales of their products. The consequences of the discovery of any dishonesty or crime could include criminal prosecution, fines by government or loss of reputation with the public.

ii. In some countries and some industries, bribery is a problem. Companies might find that in order to win sales in some countries, they have to pay bribes ('commissions') to individuals. By failing to pay bribes, companies would not win sales contracts. By paying bribes, companies act dishonestly, and could be exposed to regulatory action or criminal action by the authorities if evidence of bribery is uncovered. This problem has been reported, for example, in the markets for the sale of military equipment.

Derivatives risk

Derivatives risk include commodity derivatives and financial derivatives.

i. Commodity derivatives are contracts on the price of certain commodities, such as oil, wheat, metals (gold, tin, copper etc.) and coffee. Derivatives contracts are contracts to buy and sell a quantity of commodities at a future date at a fixed price agreed in the contract. In most cases, the buyer and seller of the derivative instrument do not intend to buy and sell the physical commodities. The contract is a contract for the price, and it is settled by the payment of the difference between the fixed price in the contract and the market price at settlement date for the contract.

ii. Financial derivatives are contracts on the price of certain financial instruments or market rates, such as foreign exchange rates, interest rates, bond prices and share prices. Like commodity derivatives, the buyer and seller of financial derivatives do not usually exchange items they have bought or sold. The contract is simply a contract on the price or market rate. It is settled by a payment for the difference between the fixed price in the contract and the market rate at the settlement date.

Derivative instruments include options, futures and swaps. They can be used to control risks by 'hedging' exposures to price risks (market risks). On the other hand, they can be used to speculate on changes in market prices.

There have been incidents where the treasury department of a company or government organisation has used derivatives to speculate on changes in market prices, and suffered heavy losses because market prices moved against its position in the derivative instruments. Every company with a treasury department could be exposed to derivatives risk from trading by its treasury staff in the commodities or financial market. Risk management and control systems (internal controls) should to be implemented and enforced to control the risk.

Marking Scheme

		Marks
• Identification of ANY FIVE of the categories of risk	1x5	**5**
• Discussion of the FIVE categories of risk identified	2x5	**10**
Total		**15**

EXAMINER'S REPORT

The question is testing candidates' knowledge of the nature and categories of risk to which a business entity could be exposed.

Many candidates attempted the question, but performance was barely average. Many of them could neither identify nor discuss the categories of risk in details.

Candidates are advised to study, in details, all the issues and topics contained in the syllabus and especially the ICAN Study text.

Solution 7

a. The purpose of an ethical decision-making model is to help individuals to assess, before they make a decision, whether the decision is ethically correct.

b. **The American Accounting Association (AAA) model**

The American Accounting Association model for ethical decision-making was constructed in 1990. It is based on a teleological approach, and is consistent with professional ethical guidelines.

The AAA model is based on a seven-step approach to decision-making.

Step	Question to ask	Comment
1	What are the facts?	It is important to establish all the relevant facts. It is difficult to make a correct decision without having a clear understanding of the facts of the case.
2	What are the ethical issues?	The decision-maker should identify what moral issues are involved (if any). What is the moral dilemma?
3	What moral principles, values or 'norms' are relevant to the decision?	The decision-maker should consider the ethical principles or values that ought to be considered in reaching the decision.
4	What are the alternative courses of action for the decision ion-maker?	Decision maker should be able to identify all the available alternative courses of action.
5	Which course of action (or courses of action) seems best, because it is consistent with the moral principles and values identified in Step 3?	Each course of action should be assessed according to whether it is morally correct. Each choice is judged against the principles and values that should be applied in the case.

6	What are the consequences of each possible course of action?	The probable consequences of each of the possible course of action must be clearly understood.
7	What is the decision?	The decision-maker makes an ethical choice.

Marking Scheme

		Marks
7a. Purpose of ethical decision models		
• Statement of purpose of ethical decision models	1x1	**1**
b. The American Accounting Association (AAA) model		
Identification of each of the SEVEN questions that characterise the AAA model.	1x7	
Explanation of each of the identified questions.	1x7	**14**
Total		**15**

EXAMINER'S REPORT

The question tests candidates' knowledge of ethical decision making models. It requires them to explain the primary purpose of ethical decision making models and discuss the AAA model.

Many of the candidates did not attempt the question and the performance of those who did was below average. Their major pitfall was their lack of understanding of the primary purpose of ethical decision making models as well as their inability to give an adequate account of the AAA model.

Candidates are advised to pay adequate attention to aspects of the syllabus that deal with ethical issues in professional life, especially as they relate to the accounting profession. These issues are to be tested in greater depth in the future.