THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

PATHFINDER

NOVEMBER 2015 SKILLS EXAMINATION

Question Papers

Suggested Solutions

Plus

Marking Guide

Examiners' Reports

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SKILLS LEVEL EXAMINATION - NOVEMBER 2015

FINANCIAL REPORTING

Time Allowed: 3 hours

ANSWER FIVE QUESTIONS IN ALL

SECTION A: COMPULSORY (30 Marks)

QUESTION 1

Statement of financial position as at December 31, 2014

	Hapu Plc	Sege Plc
	₦000	₦000
Assets		
Non-current assets		
Property, plant and equipment	32,000	25,000
Investments	33,500	–
	65,500	25,000
Current assets		
Cash at bank and in hand	9,500	2,000
Trade receivables	20,000	8,000
Inventory	30,000	18,000
	125,000	53,000
Equity and liabilities		
Share capital	40,000	10,000
Share premium	6,500	–
Retained earnings	55,000	37,000
	101,500	47,000
Current liabilities	23,500	6,000
	125,000	53,000

Statement of profit or loss for the year ended December 31, 2014

	Hapu Plc	Sege Plc
	₦000	₦000
Revenue	125,000	117,000
Cost of sales	(65,000)	(64,000)
Gross profit	60,000	53,000
Distribution costs	(21,000)	(14,000)
Administrative expenses	(14,000)	(8,000)
Profit before taxation	25,000	31,000
Income tax expense	(10,000)	(9,000)
Profit for the year	15,000	22,000

Statement of changes in equity (extract) for the year ended December 31, 2014

	Hapu Plc	Sege Plc
	₦000	₦000
Retained earnings brought forward	40,000	15,000
Retained profit for the year	15,000	22,000
Retained earnings carried forward	55,000	37,000

You are given the following additional information.

(i) Hapu Plc owns 80% of Sege's shares. These were purchased in 2011 for ₦20.5million cash, when the balance on Sege's retained earnings stood at ₦7million.

(ii) Included in the inventory of Sege Plc at December 31, 2014 were goods purchased from Hapu for ₦3.9million. Hapu aims to earn a profit of 30% on cost. Total sales from Hapu Plc to Sege Plc were ₦6million.

(iii) Hapu Plc and Sege Plc each proposed a dividend before the year end of ₦2million and ₦2.5million respectively. No accounting entries have yet been made for these.

(iv) Hapu Plc has carried out annual impairment tests on goodwill in accordance with IFRS 3 and IAS 36. There was no impairment of goodwill.

Required

Prepare the consolidated statement of profit or loss for the year ended December 31, 2014.

Prepare the consolidated statement of financial position at that date.

(30 marks)

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

QUESTION 2

The following trial balance has been extracted from the books of Well-Being Plc as at March 31, 2014.

	₦'000	₦'000
Land at cost	360	
Building at cost	750	
Equipment at cost	588	
Vehicles at cost	852	
Goodwill	900	
Accumulated depreciation:		
At April 1, 2013:		
Buildings		270
Equipment		228
Vehicles		396
Inventory at April 1, 2013	321	
Trade receivables and payables	549	351
Allowance for receivables		24
Bank balances		171
Current taxation		18
Ordinary shares of ₦1 each		600
Retained earnings at April 1, 2013		1,509
Revenue		4,296
Purchases	1,464	
Directors' fees	450	
Wages and salaries	828	
General distribution costs	303	
General administrative expenses	558	
Dividend paid	60	
Rent received		90
Disposal of vehicle		30
	7,983	7,983

The following information is also available:

1. The company's non-depreciable land was valued at ₦900,000 on March 31, 2014 and this valuation is to be incorporated into the accounts for the year ended March 31, 2014.
2. The company's depreciation policy is as follows:
   Building, 4% p.a. straight line
   Equipment, 40% p.a. reducing balance
   Vehicles, 25% p.a. straight line

In all cases, a full year's depreciation is charged in the year of disposal. None of the assets had been fully depreciated by March 31, 2013.

3. On February 1, 2014, a vehicle used entirely for administrative purposes was sold for ₦30,000. The sale proceeds were banked and credited to a disposal account, but no other entries were made in relation to this disposal. The vehicle had cost ₦132,000 in August 31, 2010. This was the only disposal of a non-current asset made during the year ended March 31, 2014.
4. Depreciation is apportioned as follows:

	Distribution cost	**Administrative expenses**
Buildings	50%	50%
Equipment	25%	75%
Vehicles	70%	30%

5. The company's inventory at March 31, 2014 is valued at ₦357,000.
6. Trade receivables include a debt of ₦24,000 which is to be written off. The allowance for receivables is to be adjusted to 4% of the receivables which remain after the debt has been written off.
7. Current tax for the year ended March 31, 2013 was over-estimated by ₦18,000. The current tax liability for the year ended March 31, 2014 is estimated to be ₦90,000.
8. One-quarter of wages and salaries, was paid to the distribution staff and the remaining three-quarters were paid to the administrative staff.
9. General administrative expenses include bank overdraft interest of ₦27,000.

Required:

Prepare a statement of profit or loss and other comprehensive income for the year ended March 31, 2014.

(20 Marks)

QUESTION 3

The summarized final accounts of Omosigho Ltd, manufacturer of Aluminum roofing sheets and its accessories for two years ended December 31, 2013 and 2014 were as follows:

Operating results		**2014**		**2013**
	₦'000	**₦'000**	**₦'000**	**₦'000**
Revenue		3,364,720		2,750,355
Profit before Interest and taxation		117,060		104,410
Interest payable		12,500		12,500
Taxation		52,530		43,735
Dividend		18,750		17,500
Statement of financial position:				
Non-current Assets		81,110		34,705
Current Assets:				
Inventories & W.I.P	311,470		260,980	
Receivables & prepayments	274,295		250,260	
Cash and bank balances	36,170		72,825	
	621,935		584,065	
Current Liabilities:				
Payables and accruals	268,545		241,770	
Net current Assets		353,390		342,295
		434,500		377,000
Financed by:				
62,500,000 ordinary shares of ₦1 each		62,500		62,500
Retained earnings		179,370		148,935
Shareholders' funds		241,870		211435
10% Loan notes(2020-2032)		125,000		125,000
Deferred taxation		67,630		40,565
		434,500		377,000

The shares of the company were quoted at ₦1.20 at December 31, 2013 and December 31, 2014.

Required

a. Calculate **TWO** accounting ratios each that will be of interest to the following stakeholders:
   i. Creditors
   ii. Management
   iii. Shareholders (15 Marks)

b. Comment briefly on the changes between the ratios arrived at in 2013 and 2014. (5 Marks)

(Total 20 Marks)

QUESTION 4

The purpose of IAS 36: Impairment of Assets is to provide entities with guidance to determine whether an asset is impaired and how the impairment should be recognised.

Required:

a. In assessing whether there is an indication that an asset may be impaired, what factors should an entity consider?
(5 Marks)

b. The following information relates to individual plant and equipment used by Phonex Nigeria Limited for its telecommunication operations as at December 31, 2014.

	Plant and Equipment	Carrying Amount	Fair Value less cost to sell	Value in use
		₦'000	**₦'000**	**₦'000**
1.	Mast	297,500	302,500	285,000
2.	Generators	592,500	517,500	512,500
3.	Computer equipment	287,500	292,500	307,500
4.	Credit card machines	207,500	187,500	197,500
5.	Motor vehicles	77,500	65,000	-

Additional information

i. The Mast and the Generator are carried at revalued amount and the cumulative revaluation surplus in other comprehensive income for the equipment are ₦30,000,000 and ₦15,000,000 respectively both equipment are field equipment.

ii. The motor vehicles are buses used for transporting employees in the morning and evening and it is not possible to determine the value in use of the buses separately because the buses do not generate cash inflow from continuing use that are independent of the cash flows from other assets.

Required:

Draft a memo addressed to your boss indicating whether each of the plant and equipment is impaired or not and also explaining how the impairment loss should be treated in the books of Phonex Nigeria Limited as at December 31, 2014.

(15 Marks)

(Total 20 Marks)

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

QUESTION 5

The trial balance of UDO Plc and its subsidiary, ALOMA Plc as at December 31, 2014 are given below:

	UDO Plc		ALOMA Plc	
	DR	**CR**	**DR**	**CR**
	₦M	**₦M**	**₦M**	**₦M**
Property, Plant & Equipment	260		6,000	
Loan to ALOMA Plc	4,600		-	
Other investments	1,200		-	
Current assets	1,600		278	
₦1 equity shares		400		200
Share premium		1,000		170
Retained earnings		5,800		662
Revaluation surplus		60		-
Loan from UDO Plc		-		4,600
Sundry payables		400		646
	7,660	7,660	6,278	6,278

UDO Plc on January 1, 2014 acquired 75% of the equity of ALOMA Plc for ₦1,300,000,000, when the retained earnings was ₦600million and share premium ₦170million. Neither this transaction nor the loan notes for the same amount obtained to finance the purchase were recorded in the trial balance above.

There had been no impairment in the value of the goodwill, nor a change in share capital since acquisition.

It is the group policy to value the non-controlling interest at the date of acquisition at fair value. The fair value of the non-controlling interest in ALOMA Plc at the date of acquisition was estimated to be ₦160,000,000.

Required:
Prepare the consolidated statement of financial position of UDO Group Plc as at December 31, 2014. (15 Marks)

QUESTION 6

Global Plc is an entity quoted on the Nigerian Stock Exchange.

You are provided with the following set of summarised published financial statements of the company for the year ended September 30, 2014.

Statement of profit or loss and other comprehensive income for the year ended September 30, 2014.

	2014
	₦'000
Revenue	500,000
Cost of sales	(300,000)
Gross profit	200,000
Administrative expenses	(29,000)
Finance cost	(1,000)
Profit before taxation	170,000
Income tax expense	(40,000)
Profit for the period	130,000

Statement of financial position as at September 30, 2014 together with their comparative figures:

	2014	2013
	₦'000	**₦'000**
Assets:		
Non-current assets:		
Property, plant and equipment	200,000	220,000
Goodwill	-	10,000
Inventories	100,000	80,000
Trade receivables	75,000	60,000
Bank balances	20,000	5,000
	395,000	375,000
Equity and liabilities:		
Ordinary shares @ ₦1.25k each	10,000	8,000
Retained earnings	250,000	197,000
	260,000	205,000
Non-current liabilities:		
10% loan notes	10,000	-
Current liabilities:		
Trade payables	60,000	90,000
Other payables	20,000	40,000
Taxation	20,000	30,000
Bank overdrafts	25,000	10,000
	135,000	170,000
Total equity and liabilities	395,000	375,000

The following information is relevant:

i. During the financial year, the company paid dividend of ₦87,000,000 to equity holders and this had been accounted for during the year. The current market price of the company is ₦10 per share.

ii. The company is planning to take a long term loan of ₦400,000,000 from consortium of banks. The company's financial statements and loan applications have already been submitted to the bank.

Required:

a. Prepare the company's statement of cash flows submitted to the bank in accordance with the provisions of IAS 7.
(10 Marks)

b. Comment briefly on the cash flow management strategies of Global Plc.
(5 Marks)

(Total 15 Marks)

QUESTION 7

a. The objectives of IAS 40- Investment Property is to prescribe the accounting treatment and disclosure requirements for investment property. The main issue in accounting for investment properties is to distinguish these properties separately from owner-occupier properties.

Required:

Explain how treatment of an investment property carried at fair value model differs from an owner-occupier property carried under revaluation model.

(5 Marks)

b. KOLA NITDA Nigeria Plc is a company engaged in the manufacturing of hand sanitizer to prevent Ebola disease. The following information relates to property owned by the company.

	₦'000
Land – Plot 404 Apapa Industrial Area	32,000
Building therein (acquired June 30, 2013)	84,000
Improvement to the building to extend rented floor capacity	16,000
Repairs and maintenance to investment property for the year	2,000
Rental received for the year	6,400

Approximately six percent of the property floor space is used as the administrative head office of the company. The property can be sold only as a complete unit. The remainder of the building is leased out under operating leases. The company provides lessees with security services.

The company values investment property using the fair value model on December 31, 2014 which is the company's year end. Tewogbade & Co. (an independent valuer) valued the property at ₦144,000,000 on that date.

Required:

i. Advise the Directors of KOLA NITDA Nigeria Plc on how the property should be treated in the financial statements of the company as at December 31, 2014 in order to ensure strict compliance with provisions of IAS 40.

(5 Marks)

ii. Calculate the value of investment property that should be disclosed in the statement of financial position as at December 31, 2014 and the amount that should be charged to the statement of profit or loss and other comprehensive income for the period then ended. (5 Marks)

(Total 15 Marks)

SOLUTIONS

SOLUTION 1

(a)

Hapu Plc
Consolidated statement of profit or loss
for the year ended December 31, 2014

	₦'000
Revenue (₦125,000 + ₦117,000 - ₦6,000)	236,000
Cost of sales (₦65,000+ ₦64,000- ₦6,000 + N900)	(123,900)
Gross profit	112,100
Distribution costs (21,000 + 14,000)	(35,000)
Administrative expenses (14,000+8,000)	(22,000)
profit before taxes	55,100
Income tax expenses (10,000 + 9,000)	(19,000)
Profit for the year	36,100
Profit attributable to:	
Owners' of the parent (bal. figure)	31,700
Non-controlling interest (20% x 22,000)	4,400
	36,100

(b)

Hapu PLC
Consolidated Statement of Financial Position
as at December 31, 2014

Assets	₦'000	₦'000
Non-Current Assets		57,000
Goodwill (w 1)		6,900
Investments (33,500 – 20,500)		13,000
		76,900
Current Assets		
Inventory (w 5)	47,100	
Trade Receivables	28,000	
Bank and cash	11,500	86,600
Total Assets		163,500
		N'000
Equity & Liabilities		
Share capital		40,000
Share premium		6,500
Retained Earnings (w 3)		78,100
Equity attributable to owners of the parent		124,600
Non-controlling interest (w 4)		9,400
Current Liabilities		29,500
		163,500

Workings

(1) Goodwill on consolidation:

		₦'000
Cost of investment/consideration		20,500
FV of NCI at acquisition (20% of N17,000,000)		3,400
		23,900
Less Sege Plc Net Asset at acquisition:		
Share Capital	10,000	
Retained earnings	7,000	(17,000)
Goodwill		6,900

(2) Consolidated Retained earnings:

	Hapu Plc ₦'000	Sege Plc ₦'000
Retained earnings per question	55,000	37,000
Pre acquisition - sege	-	(7,000)
∴ post acquisition – sege	-	30,000
Groups share at 80%	2,400	
Less unrealized profit in inventory(w3)	(900)	
	78,100	

(3) Calculation of unrealized profit:

$\frac{30}{130}$ x ₦3,900,000 = ₦900,000

(4) Non-controlling Interest:

	₦'000
Fair value at acquisition date	3,400
Share of post-acquisition retained earnings	6,000
(20% of N30,000,000)	9,400

(5) Consolidated Inventory

	₦'000
Hapu	30,000
Sege	18,000
Less unrealized profit	(900)
	47,100

(6) The dividends proposed for the year ended December 31, 2014 were Hapu Plc ₦2 million and Sege Plc ₦2.5 million.

a. <u>Consolidated Statement of Profit or Loss for the year ended December 31,2014</u>

		Marks
- Calculation of Gross Profit (GP)		
	• Revenue	1
	• Cost of sale	1
	• GP	1
		3
- Ascertainment of PBT:		
	• Distribution Cost	1
	• Admin Exp	1
	• PBT	1
		3
- Ascertainment of Profit for the year		
	• Income Tax	1
	• Profit for the year	1
		2
- Calculation of attributable profit		
	• to parent	1
	• to NCI	1
		2

b. <u>Consolidated Statement of Financial Position as at December 31, 2014</u>

- Calculation of:		
	• Non-current Assets	2
	• Investments	2
	• Goodwill	2
		6
- Ascertainment of Current Assets:		
	• Inventory	4
	• Receivables	1
	• Cash & bank	1
		6
- Calculation of equity		
	• Share Capital	1/2
	• Share Premium	1/2
	• Retained earnings	4
		5
- Calculation of non-controlling interest:		
	• Workings	1
	• Final figure	1
		2
- Stating of Current Liabilities		1
Total marks for the question		30

EXAMINER'S REPORT

The question tests candidates' knowledge of group accounts. Candidates are required to prepare a Consolidated Statement of Profit or Loss and Statement of Financial Position.

Majority of the candidates attempted the question and performance was good as over 60% of them obtained above 50% of the marks allocated.

The commonest pitfall is the inability of some candidates to present the statement in IFRS recommended format. Some also lost marks due to wrong approximation of figures and non indication of appropriate naira symbol.

Candidates are advised to be careful when answering examination questions so as to avoid loss of marks earned due to failure to follow examiners' instructions.

SOLUTION 2

Well – Being Plc
Statement of profit or loss and other comprehensive income
for the year ended March 31, 2014

	₦'000	₦'000
Revenue		4,296
Cost of sales		
Opening inventory	321	
Purchases	1,464	
	1,785	
Closing Inventory	(357)	
	1,428	(1,428)
Gross Profit		2,868
Other income:		
Rent received	90	
Profit on disposal of vehicle	30	
Decrease in allowance for receivable	3	123
		2,991
Distribution costs		(711)
Administrative expenses		(1,812)
Finance Cost		(27)
Profit before taxation		441
Income tax expense:		
Provision for the year	90	
Over provision 2013	(18)	(72)
Profit for the year		369
Other comprehensive income:		
Gain in valuation of land (N900 –N360)		540
Total comprehensive income		909

EPS	61.5 Kobo

Workings

1. Distribution costs

	₦'000
General distribution cost	303
Wages and salaries (1/4)	207
Bad debts written off	24
Depreciation	177
	711

2. Administrative Expenses

	₦'000
General administrative expenses (558-27)	531
Wages and salaries (3/4)	621
Directors fees	450
Depreciation	210
	1,812

3. Depreciation for the year:

	Total	Distribution	Administration
	₦'000	₦'000	₦'000
Building 4% of N750,000	30	15	15
Equipment 40% of (588,000- 228,000)	144	36	108
Vehicles:			
Disposed 25% of N132,000	33	-	33
Others 25% of N852,000-132,000	180	126	54
	387	177	210

4. Allowance for receivables:

	₦'000
Opening balance	24
Closing balance 4% of (N549-N24)	21
Decrease in allowance for receivable	3

5. Profit on Disposal of vehicle:

	₦'000	₦'000
Proceed on disposal		30
Carrying amount at disposal:		
Cost of purchase	132	
Depreciation 2011,2012 &2013(3yrs)		
At 25%	(99)	
Depreciation in year of disposal 2014	(33)	0
		30

6. EPS = $\frac{\text{N369,000}}{\text{600,000 shares}}$ = 61.5 kobo

Marking Guide		Marks
- Stating the title of the financial statement	1/3	
- Determination of Gross Profit GP:		
• Revenue	1/3	
• Cost of Sales	1 2/3	
• GP	2/3	
		$2^{2/3}$
- Determination of Other Income		
• Rent received	1/3	
• Profit on Disposal	1/3	
• Other Income	1	
		$1^{2/3}$
- Determination of profit before taxation		
• Distribution Cost	1/3	
• Admin Exp	1/3	
• Finance cost	1/3	
• Profit before taxation	1/3	
		$1^{1/3}$
- Calculation of profit for the year		
• Income Tax expense	1	
• Profit for the year	1/3	
		$1^{1/3}$
- Determination of other comprehensive income		
• Gain on revaluation of land	1/3	
• Total Comprehensive Income	1/3	
	2/3	
- Stating the EPS		1/3
- WORKINGS:		
• Determination of Administrative Expenses (6 ticks @ 1/3 mark each)	2	
• Determination of distribution costs (5 ticks @ 1/3 mark each)	$1^{2/3}$	
• Calculation and apportionment of Depreciation (14 Ticks @ 1/3 mark each)	$4^{2/3}$	
• Calculation of allowance for receivables (3 ticks @ 1/3 mark each)	1	
• Determination of profit on disposal of vehicle: (6 Ticks @ 1/3 mark each)	2	
• Calculation of EPS (1 Tick @ 1/3)	1/3	
		$11^{2/3}$
Total marks for the question		20

EXAMINER'S REPORT

The question tests candidates' knowledge of the preparation of Statement of Profit or Loss and Other Comprehensive Income of an entity.

More than 70% of the candidates attempted the question and the performance was fair. Only about 40% of the candidates who attempted the question obtained up to 50% of the marks allocated to it. Candidates' commonest pitfall is their inability to properly calculate and apportion depreciation charged for the year between the relevant subheads of distribution and administrative expenses.

Candidates are advised to prepare adequately before presenting themselves for examination.

SOLUTION 3

OMOSIGHO LTD

		2014	2013
(a)	**Ratios of Interest to Creditors**	2014	2013
(i)	Current ratio = Current Assets / Current liabilities	621,935 / 268,545	584,065 / 241,770
		= 2.3:1	= 2.4:1
(ii)	Quick ratio/Acid Test = Current Assets – Inventory / Current Liabilities	310,465 / 268,545	323,085 / 241,770
		= 1.16:1	= 1.34:1
(iii)	Receivable Turnover = Revenue / Trade Receivables	3,364,720 / 274,295	2,750,555 / 250,260
		12 times	11 times
(iv)	Debt to Equity Ratio: Long term Debt / S /Capital and Reserve x 100	125,000 / 241,87 x 100	125,000 / 211,435
		51.7%	59.1%
(v)	Interest cover: PBIT / Interest charged in the year	117,060 / 12,500	104,410 / 12,500
		=9.4:1	= 8.4:1

b. **Ratios of Interest to Management**

		2014	2013
i.	Return on Capital employed(ROCE): PBIT / Equity + Long term debt X 100	117,060 / 62,500 +179370 + 125,000	104,410 / 62,500+148,935 + 125,000
		31.9%	31%
ii.	Return on Assets: PBIT / Total Asset X 100	117,060 / 703,045	104,410 / 618,770
		16.7%	16.0%
iii.	Profit to sales Ratio: PBT / Revenue X 100	104560 / 3,364,720	91910 / 2,750,355
		3.1%	3.34%

iv.	Assets Turnover Ratio		2,750,335
	Revenue X 100	3,364,720	336,435
	Equity + Long term debt	366,870	8.2:1
		9.2 :1	
	'OR'		
v.	Asset Turnover	3,364,720	2750355
	Revenue	434,500	377,000
	Equity + NCL	7.7 times	7.3 times

c. **Ratios of Interest to Shareholder**

		2014	2013
i.	Earnings per share (EPS)		48175
	PAT x 100	52030	62,500
	No of ord share	62,500	77k/share
		83 k/share	
ii.	Earnings ratio (P/E Ratio)		
	MPS	1.20	1.20
	EPS	0.83	0.77
		1.4:1	1.6:1
iii.	Dividend yield	0.3	0.28
	DPS x 100	1.20	1.20
	MPS	25%	23.33%
iv.	Dividend Cover	0.83	0.77
	EPS	0.3	0.28
	DPS	2.77 Times	2.75 Times
	OR		
	Dividend Pay Out		0.28
	DPS	0.3	0.77
	EPS	0.83	36.3%
		36.1%	

N.B: The ratios stated above are not exhaustive for all categories.

COMMENTS

The Company performance appeared to be relatively stable in terms of short term and long term liquidity. This is because the current ratio and Acid test ratio are relatively stable and higher than the theoretical average for a manufacturing industry which is 2:1 for current and 1:1 for Acid test Ratio.

Also the performance of the company in terms of profitability and efficiency is fair and stable as both the profitability ratio and efficiency ratio appeared to be better than industrial average. Although the profit to sales Ratio is low but the company utilized its assets efficiently.

For minority shareholders the performance of the company is good as the dividend yield is relatively high and increased over the period (that is from 2013 to 2014). Similarly the earnings of the company adequately covers the dividend declared. However for majority shareholders the P/E ratios may not be good enough because the ratio declined over the period which is an indication that the future potential of the company might deteriorate.

Marking Guide	Marks
a. Two accounting ratios each:	
(i) CREDITORS	
• Any two ratios of interest to creditors,	
• Correctly identified with right calculations and Answers	5
(ii) MANAGEMENT	
• Any two ratios which are of interest to the management	
• Correctly identified, calculated and rightly answered	5
(iii) SHAREHOLDERS	
• Calculation of two ratios which are of interest to the Shareholders	
• Correctly identified, calculated and rightly answered	5
	15
b. Comments	
(i) CREDITORS	
• Stating the trend of profitability	1
• Comparison with industrial average	1
(ii) Management	
• Stating the trend of profitability	1
• Identifying Improvement in efficiency of utilization of assets	1
iii. SHAREHOLDERS	
• Identifying Improvement in earnings per share/Dividend yield	1
• Specifying deterioration in Price earnings ratio	1
• Stating Stability of dividend pay out ratio	1
• Any five valid points from b(i)-(biii)	5
Total marks for the question	20

Examiner's Report
The question tests the ability of the candidates to compute relevant accounting ratios which are of interest to creditors, management and shareholders as well as the interpretation of the ratios calculated.

About ninety percent (90%) of the Candidates attempted the question and performance was above average. The commonest pitfalls of the Candidates was their inability to correctly identify the relevant ratios for each class of the Stakeholders while others could not correctly interprete the ratios calculated.

Ratio analysis and interpretation of Financial Statements is a regular feature at the skill level of the Institute's examinations. Therefore candidates are advised to pay more attention to this section of the syllabus while also emphasizing other sections for better performance in future examinations.

SOLUTION 4

a. **<u>INDICATORS OF IMPAIRMENTS</u>**

When assessing whether there is an impairment, IAS 36 requires that the following factors should be considered by an entity

EXTERNAL FACTORS

i. An unexpected decline in the assets market value
ii. Significant changes in Technology, market, economic factor or laws and regulations that have an adverse effect on the company.
iii. An increase in interest rates, affecting the value in use of the assets.
iv. Whether the carrying amount of the net assets of the entity is more than its market capitalization.

INTERNAL FACTORS

i. Evidence that the asset is damaged or no longer of use to the entity
ii. There is a reduction in the assets expected remaining useful life
iii. There is plan to discontinue or restrict the operation for which the assets is currently used
iv. There is evidence from internal reporting indicating that asset is performing worse than expected.

(b) PHONEX NIG LTD – INTERNAL Memo

From: Mr. XYZ

To: Financial Controller

Subject: Impairment of Plant and Equipment

Date: 1st February, 2015

The Recoverable amount of an asset is defined as the higher of its fair value minus cost of disposal and its value in use. While Impairment loss is the amount by which the carrying amount of an asset (or a cash generating unit) exceeds its recoverable amount.

In view of the above, the following submissions are made in respect of our plant and equipments

1) MAST
The Recoverable amount is ₦302,500,000 and since the carrying amount (₦29,750,000 is lower than the recoverable amount, no impairment loss should be recognised on the plant and equipment.

2) GENERATORS
The Recoverable amount is ₦517,500,000 and since the carrying amount (₦592,500,000) is higher than the recoverable, amount, the impairment loss to be recognized is ₦592,500,000 – ₦517,500,000 =N75,000,000.

According to IAS 36 (paragraph 60) the loss should be treated as a revaluation decrease.

Therefore N15,000,000 of the loss should be debited to the revaluation surplus in other comprehensive income and the balance of the loss of N60,000,000 should be reorganized/charged in the profit or loss

3) COMPUTER EQUIPMENT
The recoverable amount is ₦307,500,000. And since the carrying amount of ₦287,500,000 is lower than the recoverable amount, no impairment should be recognized.

4) CREDIT CARD MACHINES
The Recoverable amount is ₦197,500,000. The Asset is impaired since the carrying amount of ₦207,500,000 is higher than the recoverable amount of ₦197,500,000.

The impairment loss is ₦207,500,000 – ₦197,500,000 = ₦ 10,000,000. The impairment loss of ₦10,000,000 should be debited or expensed in the Statement of profit or loss.

5) MOTOR VEHICLES
The recoverable amount of the bus cannot be determined because the assets value in use cannot be estimated to be close to its net selling price, and it does not generate cash inflow from continuing use that are largely independent of those from other assets.

Therefore the management must determine the cash-generating units to which the bus belongs and state the recoverable amount of this unit as a whole. If this unit consist of items 1 to 5 of the property plant and equipment. Then the impairment loss arrived at should be allocated on pro-rata basis to items 1,3,and 5 that is mast, computer equipment and motor vehicle.

Signed

Mr. XYZ

Marking Guide	Marks
a. 1 Mark each for any 5 correct point (External or Internal)	5
b. Calculation of recoverable amount for each item of plant & Equipment (1 mark x 5)	5
• Comparison of Recoverable & Carrying amount to determine impairment for each item of plant & Equipment (1 mark x 5)	5
• Correct treatment of Generators impairment	2
• Correct treatment of Credit card machine impairment	1
• Correct explanation on the derivation of impairment of Motor vehicle	2
Total marks for the question	20

EXAMINER'S REPORT

The question tests the provisions and applications of IAS 36 -Impairment of Assets.

More than seventy percent (70%) of the Candidates attempted the question and performance was average. Majority of the candidates were able to correctly highlight internal and external factors that are indications of assets impairment in part(a) of the question however, only few candidates could explain the treatment of the impairment loss in the books of the company in part 'b'.

Candidates are advised to make proper use of the Institutes Study Pack when preparing for their examinations because the study packs treated in details all IFRS relevant to this level of the Institutes examinations.

SOLUTION 5

a. **UDO PLC GROUP**
CONSOLIDATED STATEMENT OF FINANCIAL POSITION
AS AT DECEMBER 31, 2014

Non- current Assets	₦'m
Property, plant & Equipment	6,260.00
Other investments	1,200.00
Goodwill on consideration	490.00
Total non-current assets	7,950.00
Current Assets	1,878.00
Total Assets	9,828.00
Equity & Liabilities:	
Equity	₦'m
Equity shares of N1 each	400.00
Share premium	1,000.00
Revaluation Surplus	60.00
Retained earnings	5,846.50
	7,306.50
Non-controlling interest	175.50
Non-current Liabilities:	
Loan notes	1,300.00
Current Liabilities:	
Sundry payables	1,046.00
Total equity & Liabilities	9,828.00

Workings

1) Goodwill on Consideration:	₦'M	₦'M
Cost of investment /consideration		1,300
FV of NCI at acquisition		160
		1,460
Less Aloma Plc Net Asset at Acquisition:		
Share Capital	200	
Share Premium	170	
Retained Earnings	600	(970)
		490

2. Consolidated Retained Earnings:

	₦'M	₦'M
	Udo Plc	Aloma Plc
Retained earnings per question	5,800	662
Pre-acquisition	-	(600)
∴ Post acquisition	-	62
Group share at 75%	46.5	
	5,846.5	

4. Non- controlling interest

	N'M
Four value at acquisition	160
Share of post acquisition retained earnings 25% of N62 million	15.5
	175.5

Marking Guide **Marks**

- Determination of the components of non-current assets
  - Property Plant & Equipment ½
  - Goodwill ½
  - Other Investment ½
  - Total non-current assets ½

  2
- Stating the Current & Total Assets figures 1

- Determination of components of Equity & Liabilities
  - Share Capital ½
  - Share Premium ½
  - Retained Earnings ½
  - Revaluation surplus ½

  2

- Stating Loan notes figure ½
- Stating sundry payables and total equity & Liabilities 1

- WORKINGS:
  - Calculations of goodwill on Consolidation:
    (8 ticks @ ½ mark each) 4

  - Calculations of consolidated Retained earnings
    (6 ticks @ ½ mark each) 3

  - Calculations of non-controlling interest
    (3 ticks @ ½ mark each) $1^{1/2}$

Total marks for the question 15

EXAMINER'S REPORT

The question tests candidates' knowledge of group financial statements.

Most candidates attempted the question and the performance was good.

The commonest pitfall is the candidates' inability to properly apply the Fair Value when computing the Non-controlling interest and the wrong calculation of the consolidated retained earnings. Some candidates also lost marks due to wrong approximation of figures and non-indication of appropriate naira symbol.

Candidates are advised to note every detail in the question before attempting it, so as to avoid loss of marks.

SOLUTION 6

GLOBAL PLC
STATEMENT OF CASH FLOW
FOR THE YEAR ENDED SEPTEMBER 30, 2014

METHOD 1- USING INDIRECT METHOD

Cash flow from operating Activities

	₦'000	₦'000
Net Profit before Taxation		170,000
Adjustments:		
Depreciation	20,000	
Finance Cost	1,000	
Goodwill	10,000	31,000
		201,000
Increase in Receivables/payables:		
Increase in Taxes	(20,000)	
Increase in Trade Receivables	(15,000)	
Decrease in Trade Payables	(30,000)	
Decrease in other Payables	(20,000)	(85,000)
Taxation paid		(50,000)
Interest charges paid		(1,000)
Net cash inflow from operations		65,000
Investing activities		Nil
Financing activities		
Share Capital and Premium	12,000	
Loan notes (10%)	10,000	
Dividend paid	(87,000)	(65,000)
Net Increase /decrease in cash and cash equivalent		Nil
Opening cash and cash equivalent		
Cash and Bank	5,000	
Overdraft	(10,000)	(5,000)
Closing cash and cash equivalent		5,000

Workings ₦'000

1. Taxation paid

	₦'000
Opening balance	30,000
Per profit or loss	40,000
	70,000
Less	
Closing Balance	(20,000)
Tax Paid	**50,000**

2. Capital/ share capital

	₦'000
Increase in share capital(₦10,000-₦8,000)	2,000
Share premium received (wk 2.1)	10,000
	12,000

2.1 Share premium received

Retained earnings B/F	197,000
Profit for the period	130,000
	327,000
Closing retained earnings	(250,000)
Retained earnings declared as part of Dividend	77,000
Total Dividend paid	87,000
Share Premium paid as dividend	10,000

a. **Comments**

- The company has not managed its cash flows properly despite Net cash inflow of N65,000,000 generated from operations, since the company still went ahead to pay dividend of N87,000,000.

- As a result of high dividend payment the company depleted all funds generated from operation, share premium and part of other revenue reserve.

- The company might be profitable but the profit is not reflected in its liquidity position hence the request for additional long term loan of N400 m.

- Their bankers may not be too willing to extend the additional loan request in view of poor state of short term liquidity which may jeopardize the long term liquidity position of the company.

- If the loan is to be granted the bank might impose conditions on the company to moderate its dividend payment policy.

- There is no cash inflow or outflow from investing activities during the year. This is an indication that Global Plc may have poor investment culture or that the company has sold all its assets and money realized is shared to shareholders in form of dividend.

METHOD 2 - 'USING DIRECT METHOD'

GLOBAL PLC
STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 30 SEPTEMBER 2014

Operating Activities:	Notes	₦'000
Cash receipts from customers	1	485,000
Cash payments to suppliers	2	(350,000)
Cash payments for operating expenses	3	(19,000)
Company income Tax paid	4	(50,000)
Cash interest paid	5	(1,000)
Net cash inflow from operating activities	6	65,000
Investing activities:		----
Net cash outflow from investing activities		----
Financing activities:		
Issue of new share(including share premium)	6	12,000
10% loan notes proceeds		10,000
Dividends paid		(87,000)
Net cash outflow from financing activities		65,000
Net increase/Decrease cash & cash equipment		0
Cash and cash equivalents: opening balances:		
Bank balances		5,000
Bank Overdraft		(10,000)
Short term investments		----
		(5,000)

Expected closing balances agrees with actual closing balance of:		
Bank balances		20,000
Bank Overdraft		(25,000)
Short term investments		- (5,000)

Workings

1. **Cash receipts from customers** **₦'000**

	Opening balance of accounts receivable	60,000
	Add: Revenue for the year	500,000
	Expected cash from customers	560,000
	Deduct: Closing cash receipts from customers during the year	(75,000)
	Actual cash receipts from customers during the year	485,000

2. **Calculation of purchase during the year** **₦'000**

	Cost of sales	300,000
	Add: Closing inventory	100,000
	Cost of goods available for sale	400,000
	Deduct: Opening inventory	(80,000)
		320,000
		30,000
	Payment in respect of Trade payable	350,000

3. **Cash interest payments** **₦'000**

	Opening balance of accrued interest	-
	Add: Interest incurred for the year	1,000
	Expected interest payments	1,000

4. **Cash payments for operating expenses** **₦'000**

	Cash expenses incurred for the year (29,000-20,000-10,000)	(1,000)
	Add: Closing balance of prepayments	-
	Opening balance of other payable	40,000
	Expected payments	39,000
	Deduct: Opening balance of prepayments	-
	Closing balance of other expenses payable	(20,000)
	Actual cash payments for operating expenses during the year	19,000

5. **Company income tax paid**

		₦'000
	Opening balance of income tax payable	30,000
	Add: Income Tax expense for the year	40,000
	Expected income tax payments	70,000
	Deduct: Closing balance of income tax payable	(20,000)
	Actual company income tax paid during the year	50,000

6. **Cash interest payments**

		₦'000
	Opening balance of accrued interest	-
	Add: Interest incurred for the year	1,000
	Expected interest payments	1,000
	Deduct: Closing balance of accrued interest	-
	Actual interest payments during the year	1,000

7. **Issues of new shares**

		₦'000	₦'000
	Closing share capital	10,000	
	Less operating share capital	8,000	2,000
	Share Premium		
	Opening reserve	197,000	
	Add: Profit for the year	130,000	
		327,000	
	Deduct: dividend paid	(87,000)	
	Reserve	(240,000) 250,000	 10,000
			12,000

Marking Guide **Marks**

Global Plc
Statement of cashflow for the year ended September 30, 2014

(ai) Using Indirect method

Ascertainment of operating activities	$3^{1/2}$	
Determination of Inventory activities	$^{1/4}$	
Determination of Financing activities	1	
Determination of Cash and Cash equivalent	$1^{1/4}$	
		6

Workings relating to:		
Presentation of tax paid in the year	1	
Financing activities	3	
		4
Total		10

OR

(aii) Using Direct method

Ascertainment of operating activities	$1^{1/2}$	
Determination of Financing activities	1	
Computation of Cash and Cash equivalent	$1^{1/2}$	
workings relating to:		
Determination of cash receipts from customers	1	
Computation of purchases	$1^{1/2}$	
Ascertainment of cash interest payments	1/2	
Determination of cash payments for operating expenses	3/4	
Computation of company income tax paid	1	
Ascertainment of the value of new shares issued	1/2	
Computation of share premium	1/4	
Determination of cash interest payments	½	
Total		10

(b) Comments on the cashflow management strategies:

Any five valid points at I mark each	5
Total marks for the question	15

EXAMINER'S REPORT

The question tests preparation of statement of cash flows using either direct or indirect method. Candidates were also required to use the statement of cash flow prepared as a guide to comment on cashflow management strategies of the entity.

Almost all the candidates attempted the questions and performance was good. The commonest pitfall is the Candidates' inability to ascertain that ordinary share capital issued was at a premium and that the premium generated was also used as part of the dividend payments.

The statement of cash flows is one of the important components of Financial Statements which are normally included in annual report of companies hence candidates are advised to familiarise themselves with the Annual report of Companies and relevant International Financial Reporting Standards(IFRS) in order to improve on their performance in future.

SOLUTION 7

a. DIFFERENCE IN THE TREATMENT OF AN INVESTMENT PROPERTY CARRIED AT FAIR VALUE AND OWNER-OCCUPIER PROPERTY CARRIED UNDER REVALUATION MODEL

Generally speaking Revaluation model and fair value sound very similar because both require properties to be valued at their fair value which is usually a market based assessment (often by an independent valuer)

- However any gain or loss over the previous valuation is taken to profit or loss if it relates to an investment property, whereas for an owner-occupied property any gain is taken to a revaluation reserve (via other comprehensive income and statement of changes in equity). And a loss on the revaluation of an owner-occupier property is charged to profit or loss unless it has previous balance in its revaluation reserve which can be used to offset the loss until it is exhausted.

- A further difference is that an owner-occupier property continues to be depreciated after revaluation whereas investment properties are not depreciated

b.i. <u>TREATMENT OF THE PROPERTY IN THE FINANCIAL STATEMENTS OF KOLA NITDA PLC AS AT DECEMBER 31, 2014</u>

The property should be classified as an Investment property and should be accounted for in terms of the fair value model in IAS 40

As the portion of the property cannot be sold separately the entire property must be assessed under IAS 40. The motivation for classifying the whole property as an investment property is that the portion occupied by the company for administrative purposes (6%) is insignificant and security services rendered to the lessees are also insignificant. Furthermore, the majority of the floor space is used to generate rental income.

ii. <u>INVESTMENT PROPERTY TO BE DISCLOSED IN STATEMENT OF FINANCIAL POSITION</u>

	N'000
Opening Balance	-
Additions (32,000 + 84,000)	116,000
Improvement to building	16,000
Net gain in fair value Adj(WK1)	12,000
Closing balance at fair value	144,000

<u>Workings</u> (1)

Carrying amount of Investment Property

	₦'000
Land	32,000
Building	84,000
Improvement to building	16,000
Carrying Amount	132,000
Fair value	144,000
Fair value Adjustment per	
Profit or loss and other comprehensive	12,000

Marking Guide			Marks
a.	Explanation of measurement models	1	
	Treatment of differences in gain or loss over the previous valuation (investment property and owner-occupied property)	4	
			5
b.(i)	Correct identification of the property type	2	
	Reasons for classification as an investment Property	3	5
(ii)	Computation of the value of investment property for disclosure(5 ticks @1/2 mark each)	$2^{1/2}$	
	Computation of fair value adjustment charged to statement of Profit or loss and other Comprehensive Income (5 ticks @1/2 mark each)	$2^{1/2}$	5
	Total marks for the question		15

Examiner's Report

The question tests the application of the IAS-40 on investment property with particular emphasis on the treatment of Investment Property carried at fair value and Owner-Occupier property stated on revaluation basis.

About twenty percent (20%) of the Candidates attempted the question and performance was poor. Majority of the Candidates that attempted the question could not correctly differentiate between Investment Property carried at fair value and Owner-Occupier Property stated on revaluation basis. Similarly, most of the candidates could not correctly calculate value of Investment Property that should be disclosed in the Statement of Financial Position while others could not determine the amount to be charged to Statement of Profit or Loss and Other Comprehensive Income.

The Institute syllabus clearly identified IFRS which candidates must be familiar with at this level of the examinations; therefore Candidates are advised to pay special attention to them for better performance in future.

SKILLS LEVEL EXAMINATION – NOVEMBER 2015

AUDIT AND ASSURANCE

Time Allowed: 3 hours

SECTION A: COMPULSORY QUESTION (30 Marks)

QUESTION 1

a. Knowledge of internal control is a very basic audit skill. While auditors are not responsible for the institution of internal controls, they are responsible for providing management with information about how internal control is operating.

Required:

i. Illustrate what internal control is. (4 Marks)

ii. Describe **THREE** categories of internal control objectives. (6 Marks)

iii. Describe **FIVE** components of Internal control. (5 Marks)

b. Success Nigeria Limited is a company engaged in haulage business. The services provided by the company which has over 100 trucks in its fleet include lifting of petroleum products from the depots to the filling stations of its clients spread over many locations.

The Central Store for spare parts for repairs of the trucks is located at the Head Office. The inventory operation is handled by the Personal Assistant to the Managing Director in addition to his normal schedule of duties in the Managing Director's office. Spare parts supplied are received by the Personal Assistant who keeps them in the Central Store without raising any Goods Received Notes for the items.

The invoices and delivery notes brought by vendors are submitted to the accounts department directly for payment. Because of the pressure of work in the Managing Director's office, the Personal Assistant to the Managing Director does not maintain any inventory records. Whenever there is need for spare parts required for truck repairs, a pre-printed requisition form is completed by the mechanic in-charge of the repair.

The form is submitted to the Personal Assistant who supplies the spare parts from the Central Store. The mechanic collects the parts without any acknowledgment of receipt. The requisition forms collected for all the spare parts supplied are kept in one of the cabinets in the Personal Assistant's office and they are collated by the Accountant on monthly basis whenever he is to prepare the management accounts.

At the end of the financial year December 31, 2014, the Accountant conducted an inventory count of the items in the Central Store for the purpose of using the value for the preparation of the financial statements for the year ended December 31, 2014. The Managing Director observed later while reviewing the financial statements that the repairs and maintenance account did not reflect the true position of the repair works carried out on the trucks during the year.

Required:

In relation to the spare parts inventory operation of Success Nigeria Limited,

i. Describe **FIVE** Internal Control weaknesses from the above scenario. (5 Marks)

ii. Recommend controls required to address the identified weakness in (i) above. (5 Marks)

iii. Describe the audit tests to be carried out to assess if each of the controls is operating effectively. (5 Marks)

(Total 30 Marks)

SECTION B: ANSWER ANY TWO OUT OF THREE QUESTIONS FROM THIS SECTION (40 Marks)

QUESTION 2

The objective of an audit is for the auditor to express an opinion on the truth and fairness of the financial statements.

In the performance of his duty therefore, the auditor seeks to obtain acceptable evidence necessary for him to draw conclusions in order to express a valid opinion on the financial statements.

Required:

a. Describe audit evidence and justify why the auditor would require such evidence. (4 Marks)

b. Identify **FOUR** sources of audit evidence and illustrate how these sources would affect the auditor's reliance on the evidence. (10 Marks)

c. Describe **THREE** attributes of audit evidence. (6 Marks)

(Total 20 Marks)

QUESTION 3

You are the auditor of a Fast Food Company with many sales outlets. The company operates a central system of purchase and supply. The Goods Received Notes and Delivery Notes were not given utmost importance in the issuing and receiving of inventories. The suppliers ledger, stores' ledger and bin cards were not updated regularly. The outlet managers often complained of short supplies and shortages recorded against them regularly.

Two of the outlet managers even complained directly to the Managing Director of the company concerning the shortages recently recorded against them. As a first step to solving the inherent weakness in the company's inventory control process, management decided to undertake a physical inventory count.

Required:

a. Itemise the duties of the auditor in relation to inventories count under the following headings:

   i. Before the count.
   ii. During the count.
   iii. After the count. (9 Marks)

b. Describe **TWO** internal control procedures an auditor would expect the company to put in place in respect of inventories. (5 Marks)

c. In respect of inventories held in the sales outlets, describe the audit procedures an auditor should perform to ensure that the inventories have been properly received, issued and documented. (6 Marks)

(Total 20 Marks)

QUESTION 4

Briefly discuss the following:

a. The scope of the statutory audit as described in the independent auditors' report.
b. The main limitations of an audit.
c. The overall audit strategy.
d. Understanding the entity and its environment. **(Total 20 Marks)**

SECTION C: ANSWER ANY TWO OUT OF THREE QUESTIONS FROM THIS SECTION

(30 Marks)

QUESTION 5

a. Briefly discuss the fundamental principle of Duty of Confidentiality. (6 Marks)

b. In evaluating compliance with the fundamental principles, a chartered accountant may be required to resolve a conflict in the application of fundamental principles. You are required to state and explain what factors he must take into consideration in his evaluation. (9 Marks)

(Total 15 Marks)

QUESTION 6

Delta, Gamma and Co. are the auditors to Hope Limited. The firm proposes to move their office to a new premises and wish to destroy old audit working papers beyond six years while others are to be converted into electronic copies by using scanners. Hope Limited having decided to discontinue with Delta, Gamma & Co. as its auditors had requested that the firm should hand over to their new auditors all the audit working papers of the previous years and the permanent audit file.

Required:

a. Advise Delta, Gamma & Co. on the above scenarios. (5 Marks)

b. Justify why it is important to maintain and keep audit working papers. (5 Marks)

c. State **FIVE** types of information you would expect to see in each of the following:

   i. Permanent audit file
   ii. Current working paper file. (5 Marks)

(Total 15 Marks)

QUESTION 7

Ade, Bala, Chris and Co. are the auditors to Victory Ventures Limited, a chemical manufacturing company. The firm has been carrying out statutory audit for this client for several years. Recently, the company asked the firm to carry out tax planning and compliance advisory services and also perform financial reporting valuation services for the company.

Required:

a. Discuss ethical issues the firm will need to take into consideration in accepting to carry out the new assignments for the client. (5 Marks)

b. Describe the **FIVE** fundamental ethical principles according to ICAN Professional Code of Conduct and Guide for Members and IFAC Code of Ethics. (5 Marks)

c. Describe the differences between rules based and principles based approaches to professional ethics. (5 Marks)

(Total 15 Marks)

SOLUTIONS

SOLUTION 1

ia) "Internal control" as described by the "Committee of Sponsoring Organizations of the Treadway Commission(COSO)" is a process effected by an entity's board of directors, management, and other personnel designed to provide reasonable assurance regarding the achievement of objectives in the following categories.

- Effectiveness and efficiency of operations
- Reliability of reporting
- Compliance with applicable laws and regulations

Internal control is not simply a set of procedures and checks but rather embraces a whole range of activities and attitudes relating to an entity. The International Standard on Auditing (ISA) No 315 requires auditors to obtain understanding of the internal control sufficient to plan the audit and develop an effective audit approach.

(ii) Three categories of internal control objectives are :

- Effectiveness and Efficiency of operations
  This addresses an entity's business objectives including performance and profitability goals, safeguarding of resources from inappropriate use or from loss and fraud and ensuring that liabilities are identified and managed.

  It facilitates effective and efficient operations by enabling it to respond to significant business, operational, financial, compliance and other risks in order to achieve the entity's objectives.

- Reliability of Reporting
  This relates to ensuring the quality of internal and external reporting. This demands the maintenance of proper records and processes that generate a flow of timely, relevant and reliable information within and outside the entity, including financial data derived from such statements.

- Compliance with applicable laws and regulations
  This deals with compliance with applicable laws and regulations to which the entity is subject to and also with internal or corporate policies with respect to the culture of conduct of business.

(iii) The five components of internal control

- The Control Environment
  The control environment is referred to as the general attitude of management and the employees of the entity to internal control. It is said to set the tone of an entity, influencing the control consciousness of its people. The control environment includes the views, awareness and actions of management regarding an entity's internal control. It includes the governance and functions of management and asserts the premise of an organization.

  It is the foundation for all other components of internal control providing guidance, discipline and structure.

- The Entity's Risk Assessment Process
  Significant business risks are any events or omission that may prevent an entity from achieving its objectives. Every entity faces a variety of risks from external and internal sources that must be assessed. Management should, within a strong system of internal control identify, assess and manage business risks on a continual basis. ISA 315 requires the auditor to gain an understanding of these risk assessment processes used by the entity to the extent that the assessment process may affect the financial reporting process.

- Control Activities
  Control activities are the policies and procedures, other than the control environment, that help ensure that the entity's objectives are achieved. The control activities are specific procedures designed to prevent, detect and correct errors that may arise in processing information. The categories include performance reviews, information processing, physical controls and segregation of duties.

- The information system:
  The information system consists of
  - Physical and hardware components
  - Software
  - People
  - Procedures
  - Data

  The information system produces reports containing operational, financial and compliance related information that makes it possible to run and control the entity. It deals with both internally and externally operated data, events, activities and conditions necessary to informed decision- making and reporting.

- Monitoring of Controls
  Internal control system needs to be monitored- a process that assesses the quality of the system's performance, over time. Monitoring should be done on a systematic basis to ensure that the controls remain adequate and are being applied properly. This is done through ongoing monitoring activities in the course of operations and/or separate evaluations- for exceptional reporting to top management as appropriate.

(bi) Internal control weaknesses from the scenario highlighted above include:-

- Personnel-use of inexperienced, unqualified or non-specialised staff for the inventory process and procedure notwithstanding the significant quantity of the fleet and expected high level of spare parts holding.
- Lack of control in the respect of spare parts received- No Goods Received Notes are raised for spare parts received.
- Lack of Physical controls over inventory since inventory records do not exist.
- No segregation of duties.
- The mechanic collects the spare parts without acknowledgement of receipt.
- The mechanic prepares requisition form and collects spare parts directly from the Personal Assistant to the Managing Director without authorization of any superior staff.
- The Invoices and Delivery Notes submitted by suppliers are referred to the accounts department directly for payment.
- No performance review of budgets and actuals on monthly basis and exceptional reports are also not prepared. Leaving the review till the year end by Management may be too late.
- Lack of control over integrity of financial information as there is control risk of material misstatement of inventory figures in the financial statements.
- Absence of internal audit staff/department.

ii. The recommended controls to address the indentified weakness include:

- Engagement of specialized, competent or qualified staff to monitor inventory operations since there is otherwise "pressure of work" for the Personal Assistant to the Managing Director.
- The Goods Received Notes are prepared for spare parts received to check the quantity and quality against the Company's orders and suppliers delivery notes.
- Lack of inventory records could cause avoidable errors and /or fraud therefore management should establish sound recording culture.
- Lack of segregation of duties could increase the likelihood of errors or fraud going undetected.

- Issuance and collections from the store must be acknowledged on the Stores Issue Notes.
- There should be authorisation controls as the mechanic himself initiating requisition and "approving" for presentation to the Personal Assistant for supply should have obtained approval from a superior officer.
- Presentation of invoice directly to the accounts for payment may cause overpayment or unauthorized payments. The invoice should be checked against the company's order and delivery note.
- Lack of performance reviews may affect the achievement of an entity's corporate objectives, therefore management should initiate monthly performance reviews.
- There should be proper recording system of inventory and entire accounting transactions.
- Management may consider establishing an internal audit department.

(iii) The audit tests to be carried out to assess if each of the controls is operating effectively include:

- The control environment as regards appropriate human resources policies as to personnel operating the inventory system are evaluated as to their competence and motivation.
- Examine the process of receipt of spare parts and ascertain if Goods Received Notes (Preferably pre-numbered) are applied for recording of receipts of spare parts from suppliers by a responsible officer and such function acknowledged. Spare parts received should be seen to have been checked for quantity, quality and condition against the company's order.
- Review the operation of the Inventory system to confirm that the inventory control procedures are properly applied for protection against error, loss and/or misuse or fraud.
- Examine the system of approval of requisition and confirm that there is segregation of duties and authorisation control- whereby transactions are authorized by an appropriate person within his/her limit
- Review the payment procedure to ensure that suppliers invoices are checked by the relevant officer for goods received in agreement with order, and that pricing is properly done.
- Performance review control activity should be examined to ensure more timely review by respective level of management.
- Tests should be carried out to confirm that Inventory recording process of the Inventory control procedures are properly instituted and operated
- Review the operations of the internal audit section, if in existence, to assess its effectiveness and relevance.

Marking Guide		Marks
ai. Definition of internal control	2	
Illustration and explanation	2	
		4
ii. Listing (1 mark for each category listed)	3	
(1 mark for each category described)	3	
		6
iii. 1/2 mark for each component listed	2 1/2	
1/2 mark for each component described	2 1/2	
		5
bi 1 mark for each internal control weakness described (subject to a maximum of 5 points)		5
ii. 1 mark for each recommendation (subject to a maximum of 5 points)		5
iii. 1 mark for each audit test described (subject to a maximum of 5 points)		5
		30

EXAMINER'S REPORT

The question tests candidates' knowledge on Internal Control.

Being a compulsory question, about 100% of the candidates attempted the question. Candidates' understanding of the requirements of the question was poor for part (a) and fair for part (b). Performance was therefore average.

The commonest pitfall was failure of candidates to update their knowledge in line with current developments in the profession.

Candidates are advised to be conversant with current dispensation in the profession and should make use of the Institute's Study Text which is current in the course of their study for the examination.

SOLUTION 2

a. Audit Evidence refers to "information used by the auditor in arriving at the conclusions on which the auditor's opinion is based. Audit evidence includes both information contained in the accounting records underlying the financial statements and other information".

The outcome of an audit is a report usually expressing opinion. The said report and opinion must be supportable by the auditor, if challenged. The auditor consequently will collect evidence on which to base his report and opinion.

- International Audit Standards ISA 500 requires auditors to "design and perform appropriate audit procedures for the purpose of obtaining sufficient appropriate audit evidence".
- The Companies and Allied Matters Act CAP C20 LFN 2004 Schedule (6) requires auditors to state if they have obtained all the information and explanations which to the best of their knowledge and belief are necessary for the purpose of their audit.

b. The sources of evidence include:

(i) Accounting System
(ii) Accounting records
(iii) Documents
(iv) Management and Staff
(v) Suppliers
(vi) Lenders and borrowers
(vii) Professional advisers

The manner in which the above sources of audit evidence will affect the auditors' reliance on the evidence include:

i) Audit evidence is more reliable when it is obtained from independent sources outside the entity under audit. Examples of these are:
   - Bank confirmation letters
   - Circularisation letters-Receivables and Payables
   - Suppliers statements

(ii) The evidence obtained by the auditor as a result of their own tests and procedures is more reliable than evidence obtained indirectly or by inference. The tests and procedures include:
   - Compliance test of controls
   - Substantive tests

- Observation of company procedures e.g. wages payment, Inventory count
- Inspection of documents

External source: Title deeds, contract agreements, sales invoices
Internal source: Minutes of meeting, Accounting records

(iii) Internally generated documents are more reliable when the related internal controls are effective

(iv) Audit evidence is more reliable when it exists in documentary form- paper or other medium.

(v) Audit evidence provided by original documents is more reliable than copy documents or documents transformed into electronic form.

(vi) Representations made by management of an entity is considered the least reliable form of audit evidence.

(c) The three attributes of Audit Evidence are Sufficiency, Appropriateness-Relevance and Reliability

(i) Sufficiency:

Deciding the sufficiency of audit evidence is a matter of judgment by the auditor, the quantity and also the quality of the evidence required.

The Auditor's judgment is usually influenced by:

- The knowledge of the entity
- Degree of the audit risk

Other factors the auditor will consider include:

- Materiality of the item
- Strengths of the internal controls in the entity's accounting system
- The sampling method adopted to obtain the audit evidence.

(ii) Relevance

Audit evidence must be relevant to the matter under consideration. ISA 500 states that relevance deals with the logical conclusion with or bearing upon the purpose of the audit procedure and where appropriate, the assertion under consideration. A good audit procedure may provide audit evidence that is relevant to certain assertions but not others. Relevant audit evidence would include identifying conditions that indicate performance of a control and deviation conditions.

(iii) Reliability

This relates to the extent to which the auditor can base his opinion on the evidence. ISA 500 sets out general principles to assist the auditor in assessing the reliability of audit evidence. These include:

- Audit evidence is more reliable when obtained from independent sources outside the entity under audit.
- Internally generated audit evidence is more reliable when the related controls are effective.
- Audit evidence obtained directly by the auditor is more reliable than audit evidence obtained indirectly or by inference.
- Audit evidence is more reliable when it exists in documentary form.
- Audit evidence provided by original documents is more reliable than audit evidence provided by photocopies.

Marking Guide	Marks	
a. Definition/description of audit evidence	2	
Justification	2	4
b. 1 mark each for listing of four sources	4	
$1^{1/2}$ Marks each for illustrating how the sources will affect reliance.	6	
		10
c. 1 mark each for three attributes listed	3	
1 mark each for description of three attributes	3	
		6
		20

EXAMINER'S REPORT

The question, tests candidates' knowledge on audit evidence.

About 95% of the candidates attempted the question. Notwithstanding that the area tested is very common in auditing, candidates understanding of the question was very poor in part (b) but fair in parts (a) and (c).

Their commonest pitfall was taking methods and techniques of collecting audit evidence for sources.

Candidates should understand the requirements of the question before answering and they should widen the scope of their study.

SOLUTION 3

a. The duties of the auditor in relation to inventory count include the following:

(i) Before the count

- The auditor should review the audit files of the previous year and plan to make sure that the previous years' inventory count problems are not repeated.
- Review the client entity's count instructions and suggest appropriate changes where necessary.
- Confirm the date, time and location of the counts
- Decide which counts at which location will be observed by members of the audit team
- Decide when written confirmation is needed for inventory held by third parties
- -Make arrangements for a local firm of auditors to attend a physical count location if the audit firm's staff are unable to attend
- Consider the possible use of client's internal audit department (where available) which may be involved in checking inventory counts.
- Request for appropriate number and grade of audit staff to observe the counts
- Circulate the count instructions to the responsible audit staff and invite their opinion or comments
- Consider giving particular attention to high value, complex or specialized inventory
- Decide the scope of audit testing to be performed during the count, based on materiality and risk considerations.
- Consider if there is need for the use of expert to assist in the count of complex items.

(ii) During the count

The auditor should observe

- The count and make his own records
- Whether or not the count is carried out according to client's instructions
- The condition of the inventory in order to identify items where the Net Realisable Value might be below cost, and note the particular inventory items.
- Whether or not inventory not owned by the client is properly indentified and labelled

- Whether or not during the count, production of new inventory and the movement thereof are controlled and properly documented, in accordance with management's instructions for the count.
- Whether or not all inventory items have been counted and tagged accordingly
- The auditor should also make test counts during the counts, comparing the quantity of the sample selected with the inventory count list for "completeness" and also select a sample from the client's count list and physically count himself for "existence" tests.
- The auditor should make a record of the sequence numbers and summary sheets during the count to confirm all inventory items are included in the inventory list.
- The auditor should record cut-off information for confirmation of the cut-off assertion. He should record details of last few Goods Received Notes and Dispatch Notes and the first Goods Received Notes and Dispatch Notes after the count,
- The auditor should record details of damaged, slow moving or obsolete inventory to support the valuation assertion.
- The auditor should prepare an Inventory Count Memorandum recording his observation and conclusions thereon, in the audit file.

(iii) After the count

The audit work in verifying inventory quantities should include:

- Obtain the final client's inventory count sheets
- Cross check the numerical sequence of the count sheets to the auditor's record for completeness
- Check if the client's final tag number corresponds with the auditor's records
- Check and confirm that the arithmetical calculation on the sheets are correct
- Confirm that inventory belonging to the client but held by third parties is included in the inventory sheets.
- Confirm that inventory belonging to third parties but on the client's premises at the count rate is not included in the inventory sheets
- Check that the cut-off is correct
- Review reports of experts where engaged

b. The internal control procedures an auditor would expect the company to put in place in respect of inventory include:

Area/Process	Internal Control procedure
i. Complete and accurate Inventory Recording	- There should be segregation of duties between ordering, custody and accounting. - There should be proper documentation for inventory movement
ii. Physical safeguards	- There should be restricted access to storage areas. - Regular inventory counts should be performed using appropriate procedures. - Inventory should be stored in the appropriate storage conditions
iii. Valuation	- International Accounting Standard (IAS) No 2 should be applied. - There should be procedures for identifying obsolete, slow moving and damaged inventory items
iv. Inventory Management at appropriate levels	- There should be maximum and minimum inventory levels for all items of value. - There should be re-order level and re-order quantities to obviate loss of goodwill and incurring unnecessary inventory holding costs

c. In respect of inventory held in the sales outlets, the audit procedures an auditor should perform to ensure that the Inventories have been properly received, issued and documented include to

- Check the requisition from the sales outlet and confirm that it bears approval from a responsible officer.
- Confirm the receipt from the sales outlet Goods Received Note
- Check the way bill or dispatch notes to the outlet to confirm receipt of Inventory items in good condition.
- Ascertain that issuance of inventory from the sales outlet is at the recommended or approved price
- Confirm that the head of the sales outlet bears full responsibility for the physical control of the inventory.
- Observe physical inventory counts at the year end on rotational basis if all the outlets cannot be covered simultaneously
- Confirm that reconciliation of inventory quantities are done periodically between the outlets and the head office
- Record and confirm cut-off information
- Scrutinise returns from outlets
- Obtain Inventory Certificates, as needed, from the outlet managers
- Ensure that competent staff are employed as outlet managers.

Marking Guide		Marks	
ai.	Duties of auditor before the count		
	(1 mark each for maximum of three duties)	3	
ii.	Duties of auditor during the count		
	(1 mark each for maximum of three duties)		
iii.	Duties of auditor after the count	3	
	(1 mark each for maximum of three duties)	3	
			9
b.	1 mark for each internal procedure listed		
	(Subject to a maximum of two points)	2	
	$1^{1/2}$ marks for each Internal Control procedure described	3	
			5
	(viii) 2 marks for description of audit procedures an auditor performs		
	(Subject to a maximum of three points)		6
			20

EXAMINER'S REPORT

The question is on Inventory counts and internal control procedures in relation thereto. About 60% of the candidates attempted the question and performance was below average.

Candidates' commonest pitfall was their inability to relate academic knowledge to practical or real life situations.

Candidates are adviced to study hard and relate the knowledge acquired to practical situations.

SOLUTION 4

a. The scope of the statutory audit as described in the Independent Auditors' report states that" An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of:

- Whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed.
- The reasonableness of significant accounting estimates made by the directors.
- The overall presentation of the financial statements."

This evidently informs the users of the financial statements that the auditor does not test 100% of the transactions of an entity and that the information in the scope of the audit is garnered from the clients records and other relevant financial information, applying rules and guidelines obtained from relevant International Accounting Standards, International Statements on Auditing and other guidelines and relevant legislations.

b. The main limitations of an audit include:

i. Post Mortem Process – Audit is a post-mortem process. It may not reflect the current realities of the situation in the enterprise. Things may have gone awry before the audit exercise.

ii. Use of Professional Judgment: Audit involves the use of judgment in the identification of audit risk, selection of appropriate auditing procedures and the interpretation of audit evidence. Although auditing standards provide guidelines to assist auditors in forming sound professional judgments, it is inevitable that an auditor may at times misjudge a situation which may cause the auditor to overlook a misstatement in the financial statements.

iii. Use of Sampling: Auditors apply sampling techniques to limit the number of transactions and balances selected for audit testing in order to perform the audit, cost effectively and efficiently. The results derived from the selected transactions and balances may not however be representative of the entire population. There is therefore an inherent risk that the audit procedures may fail to detect a material misstatement in the financial statements due to the inability of auditors to perform detailed testing of the entire population of transactions and balances.

iv. Management Representation: Generally, external evidence is considered to be a more reliable form of audit evidence than internal evidence produced by management. Although auditors collect audit evidence from a range of sources, too often they have to rely on the representations from management in order to assess the reasonableness of the matters concerning financial statements. This is particularly the case in matters that involve the use of judgment by management as it is usually difficult to corroborate management representations about the appropriateness of their judgment with external evidence.

v. Risk of Fraud: By their very nature, frauds are intended to be concealed by the perpetrators and therefore pose a very high risk of remaining undetected by the auditors even in spite of the application of sound audit methods and procedures.

vi. Time constraints: In practice, auditors face strict time constraints within which they have to provide their opinion on the financial statements. Auditors tend to prioritize tasks that are essential for the effective performance of the audit. In some cases, particularly where there is legal requirements for companies to publish their financial reports within a certain time frame, the auditors may in a bid to meet the assignment deadlines, fail to consider an important matter in the finalization of the audit report.

vii. Independence threats: whereas the ethical guidelines issued by IFAC and other professional bodies attempt to minimize the instances of loss of objectives of auditors, certain level of conflicts of interest are inevitable in practice. The perceived independence of an auditor is for instance impaired where a client accounts form a significant portion of the revenue of the audit firm.

viii. Scope: Audit procedures are designed to detect material misstatements in the financial statements and focus on the financial aspects of transactions and events. Non-financial matters are generally not considered in the performance of the audit unless they have relevance to the financial statements. Stakeholders often misinterprete the role and scope of an external audit.

ix. Audit Opinion

The Audit opinion of the auditor is considered not a “certificate” of assurance of accuracy.

This may serve as a constraint for dependence on the audited financial statements for informed decision making.

x. Cost

The cost of statutory audit may be considered high especially for small and medium sized entities.

c. The overall audit strategy

The International Standard on Auditing ISA 300 requires the auditor to establish an overall audit strategy which sets the scope, timing and direction of the audit and guides the development of the more detailed audit plan.

The establishment of the overall audit strategy involves:

(i) Determining the characteristics of the engagement that defines its scope such as
  - The financial reporting framework used (e.g. IFRS)
  - Any industry reporting requirements
  - The locations of units or branches of the entity

(ii) Ascertaining the reporting objectives of the engagement e.g. reporting deadlines and nature of communication required.

(iii) Considering important factors which will determine the focus of the audit team's effort, like
  - Materiality threshold
  - High risk areas of the audit
  - The audit approach
  - Recent developments in relation to the entity, industry and financial reporting requirements.

(iv) Determining the nature, extent and timing of resources needed to perform the engagement such as
  - The level of audit staff to be deployed e.g. more experienced staff for high risk arrears
  - The number of staff needed for specific areas
  - The time that the resources are needed
  - How the resources are to be managed, directed and supervised

d. Understanding the entity and the environment. The International Standards of Auditing (ISA) No 315 requires that the auditor will need to form an understanding of the entity and its environment in order to prepare the overall audit strategy and audit plan.

The factors that the auditor will consider include:

(i) The industry in which the entity operates
(ii) The nature and competences of management
(iii) The entity's internal control system
(iv) The current financial results
(v) Reporting deadlines and requirements
(vi) Any recent developments.

Understanding the entity and the environment will enable the auditor identify and assess the risks of misstatement whether due to error or fraud. The risk assessment process will provide a basis for designing and implementing responses to the assessed risks which will now take the form of audit procedures.

Marking Guide			Marks
a.	4 marks for description of scope of statutory audit 1 mark for further explanation on the scope of statutory audit		5
b.	1 mark for each limitation (subject to a maximum of 5 points)		5
c.	3 marks for description of audit strategy	3	
	1 mark for valid procedure of audit strategy (subject to a maximum of 2 points)	2	5
d.	1 mark for introduction of entity and its environment	1	
	1 mark for each factor to be considered to the understanding (subject to a maximum of 4 points)	4	5
			20

EXAMINER'S REPORT

The question tests candidates' knowledge as regard scope, limitation and strategy on statutory audit.

About 60% of the candidates attempted the question, and performance was poor in sections (a) and (c) but fair in sections (b) and (d).

The commonest pitfall was misinterpretation of the requirements of the question in part (a) where candidates discussed the objectives of statutory audit instead of the "scope" required.

Candidates are advised to work hard and understand the questions before attempting it.

SOLUTION 5

a. One of the five fundamental principles of the ICAN Professional Code of Conduct and Guide for Members and IFAC is Code of Ethics is Confidentiality. The principle states that information obtained in the course of professional work should not be disclosed to others, except in the following circumstances

- Consent has been obtained from the person or entity to which the information relates
- There is a legal or professional right of duty to disclose

Also, information gained when acting in a professional capacity should not be disclosed in order to

- Gain a personal advantage
- Gain advantage for another party

A major reason for the principle is that if any client cannot be assured of the confidentiality of information, he may be unwilling to provide the auditors with all the information they require.

In applying this principle,

- A chartered accountant should maintain confidentiality even in social environment.
- Scope of the duty in confidentiality not only covers existing clients but also covers a prospective client or employer.
- A chartered accountant should also maintain confidentiality of information within the firm or employing organization.
- A chartered accountant should ensure that his staff and other stakeholders respect the duty of confidentiality
- The need for confidentiality continues even after the chartered accountant has disengaged from the client or the employer.

b) In evaluating compliance with the fundamental principles, the factors a chartered accountant may take in his evaluation to resolve a conflict include the following:

i) Consideration of

- The relevant facts of the issue at hand
- Ethical issues involved
- Fundamental principle related to the particular matter
- Established internal procedures
- Alternative courses of action.

The chartered accountant will, after considering the issues above, determine the appropriate course of action that is consistent with the identified fundamental principles whilst bearing in mind the consequences of each course of action. If the matter remains unresolved the chartered accountant should consult with other appropriate persons within the firm or employing organization for assistance in resolving the issue.

The chartered accountant should also consider consulting those charged with governance of an organization if a matter involves a conflict with or within such organization.

ii) Non Resolution

If a significant conflict cannot be resolved, a chartered accountant may seek professional advice from the Institute or legal advisers without breaching confidentiality. If after exhausting all relevant possibilities, the ethical conflict remains unresolved, a chartered accountant, where possible, should dissociate himself from the matter creating the conflict and he may even decide to withdraw from the engagement team or the specific assignment. He may decide to even resign from the firm or the employing organization.

Marking Guide	Marks	
a. 3 marks for description of fundamental principle of duty of confidentiality	3	
1 mark for application (subject to a maximum of three points)	3	6
b. 2 marks for stating and explaining factors to be taken Into consideration (Subject to a maximum of 3 points)	6	
1 mark for stating the conclusion (subject to a maximum of Three points)	3	9
		15

EXAMINER'S REPORT

The question tests candidates' knowledge of ethical principles on Duty of Confidentiality and resolution of conflicts.

About 30% of candidates attempted the question and performance was fair in part (a), but poor in part (b).

The commonest pitfall was mistaking of fundamental principles of duty of confidentiality as threats to auditors' duty.

Candidates should prepare well for the examination utilizing reading materials as ICAN Study Text and other relevant literature.

SOLUTION 6

a

i. The firm, Delta, Gamma & Co is believed to possess the right to destroy old audit working papers after 6 years if it has satisfied the requirements of the Limitation Act, but the firm will be wise to retain information about any non-routine, extraordinary, or contentious issues on which they had to take a decision.

ii. Audit working papers can be in paper or electronic form. It is believed that Delta, Gamma & Co can convert the working papers into electronic copies so far as stated in International Standards of Auditing (ISA) No 230, the audit working papers (audit documentation) provide

- A sufficient and appropriate record of the basis for the auditors' report
- Evidence that the audit was planned and performed in accordance with International Standards of Auditing and applicable legal and regulatory requirements. The conversion may be beneficial to the firm if it decides not to destroy old audit working papers but to convert them into electronic form for retention of working papers of over six years, for prudence sake.

iii. Ownership of the audit working papers rests with Delta, Gamma & Co but the books of account, originals of bank statements, deeds, invoices etc, if in the firm's possession, should be returned to the client company -Hope Limited, subject to the fact that Hope Limited is not owing Delta, Gamma & Co- since the audit firm can exercise lien over the books and records for unpaid fees.

c. Importance of maintaining and keeping audit working papers include:

(i) To serve as evidence of the planning of the audit and the design of audit procedures

(ii) To control the current year's work
   - Recording of the current year's detailed testing including compliance and substantive testing and analytical review.
   - Recording of the conclusions drawn from the audit tests performed.
   - Recording evidence of review at each stage of the audit testing
   - To enable the audit team to be accountable for its work

(iii) To serve as evidence of audit work carried out in line with the audit programme and the review carried out at a more senior level

(iv) To assist the members of the audit team responsible for supervision to direct and supervise the audit work

(v) To enable evidence to be available in the final review stage so that it can be considered whether the financial statements show a true and fair view and comply with statutory and regulatory requirements.

(vi) To record the rationale for departure from the International Standards on Auditing if the situation demands and the final tests carried out.

(vii) To enable an experienced auditor conduct quality control reviews and inspection or external inspections as required by legal or regulatory requirements.

(viii) To form a basis for the plan of the audit of the following year.

(c) Information expected to be found in the audit files include:

(i) Permanent audit file. The information that is likely to be significant to every annual audit. The information include:

- legal constitution of the company(Memorandum and Articles of Association and Certificate of Incorporation).
- other important legal documents such as loan agreements, deeds, contracts, minutes etc
- A summary of the history, development and ownership of the business
- A summary of accounting systems and procedures
- Copies of previous years' financial statements with key ratios, indicators and trends
- The organogram of the entity
- Advisors like Lawyers, Bankers
- Engagement letter

(ii) Current audit working paper file: This file contains information of relevance to the current year's audit which include

- The final financial statements
- A summary of audit adjustments including those not included in the final figures
- Audit letters and reports
- For each audit areas like Inventory, Bank and Cash, payables etc.
    - Audit programme
    - Details of tests, performance and conclusion
    - Lead or summary schedules
- Audit Plan
- Minutes
- Analytical Review and statistics
- A description of the internal control system in the form of internal control questionnaire, flowcharts, or written systems description together with specimen documents.
- Lists of audit queries and their dispositions

- A checklist showing compliance with statutory disclosure requirements.
- Other relevant information

Marking Guide			**Marks**
a.	1 mark for the advice on retention of working papers	1	
	2 marks for advice on conversion to electronic form	2	
	2 marks for advice on ownership and transfer of working papers	2	5
b.	1 mark for each important point to maintain and keep audit working papers (subject to a maximum of five points)	5	
c.	i. $^1/_2$ mark for each type of information to be found in a permanent audit file (subject to a maximum of five points	$2^{1/2}$	
	ii. $^1/_2$ mark for each type of information to be found in a current audit file (subject to a maximum of five points)	$2^{1/2}$	
			5
			15

EXAMINER'S REPORT

The question is on audit documentation as regards Audit Working Papers and Audit files.
Part (a) seeks for advice in a given scenario.

Part (b) Tests on justification for the importance of maintaining audit working papers
Part (c) Tests Candidates' knowledge concerning contents of audit files.
About 85% of the candidates attempted the question and performance was average.

The commonest pitfall especially in part (a) was the inability of candidates to apply their knowledge to practical scenarios.

Candidates should cultivate the ability to interprete scenarios and advise accordingly.

SOLUTION 7

a. The ethical issues the firm of Ade, Bala, Chris & Co will need to take into consideration in accepting to carry out new assignments for Victory Ventures Limited include:

(i) Tax Planning and Compliance Advisory Services: These services are not considered by the professional code of conduct of IFAC/ICAN to threaten independence. But if the audit firm earns a significant large amount of income on these assignments from Victory Ventures Limited which makes Ade, Bala, Chris & Co to be economically dependent on the company, there may be self-interest threat

(ii) Financial Reporting Valuation Services:

A self-review threat might arise if Ade,Bala, Chris & Co performs valuation services for items to be included in the financial statements to be audited. The audit firm should not provide valuation services where

- The matter is material to the financial statements
- The services involve significant degree of subjectivity.

The safeguards which may be though relevant for the performance of the valuation services include

- The company acknowledging responsibility for the result of the work
- The company confirming their understanding of and approving the underlying assumptions and methodologies used
- An additional/another professional accountant reviewing the work done
- The audit staff carrying out the assignment not being involved in the audit.

b. The five fundamental ethical principles are:

(i) Integrity

Members are expected to be straightforward and honest in all professional and business relationships. Integrity implies not just honesty but also fair dealing and truthfulness.

(ii) Objectivity

Members should not allow bias, conflicts of interest or undue influence of others to override their professional or business judgments.

(iii) Professional competence and due care

Members 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. Members should act diligently and in accordance with applicable technical and professional standards.

(iv) Confidentiality

Members should respect the confidentiality of information acquired as a result of professional and business relationships and should not disclose such information to third parties without authority unless there is a legal and professional right or duty to disclose. Confidential information acquired as a result of professional and business relationships should not be used for the personal advantage of members or third parties.

(v) Professional behaviour

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

(c) (i) Rules-based approach

The regulatory body will issue code of ethics for accountants that contain specific rules about how to act in specific situations. The attending weaknesses of this approach include:

- There are many situations a professional accountant might face when an ethical decision must be taken. It might be impossible to plan ahead for every type of ethical problem that will arise because of likely attendant complex and varied circumstances, so it is not flexible.
- Over time, ethical dilemmas that an accountant might face could change, as the business environment changes. It might then be necessary to review and update the rules regularly.

- Ethical views differ between countries and cultures. Behaviour that might be considered somewhat unethical in a country might be perfectly normal and acceptable in another country. A rule book cannot easily make allowances for national and cultural difference in ethical viewpoint.

(ii) Principles-based approach

The principles-based approach to professional ethics for accountants is whereby the code specifies general principles of ethical behavior and requires the accountant to act in accordance with the principles.

The accountant is required to use judgment whether in each case; a particular course of action is a proper or ethical one. But a likely disadvantage is that since this approach requires judgment on the part of the accountant, differing interpretations may arise. It should however be noted that IFAC and ICAN Code of Ethics are principles based.

Marking Guide		**Marks**	
a.	2 marks for tax planning and compliance advisory services	2	
	3 marks for financial reporting valuation services	3	5
b.	1 mark for each listing and explanation (Subject to a maximum of five points)		5
c.	Explanation - 1 Mark each (two points)	2	
	$1^1/^2$ marks for each difference (subject to a maximum of two points)	3	
			5
			15

EXAMINER'S REPORT

The question tests candidates' knowledge of fundamental ethical principles.

About 85% of the candidates attempted the question and performance was poor in part (a) but good in parts (b) and (c).

The commonest pitfall was poor understanding of the questions by the candidates.
Candidates should prepare adequately for the examination.

SKILLS LEVEL EXAMINATION – NOVEMBER 2015

TAXATION

Time Allowed: 3 hours

SECTION A: COMPULSORY QUESTION (30 Marks)

QUESTION 1

Quickfix Limited deals in the sale of Sweetmilk brand of drink. The company commenced business on 1 May 2000. Due to the prohibitive cost of doing business in Nigeria, it decided to cease business on 1 July 2012. The following information were extracted from its records:

Year of Assessment	Assessable Profit/(Loss)	Capital Allowance	Total Profit	Tax Paid
	₦	₦	₦	₦
2007	(1,921,400)	4,681,450	——	——
2008	3,942,000	5,817,000	1,314,000	394,200
2009	9,201,750	4,168,500	3,067,250	920,175
2010	7,581,750	6,633,000	2,527,250	758,175
2011	11,580,750	9,058,000	3,860,250	1,158,075
2012	4,664,375	4,190,500	1,554,790	466,438

The company made a claim for unutilised capital allowances to be carried back. During the period, 1 January to 30 June 2013, the adjusted loss of the company was ₦1,614,500. Capital Allowance due was ₦2,561,250.

The tax computations as agreed are as follows:

(i) Accounting year ended 31 December 2006:

2007 Year of Assessment	₦
Loss	(1,921,400)
Capital allowances carried forward	4,681,450

(ii) Accounting year ended 31 December 2007:

2008 Year of Assessment	₦	₦
Total Assessable Profit		3,942,000
Deduct: Loss brought forward		(1,921,400)
		2,020,600

Deduct: Capital allowances:		
Unutilised capital allowance brought forward	4,681,450	
Current year	5,817,000	
	10,498,450	
Restricted to $^2/_3$ of Assessable Profit	(1,347,067)	(1,347,067)
Unutilised Capital allowance c/f	9,151,383	
Total profit		673,533
Companies Income Tax payable @30% of ₦673,533		202,060

(iii) Accounting year ended 31 December 2008:

2009 Year of Assessment	₦	₦
Assessable Profit		9,201,750
Deduct: Capital allowances:		
Brought forward	9,151,383	
Current year	4,168,500	
	13,319,883	
Restricted to $^2/_3$ of Assessable Profit	(6,134,500)	(6,134,500)
Unutilised Capital Allowance	7,185,383	
Total Profit		3,067,250
Companies Income Tax payable @30% of ₦3,067,250		920,175

(iv) Accounting year ended 31 December 2009:

2010 Year of Assessment	₦	₦
Assessable Profit		7,581,750
Deduct: Capital allowances:		
Brought forward	7,185,383	
Current year	6,633,000	
	13,818,383	
Restricted to $^2/_3$ of Assessable Profit	(5,054,500)	(5,054,500)
Unutilised Capital Allowance	8,763,883	
Total Profit		2,527,250
Companies Income Tax payable @ 30% of ₦2,527,250		758,175

(v) Accounting year ended 31 December 2010:

2011 Year of Assessment	₦	₦
Assessable Profit		11,580,750
Deduct: Capital Allowances:		
Brought forward	8,763,883	
Current year	9,058,000	
	17,821,883	
Restricted to $^2/_3$ of Assessable Profit	(7,720,500)	(7,720,500)
Unutilised Capital Allowances	10,101,383	
Total Profit		3,860,250
Companies Income Tax payable		
@ 30% of ₦3,860,250		1,158,075

(vi) Accounting year ended 31 December 2011:

2012 Year of Assessment	₦	₦
Assessable Profit		4,664,375
Deduct: Capital Allowances:		
Brought forward	10,101,383	
Current year	4,190,500	
	14,291,883	
Restricted to $^2/_3$ of Assessable Profit	(1,399,313)	(1,399,313)
Unutilised Capital Allowance c/f	12,892,570	
Total Profit		3,265,062
Companies Income Tax payable		
@ 30% of ₦3,265,062		979,519

Required:

As the Chief Inspector of Taxes,

a. Compute the revised assessment of Quickfix Limited on cessation basis, taking into account unutilised capital allowances.

b. Determine the tax refundable by Federal Inland Revenue Service (FIRS) for the relevant years of assessment. **(Total 30 Marks)**

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

(40 MARKS)

QUESTION 2

a. What are the specific particulars to be included in a Notice of Appeal against an assessment pending before a Tax Appeal Tribunal? (5 Marks)

b. Explain the procedure for an appeal against the decision of a Tax Appeal Tribunal. (5 Marks)

c. As a Tax Consultant, the Managing Director of your client brought an Assessment Notice served on the company by the Federal Inland Revenue Service complaining that the assessment was outrageous. You observed that the amount assessed was higher than the assessment based on the documents submitted by you.

Required:
State what you would advise your client to do under this circumstance.

(10 Marks)
(Total 20 Marks)

QUESTION 3

Mr. Babangida Muhammed was employed as General Manager by Casio Nigeria Limited, a subsidiary of a United Kingdom-based holding company. He commenced the employment on 1 January 2013.

He has provided the following details:

	2013	2014
	₦'000	₦'000
Basic salary	5,400	6,000
Rent subsidy	1,800	1,800
Furniture grant	600	600
Entertainment allowance	660	660

Other benefits:

(i) The company provided him a brand new car valued at ₦3,800,000.

(ii) A scholarship worth ₦500,000 per annum was awarded to two of his four children attending a government approved private university by his employer.

Mr. Babangida Muhammed has approached your firm to assist him in determining his personal income tax liability for the last two years and also assist in obtaining a current Tax Clearance Certificate on his behalf from his relevant tax authority. Your firm is also to determine whether he had underpaid his tax for the previous two years and if so, how much additional tax he may be required to pay.

He has also supplied you with the following additional information:

		2013	2014
		₦	₦
•	Gratuity from his former employment	240	-
•	Rental income (Gross)	600	600
•	Interest received on Fixed Deposit Account	75	90
•	Annual premium paid on life assurance policy	100	100
•	Contribution to National Housing Fund	$2^1/_2$%	$2^1/_2$%
•	Contribution to National Pension Scheme	$7^1/_2$%	$7^1/_2$%

- Contribution to National Housing Scheme is based on his annual Basic Salary, while National Pension Scheme is based on his Annual Total Emoluments.
- The sum assured on the Life Assurance Policy is ₦2,000,000 while the sum of ₦45,000 was spent on repairs to property.
- He spent a total sum of ₦480,000 to maintain his aged parents.
- The actual amount he paid in respect of Personal Income Tax Liability for each of the relevant years was ₦850,000 and ₦960,000 respectively.

You are required to advise Mr. Babangida Muhammed highlighting the following:

a. The Personal Income Tax payable in 2013 and 2014 Years of Assessment. (16 Marks)

b. The effect of previous payments on the tax payable. (4 Marks)

(Total 20 Marks)

QUESTION 4

a. Mr. Alexis Sanchez was employed by Zenon Ltd as Director Commercial, West and Central Africa with effect from 1 March 2011. He entered Nigeria on the date his employment became effective and remained in Nigeria till 25 August 2011. He returned to Nigeria on 15 January 2012, and remained in Nigeria till 31 July 2012.

Required:

Explain the basis for the taxation of income earned by Mr. Alexis Sanchez in Nigeria for the relevant tax years.
(5 Marks)

b. Mr. Abass works with the Federal Ministry of Works, Abuja. He lives in a self-contained flat in Gwagwalada and travels every weekend to see his first wife and children in Kaduna. He also visits and stays with his second wife and children in Nyanya, Nassarawa State on Thursdays and Fridays of every week.

Required:
Determine the tax authority to which Mr. Abass would be liable to tax in any year of assessment. (5 Marks)

c. Explain the following terms in relation to First Schedule to the Personal Income Tax Act 2011 (as amended):

i. Resident individual,
ii. Non-resident individual,
iii. Residence and nationality,
iv. Place of residence,
v. Principal place of residence.

(10 Marks)

(Total 20 Marks)

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

QUESTION 5

a. i. Briefly highlight the main features of Withholding Tax.
ii. State the relevant tax authorities in relation to Withholding Tax in Nigeria.
iii. Enumerate the contents of a Payment Schedule for the remittance of Withholding Tax.
(6 Marks)

b. Adebola Nigeria Limited has been trading for many years. The company makes up its accounts to 31 December, annually.

The extracts from its Statement of Comprehensive Income for the years ended 31 December 2013 and 2014 (as adjusted for tax purposes) are as follows:

Year ended 31 December	**2014**	**2013**
	(₦)	**(₦)**
Profit for the year	14,000,000	10,000,000
Bank interest received (gross)	2,400,000	1,600,000
Debenture interest received (gross)	800,000	800,000
Dividend received from Adesemowo Ltd. (Net)	720,000	720,000
Dividend paid to shareholders (gross)	6,000,000	4,000,000

Required:

i. Compute the company's tax liabilities for the relevant years of assessment. Ignore capital allowances.
(5 Marks)

ii. Determine the net withholding tax payable or receivable by Adebola Nigeria Limited, arising from dividends paid and received by it. (4 Marks)

(Total 15 Marks)

QUESTION 6

As part of the induction programme for the newly recruited staff of your firm of Tax Consultants, you have been saddled with the responsibility of making a presentation on companies tax computation for beginners during the firm's training session.

The following data were submitted for the purpose of the training:

JohnGab Limited, a training company was incorporated on 1 June 2008 but commenced business on 1 September 2008. The following information is made available to you:

Period	**Assessable Profit**
	₦'000
Four month-period ended 31 December 2008	37,500
Year ended 31 December 2009	60,000
Year ended 31 December 2010	90,000

The following assets were purchased during the period:

	₦'000
5 June 2008 - Land and building	17,500
1 July 2008 - Motor car	6,000
15 October 2008 – Machinery	14,000
28 February 2009- Furniture	3,750
1 May 2009 -Delivery van	5,000

In order to clearly explain the extant rules on computation of capital allowances by companies, **you are required to:**

a. State the basis periods of assessment and compute the total capital allowances for the first **FIVE** years of assessment. (5 Marks)

b. Calculate the capital allowances due to be utilised for the first three years of assessment in respect of the qualifying capital expenditure incurred by the company. (5 Marks)

c. Compute the company's tax liabilities for the first three years of assessment. (5 Marks)

(Total 15 Marks)

QUESTION 7

Chief Sarki Oliver died peacefully in his sleep on 31 December 2009. He is survived by three children – Jimmy, Ngozi and Charles. Two Trustees were appointed for the Settlement created in favour of the children to ensure that they were not badly affected by the demise of their father. Details presented by the two Trustees for the year ended 31 December 2010 are as follows:

	₦'000
Rental income (gross)	225,000
Trading income	250,000
Dividends (gross)	170,000
Interest on bank deposit	107,500
Sundry income	105,000

The following additional information is provided:

(i) The Interest income is from Super Bank plc

(ii) Administrative and other expenses amounted to ₦32,000

(iii) Interest on debt repayment by the Settlement was ₦25,000

(iv) Fixed annuity to a beneficiary was ₦41,000 (Gross)

(v) Each beneficiary is entitled to $^1/_5$ share of the net distributable income

(vi) Under the terms of the Trust Deed, the Trustees made discretionary payments to:
- Jimmy ₦30,000
- Ngozi ₦26,000
- Charles ₦15,000

(vii) Capital allowances - ₦64,000

(viii) Trustees' remuneration:
Deed: Fixed amount of ₦25,000 each plus 2% of Computed Income.

(ix) The children have no other income.

In view of the recent agitation by the extended family members, you were contracted as a consultant to compute the following:

a. Income tax payable by the Trustees on the Trust income. (8 Marks)

b. The amount due to each beneficiary of the Settlement. (7 Marks)

(Total 15 Marks)

NIGERIAN TAX RATES

1. **CAPITAL ALLOWANCES**

		Initial %	Annual %
Office Equipment		50	25
Motor Vehicles		50	25
Office Buildings		15	10
Furniture and Fittings		25	20
Industrial Buildings		15	10
Non-Industrial Buildings		15	10
Plant and Machinery	- Agricultural Production	95	Nil
	- Others	50	25

2. **INVESTMENT ALLOWANCE** 10%

3. **RATES OF PERSONAL INCOME TAX**

Graduated tax rates with Consolidated Relief Allowance of ₦200,000 or 1% of Gross Income whichever is higher + 20% of Gross income.

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

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

4. **COMPANIES INCOME TAX RATE** 30%

5. **TERTIARY EDUCATION TAX** 2% of Assessable Profit

6. **CAPITAL GAINS TAX** 10%

7. **VALUE ADDED TAX** 5%

SOLUTIONS

SOLUTION 1

QUICKFIX LIMITED
COMPUTATION OF REVISED ASSESSMENTS
FOR THE RELEVANT YEARS (ON CESSATION BASIS)

	N	N
Assessment Year 2012 (1/1/12 – 30/6/12)		
Adjusted Loss		(1,614,500)
Deduct:		
Unutilized Capital Allowances carried backward	12,892,570	
Current – for the period	2,561,250	
Unutilized Capital Allowances on cessation	15,453,820	

	N
Assessment Year 2011	
Total Profit	3,860,250
Unutilized Capital Allowances carried backward	(15,453,820)
Unutilized Capital Allowances carried backward	(11,593,570)
Companies Income Tax Liability	Nil
Tertiary Education Tax Liability	Nil

	N
Assessment Year 2010	
Total Profit	2,527,250
Unutilized Capital Allowances carried backward	(11.593,570)
Unutilised Capital Allowances carried backward	(9,066,320)
Companies Income Tax Liability	Nil
Tertiary Education Tax Liability	Nil

	N
Assessment Year 2009	
Total Profit	3,067,250
Unutilized Capital Allowances carried backward	(9,066,320)
Unutilised Capital Allowances carried backward	(5,999,070)
Companies Income Tax Liability	Nil
Tertiary Education Tax Liability	Nil

	N
Assessment Year 2008	
Total Profit	1,314,000
Unutilized Capital Allowances carried backward	(5,999,070)
Unutilised Capital Allowances carried backward	(4,685,070)
Companies Income Tax Liability	Nil
Tertiary Education Tax Liability	Nil

Assessment Year 2007	**N**
Total Profit	0
Unutilized Capital Allowances carried backward	4,685,070

Capital Allowances carried back against the remainder of profits are as follows:

	₦
2011 Assessment Year	3,860,250
2010 Assessment Year	2,527,250
2009 Assessment Year	3,067,250
2008 Assessment Year	1,314,000
2007 Assessment Year	-
	10,768,750

(b) Tax refundable by FIRS based on the above:

		₦	₦
Assessment Year 2007	(30%	of Nil)	-
Assessment Year 2008	(30% of	1,314,000)	394,200
Assessment Year 2009	(30% of	3,067,250)	920,175
Assessment Year 2010	(30% of	2,527,250)	758,175
Assessment Year 2011	(30% of	3,860,250)	1,158,075
Total		10,768,750	3,230,625
Tertiary Education Tax			Nil

Note:

Any part of the Capital allowances, which remains unutilised after carrying back against the remainder of profits will be deemed lost. The period of carrying back is limited to five years before the year of cessation, starting from the penultimate year, that is, year preceding that of cessation.

			MARKS
(a)	Heading		1
	Assessment Year 2012		
	Loss	1	
	Unutilized Capital Allowances carried backward	1	
	Current – for the period	1	
	Unutilized Capital Allowances on cessation	½	3½
	Assessment Year 2011		
	Total Profit	1	
	Unutilized Capital Allowances carried backward	1	
	Unutilized Capital Allowances carried backward	½	
	Companies Income Tax Liability	½	
	Tertiary Education Tax Liability	½	3½
	Assessment Year 2010		
	Total Profit	1	
	Unutilized Capital Allowances carried backward	1	
	Unutilised Capital Allowances carried backward	½	
	Companies Income Tax Liability	½	
	Tertiary Education Tax Liability	½	3½
	Assessment Year 2009		
	Total Profit	1	
	Unutilized Capital Allowances carried backward	1	
	Unutilised Capital Allowances carried backward	½	
	Companies Income Tax Liability	½	
	Tertiary Education Tax Liability	½	3½
	Assessment Year 2008		
	Total Profit	1	
	Unutilized Capital Allowances carried backward	1	
	Unutilised Capital Allowances carried backward	½	
	Companies Income Tax Liability	½	
	Tertiary Education Tax Liability	½	3½
	Assessment Year 2007		
	Unutilized Capital Allowances carried backward		1
	Capital Allowances carried back against the remainder of profits, 2007 – 2011 Assessment Years (1 mark each)	4	
	Total of Capital Allowances carried back against remainder of Profits	½	4½

(b)	Tax refundable by FIRS on Cessation Basis Assessment Years 2007 – 2011 for 5 years (½ mark each)		
	Capital Allowances carried back against remainder of Profits for 5 years (½ mark each)	2½	
	Tax refundable for 5 Assessment Years (½ mark each)	2½	
	Tertiary Education Tax Payable	½	
	Comment(s)	½	6
			30

EXAMINER'S REPORT

The question tests candidates' understanding of the rules of cessation and terminal capital allowances.

Candidates' demonstrated a fair understanding of the question and performance was also fair. The commonest pitfall was the inability of the candidates to compute unutilized capital allowances and also tax refunds from FIRS arising from carrying back of capital allowances.

Candidates are advised to pay attention to these two important areas.

SOLUTION 2

(a) Notice of Appeal shall specify the following specific particulars:

(i) The official number of the assessment and the year of assessment for which it was made;

(ii) The amount of tax payable under such assessment;

(iii) The amount of the Total Profit based on which the tax payable was computed and appearing in the Notice of Assessment;

(iv) The date upon which the appellant was served with Notice of Refusal by the FIRS to amend the assessment as desired;

(v) The precise grounds of appeal against the assessment but such grounds are limited to the grounds stated by the appellant in its Notice of Objection; and

(vi) An address for service of any notices, receipts or other documents to be given by the Secretary to the Tax Appeal Tribunal, provided that at any time, the appellant may give notice to such Secretary and to the FIRS by delivering same by registered post, of a change of such address by any such notice shall not be valid until delivered or received.

(b) Appeal against the decision of the Appeal Tribunal

The Tax Appeal Tribunal was established and provided for in Section 59 (1) of the Federal Inland Revenue Service Act, 2007. The Tribunal has power to settle disputes between taxpayers and the tax authority (like FIRS). However, once the Tax appeal Tribunal has delivered its judgment, an appeal may be lodged to the Federal High Court within 30 days of the receipt of the judgment. The appeal must be in writing and must show the grounds of law on which the decision of the Tax Appeal Tribunal is being challenged.

(c) The following actions would be taken to remedy the disputed tax assessment:

(i) The tax consultant will review the accounts and documents which were earlier sent to the tax office to determine whether or not there was any basis for the variation in the assessment. If there is any genuine reason for the upward review of the assessment, the taxpayer will be advised not to pursue the disputed assessment, but to make payment without any further delay.

(ii) However, if there is no ground or basis for the variation in the assessment, then a valid Notice of Objection will be written to the FIRS within 30 days of the receipt of the Notice of Assessment. The Notice of Objection will contain the grounds of objection.

(iii) The Tax Consultant will expect the FIRS to see reasons and amend the assessment. On the other hand, where the FIRS refuses to amend the assessment, a NOTICE of Refusal to Amend should be written and sent to the company (the taxpayer).

(iv) Within 30days upon the receipt of the NOTICE of Refusal to amend from the tax authority, a Notice of Appeal would be filed with the Tax Appeal Tribunal.

MARKING GUIDE

			MARKS
(a)	The particulars to be included in a Notice of Appeal		
	- The Office/Number	1	
	- The amount of tax charged	1	
	- The amount of Total Profit	1	
	- The date the application was served with the Notice of Refusal	1	
	- The grounds of appeal against a tax assessment	1	
	- The address for service of notices	1	
	(Any five (5) particulars)		5
(b)	The procedure for an appeal against the decision of Tax Appeal Tribunal		
	- Power of Tribunal to settle disputes	1¼	
	- Must be lodged within 30 days	1¼	
	- Must be in writing	1¼	
	- Must be on the grounds of law	1¼	5
(c)	Steps to be taken to remedy a disputed tax assessment		
	- Review the accounts and documents	2½	
	- File a valid objection	2½	
	- Revenue to Refuse/Amend	2½	
	- Within 30 days, file Notice of Appeal	2½	10
			20

EXAMINER'S REPORT

The question tests candidates' knowledge of appeal against assessments.

Candidates' demonstrated a poor understanding of the question and performance on it was also poor. The commonest pitfall was the inability of the candidates to correctly state the contents of the Notice of Appeal.

Candidates are advised to pay attention to the basic rules of taxation, regarding cases of appeals against assessments and bases/contents of such appeals.

SOLUTION 3

a.

MR BABANGIDA MUHAMMED
COMPUTATION OF PERSONAL INCOME TAX PAYABLE
FOR 2013 AND 2014 YEARS OF ASSESSMENT

	2013		2014	
	₦	₦	₦	₦
Basic salary		5,400,000		6,000,000
Rent subsidy		1,800,000		1,800,000
Furniture grant		600,000		600,000
Entertainment allowance		660,000		660,000
		8,460,000		9,060,000
Benefits – in – Kind:				
- Car (5% of the cost)	190,000		190,000	
- Scholarship award	500,000		500,000	
		690,000		690,000
		9,150,000		9,750,000
Gratuity		240,000		-
Rental income	600,000		600,000	
Less: Repairs	(45,000)		(45,000)	
		555,000		555,000
Interest received on fixed deposit		75,000		90,000
Gross Income		10,020,000		10,395,000
Less: Reliefs and allowances:				
- Consolidated Relief Allowance	2,204,000		2,279,000	
- Life Assurance Premium	100,000		100,000	
- Gratuity	240,000		-	
- Contribution to National Housing Fund	135,000		150,000	
- Contribution to National Pension Scheme	751,500		779,625	
		(3,430,500)		(3,308,625)
Taxable Income		**6,589,500**		**7,086,375**

COMPUTATION OF TAX PAYABLE

				2013	2014
	₦			₦	₦
First	300,000	@ 7%		21,000	21,000
Next	300,000	@ 11%		33,000	33,000
Next	500,000	@ 15%		75,000	75,000
Next	500,000	@ 19%		95,000	95,000
Next	1,600,000	@ 21%		336,000	336,000
Next	3,389,500	@ 24%		813,480	813,480
	6,589,500				
Next	496,875	@24%		-	119,250
	7,086,375				
				1,373,480	1,492,730
Amount previously paid				(850,000)	(960,000)
Withholding tax on rent (10%)				(60,000)	(60,000)
Net Tax payable				**463,480**	**472,730**

(b) Given the computation of Personal Income Tax payable shown above, Mr Babangida Muhammed will be advised to pay additional personal income tax of ₦463,480 and ₦472,730 for 2013 and 2014 years respectively.

MARKING GUIDE

	MARKS
Heading	$^1/_3$
Basic Salary ($^1/_3$ mark for each year)	$^2/_3$
Rent Subsidy ($^1/_3$ mark for each year)	$^2/_3$
Furniture grant ($^1/_3$ mark for each year)	$^2/_3$
Entertainment allowance ($^1/_3$ mark for each year)	$^2/_3$
Benefits – in – Kind	
- Company Car ($^1/_3$ mark for each year)	$^2/_3$
- Scholarship worth ($^1/_3$ mark for each year)	$^2/_3$
Gratuity ($^1/_3$ mark for 2013 only)	$^1/_3$
Rental Income ($^1/_3$ mark for each year)	$^2/_3$
Repairs ($^1/_3$ mark for each year)	$^2/_3$
Interest received on Fixed Deposit ($^1/_3$ mark for each year)	$^2/_3$
Consolidated Relief Insurance ($^1/_3$ mark for each year)	$^2/_3$
Life Assurance Premium ($^1/_3$ mark for each year)	$^2/_3$
Gratuity ($^1/_3$ mark for each year)	$^1/_3$
Contribution to National Housing Fund ($^1/_3$ mark for each year)	$^2/_3$

	Contribution to National Pension Scheme	$^{2}/_{3}$	
	Computation of Tax Payable		
	- First - ₦300,000 @ 7% ($^{1}/_{3}$ mark for each year)	$^{2}/_{3}$	
	- Next - ₦300,000 @ 11% ($^{1}/_{3}$ mark for each year)	$^{2}/_{3}$	
	- Next - ₦500,000 @ 15% ($^{1}/_{3}$ mark for each year)	$^{2}/_{3}$	
	- Next - ₦500,000@ 19% $^{1}/_{3}$ mark (for each year)	$^{2}/_{3}$	
	- Next - ₦1,600,000 @ 21% ($^{1}/_{3}$ mark for each year)	$^{2}/_{3}$	
	- Next - ₦3,389,500 @ 24% ($^{1}/_{3}$ mark for years 2013 and 2014 and additional $^{1}/_{3}$ mark for 2014)	1	
	Amount previously paid ($^{1}/_{3}$ mark for each year)	$^{2}/_{3}$	
	Withholding Tax on Rent ($^{1}/_{3}$ mark for each year)	$^{2}/_{3}$	
	Balance of Tax Payable ($^{1}/_{3}$ mark for each year)	$^{2}/_{3}$	16
(b)	Additional tax of ₦463,480	1	
	2013 Year of Assessment	1	
	Additional tax of ₦472,730	1	
	2014 Year of Assessment	1	4
			20

EXAMINER'S REPORT

The question tests candidates' knowledge of the rules governing the computation of tax liability for individuals.

Candidates demonstrated a good understanding of the question and performance was also good. The commonest pitfall was the inability of some candidates to correctly compute the National Pension Scheme Contribution.

Students are advised to pay attention to the provisions of the Pensions Act as they relate to taxation.

SOLUTION 4

a. Based on the Personal Income Tax (Amendment) Act 2011 (PITAM), a taxpayer is deemed to be resident in Nigeria if employment costs are recharged to a Nigerian company or borne by a "fixed base" in Nigeria; or he is in Nigeria for an aggregate of 183 days in any 12-month period (including leave and temporary absence).

Mr Alexis Sanchez will therefore be treated as a resident taxpayer for the relevant tax year and would be liable to Personal Income Tax in Nigeria, having stayed beyond the required number of days and with a fixed base in Nigeria through Zenon Limited. The fact that he left Nigeria and returned some months after, does not exempt him from this provision, as such period of absence would be considered temporary. Consequently, income earned in Nigeria would be liable to Nigerian tax.

b. Where an individual has more than one place of residence in the relevant tax year, a principal place of residence would have to be determined for the purpose of identifying the tax authority to which such individual will be responsible to pay tax.

A principal place of residence in relation to an individual with two or more places of residence on a relevant day, not being both within any one territory with earned income other than pension is:

i. The State where he normally resides;

ii. The State or place nearest to his place of work; and

iii. The State where the income is derived. If the income is derived from more than one State, then the Federal Capital Territory.

A principal place of residence was further redefined by PITAM 2011 to include a branch office, operational site such as Oil Terminals, Oil Platforms, flow Stations, Factories, etc with a minimum of 50 workers.

Based on the above, Mr Abass stays more days in Gwagwalada (Abuja) where he works and resides than either Kaduna or Nasarawa States. Consequently, he would be liable to tax on his income to the Federal Inland Revenue Service/ Federal Capital Territory Internal Revenue Service.

i. Resident Individual

A resident individual is that with a place of residence or principal place of residence in Nigeria, either through a Nigerian employment with a fixed base, or having stayed in Nigeria for at least 183 days.

ii. Non-resident Individual

A non-resident individual is that person who has no place of residence in Nigeria either through an employment with fixed based or having worked and stayed in Nigeria for at least 183 days including the leave period or temporary period of absence.

iii. Residence and Nationality

Residence should not be confused with nationality. The Nigerian tax laws attach importance to residence and not nationality. Therefore, whether a taxpayer is a citizen of Nigeria or a citizen of another country, the same standards apply as far as the taxpayer is resident in Nigeria. The same condition will also apply to an individual who is not resident in Nigeria whether he is a Nigerian national or foreign national.

iv. Place of Residence

In relation to an individual, a place of residence means a place available for his use in Nigeria on a relevant day, and does not include any hotel, rest-house or other place at which he is temporarily lodging unless no permanent place is available for his use on that day.

v. Principal Place of Residence

Principal place of residence in relation to an individual with two or more places of residence on a relevant day, not being both within any one territory means:

- ❖ In the case of an individual with no source of income other than a pension in Nigeria, that place or those places in which he usually resides;
- ❖ In the case of an individual who has a source of earned income other than a pension in Nigeria, that place or those places which on a relevant day is nearest to his usual place of work;
- ❖ In the case of an individual who has a source or sources of unearned income in Nigeria, that place or those places in which he usually resides; and
- ❖ In the case of an individual who works in an office or operational site of a company or other body corporate, the place of which the branch office or operational site is situate; provided the operational site shall include oil terminals, oil platforms, flow stations, factories, Quaries, construction sites with a minimum of 50 workers, etc.

MARKING GUIDE

			MARKS
(a)	Basis of Income Tax Liability		
	- Provided in PITAM	1	
	- If costs are borne by a Nigerian company	1	
	- Must be in excess of 183 days in 12 months period including leave and temporary absence	1	
	- He is liable to Nigerian Income Tax	1	
	- Sanchez was in Nigeria for more than 183 days	1	5
(b)	Principal Place of Residence		
	- Provided for in PITAM	1	
	- When a taxpayer has more than one place of residence	1	
	- Determined by if not pension		
	• State of residence	½	
	• State nearest to place of work	½	
	• State where income is derived	½	
	- Stays more in Abuja	½	
	- He is liable to FCT Internal Revenue	1	5
(c) (i)	Resident Individual		
	- Having a place of residence in Nigeria	1	
	- Having stayed for at least 183 days	1	
(ii)	Non-Resident Individual		
	- Having no place of residence in Nigeria	1	
	- Having stayed in Nigeria for less than 183 days	1	
(iii)	Residence and Nationality		
	- Law attaches importance to residence not nationality	1	
	- Same condition as a non-resident individual	1	
(iv)	Place of Residence		
	- Place available for his use in Nigeria on a relevant day	1	
	- Does not include any hotel, rest-house or other place at which he is temporarily lodging unless no permanent place is available	1	
(v)	Principal Place of Residence		
	- Individuals with more than one residence	1	
	- The place he usually resides	1	10
			20

EXAMINER'S REPORT

The question tests the candidates' knowledge of principles of tax laws relating to residence.

Candidates' demonstrated a poor understating of the question, hence performance was poor. The commonest pitfall was the inability of the candidates to apply the provisions of Personal Income Tax Amendment Act, 2011 (PITAM) as regards the inclusion of leave period and temporary absence as part of the period of stay in Nigeria.

Candidates are advised to study PITAM as there are many amendments to PITA 2004.

SECTION C:

SOLUTION 5

(a)

(i) The main features of the Withholding Tax include:

- Payment of Withholding Tax is statutory on a person making the payment;
- Withholding tax credit cannot be used to off-set tax liabilities of previous years except the year in which the income relates;
- It is an advance payment of income tax which are utilized as tax credit against income tax liability of the year to which the income relates; and
- Withholding Tax represents the final tax on Frank Investment Income in the hands of the recipients.

(ii) The relevant tax authorities in relation to Withholding Tax in Nigeria are:

- Federal Inland Revenue Service for corporate bodies;
- State Internal Revenue Service for individuals; and
- Federal Inland Revenue Service for residents of the Federal Capital Territory, Abuja, members of the Nigerian Armed Forces and Police and officers of Nigerian Foreign Service.

(iii) Contents of the Payment Schedule for the remittance of Withholding Tax include:

- Name of the taxpayers who suffered the deductions;
- Their addresses;
- The nature of their activities/services and period covered;
- Their tax file numbers – now Tax Identification Number (TIN);
- The total amount payable;
- The rate of tax applied;
- The amount of tax withheld;
- The balance paid to the taxpayer;
- The tax contract for which Returns were being made;
- The date of payment; and
- The cheque number and date.

b.

(i) **ADEBOLA NIGERIA LIMITED**
COMPUTATION OF INCOME TAX LIABILITIES
FOR THE RELEVANT YEARS OF ASSESSMENT

	2015	**2014**
	₦	**₦**
Profit of the Year (adjusted)	14,000,000	10,000,000
Bank interest received (gross)	2,400,000	1,600,000
Debenture interest received (gross)	800,000	800,000
Total Profit/Assessable Profit	**17,200,000**	**12,400,000**
Companies Income Tax:		
(30% of Total Profit)	**5,160,000**	**3,720,000**
Tertiary Education Tax		
(2% of Assessable Profit)	**344,000**	**248,000**

(ii) **ADEBOLA NIGERIA LIMITED**
COMPUTATION OF NET WITHHOLDING TAX PAYABLE OR RECEIVABLE
FOR THE RELEVANT YEARS OF ASSESSMENT

	2015	**2014**
	₦	**₦**
Gross Dividend received		
$\left(N720{,}000 \times \frac{100}{90}\right)$ and $\left(N720{,}000 \times \frac{100}{90}\right)$	800,000	800,000
Withholding tax on Dividend paid	600,000	400,000
Withholding tax of 10% thereon	(80,000)	(80,000)
Net Withholding Tax payable to the FIRS	**520,000**	**320,000**

MARKING GUIDE

		MARKS
(a)(i)	Features of Withholding Tax	
	- Withholding tax is statutory	½
	- Withholding tax cannot be used to off-set tax liabilities of previous years	½
	- Advance payment of Income Tax	½
	- Represents the final tax	½
		2

(ii)	Relevant Tax Authorities (Withholding tax)		
	- Federal Inland Revenue Service	½	
	- State Internal Revenue Service	1	
	- Federal Inland Revenue Service		
	• Residents of Federal Capital Territory, Abuja • Nigerian Armed Forces • Police and Officers of Nigerian Foreign Service — ½ mark for any point – maximum of 1 point	½	
			2
(iii)	Contents of a Payment Schedule		
	- 1/3 mark for each point subject to a maximum of six points		2
(b)(i)	Heading	½	
	Years (2015 and 2014) – ¼ mark for each year	½	
	Trading Profit - ½ mark for each year	1	
	Bank Interest - ½ mark for each year	1	
	Debenture Interest - ½ mark for each year	1	
	Companies Income Tax – ¼ mark for each year	½	
	Tertiary Education Tax - ¼ mark for each year	½	
			5
(ii)	Heading	½	
	Each year of Assessment (2015 and 2014) (½ mark for each year)	1	
	Withholding Tax on Dividend Received (½ mark for each year)	1	
	Withholding Tax on Dividend paid (½ mark for each year)	1	
	Net Withholding Tax payable (¼ mark for each year)	½	4
			15

EXAMINER'S REPORT

The question tests the candidates' knowledge of the computation of Companies Income Tax Liability.

Candidates demonstrated a poor understanding of the question, hence the poor performance. The commonest pitfall was the inability of the candidates to identify the relevant year of assessment.

Candidates are advised to pay attention to the main features of Withholding Tax.

SOLUTION 6

(a)

JOHNGAB LIMITED
DETERMINATION OF BASIS PERIODS
FOR THE RELEVANT ASSESSMENT YEARS AND CAPITAL ALLOWANCESS

ASSESSMENT YEAR	Basis Period for Assessment	Basis Period for Capital Allowances
2008	1/9/08 – 31/12/08	1/9/08 – 31/12/08
2009	1/9/08 – 30/8/09	1/1/09 – 30/8/09
2010	1/1/09 – 31/12/09	1/9/09 – 31/12/09
2011	1/1/10 – 31/12/10	1/1/10 – 31/12/10
2012	1/1/11 – 31/12/11	1/1/11 – 31/12/11

(b)

COMPUTATION OF CAPITAL ALLOWANCES
DUE FOR 3 YEARS

	Land & Building	Machinery	Furniture & Fittings	Motor Car	Delivery Van	Total Allowance
Initial allowance (%)	15	50	25	50	50	
Annual allowance (%)	10	25	20	25	25	
Investment allowance (%)	-	10	-	-	-	
	₦'000	**₦'000**	**₦'000**	**₦'000**	**₦'000**	**₦'000**
<u>**2008 Assessment Year**</u>						
5/6/08 – Land & Building	17,500					
1/7/08 – Motor Car				6,000		
15/10/08 – Machinery		14,000				
<u>**Allowances:**</u>						
Initial allowance	(2,625)	(7,000)	-	(3,000)	-	12,625
Annual allowance (W1)	(496)	(583)	-	(250)	-	1,329
Written down Value c/f	14,379	6,417	-	2,750	-	13,954
Investment allowance		1,400				1,400
<u>**2009 Assessment Year**</u>						
Addition:						
28/2/09 – Furniture			3,750			
1/5/09 – Delivery Van					5,000	
	14,379	6,417	3750	2,750	5,000	

Allowances:						
Initial allowance	-	-	(938)	-	(2,500)	3,438
Annual allowance (W2)	(1,488)	(1,750)	(562)	(750)	(625)	5,175
Written down Value c/f	12,891	4,667	2,250	2,000	1,875	8,613

	Land & Building ₦'000	Machinery ₦'000	Furniture & Fittings ₦'000	Motor Car ₦'000	Delivery Van ₦'000	Total Allowance ₦'000
2010 Assessment Year						
Annual allowance	(1,488)	(1,750)	(562)	(750)	(625)	5,175
Written down Value c/f	11,403	2,917	1,688	1,250	1,250	
2011 Assessment Year						
Annual allowance	(1,488)	(1,750)	(562)	(750)	(625)	5,175
	9,915	1,167	1,126	500	625	
2012 Assessment Year						
Annual allowance	(1,488)	(1,157)	(562)	(490)	(615)	4,312
	8,427	10	564	10	10	

Note: Since the Capital Allowance is less than $\frac{2}{3}$ of Assessable Profit for each of the relevant years, all the Capital Allowances are claimable.

Workings

(i) Annual Allowance 2008 Assessment Year
(4 months basis period)

$= ₦1488 \times \frac{4}{12}$ $\quad$ $₦\ 1750 \times \frac{4}{12}$ $\quad$ $₦\ 750 \times \frac{4}{12}$ $\quad$ $₦\ \frac{2812}{5}$

= ₦496 $\quad$ = ₦583 $\quad$ = ₦250 $\quad$ = ₦562

(ii) Annual Allowance 2008 – 2010 Assessment Years

L&B	P&M	MV	F&F	DV
₦ $\frac{17500-2625}{10 years}$	₦ $\frac{14000-7000}{4 years}$	₦ $\frac{6000-3000}{4 years}$	₦ $\frac{3750-938}{4 years}$	₦ $\frac{5000-2500}{4 years}$
= ₦1487.5	= ₦1750	= ₦750	= ₦938	= ₦625

(iii) Investment Allowance - P&M

@ 10% x ₦1,400,000

= ₦1,400,000

c.

JOHNGAB LIMITED
COMPUTATION OF CAPITAL ALLOWANCE
FOR 3 YEARS OF ASSESSMENT

	₦'000	₦'000
2008 Year of Assessment		
Basis Period (1/9/08 – 31/12/09)		
Assessable Profit		37,500
Deduct:		
Capital allowance	13,954	
Investment allowance	1,400	(15,354)
Total Profit		22,146
Income Tax Payable		
₦22,146,000 @ 30%		₦6,643,800
Tertiary Education Tax payable		
₦37,500,000@ 2%		₦750,000

2009 – Year of Assessment		
Basis Period (1/9/08 – 30/08/09)		
Assessable Profit		
1/9/08 – 31/12/08	37,500	
1/1/09 – 30/8/09 ($\frac{8}{12}$ x ₦60,000)	40,000	77,500
Deduct:		
Capital allowances		(8,613)
Total profit		68,887
	N'000	N'000
Companies Income Tax payable:		
N68,887,000 @ 30%		₦20,666,100
Tertiary Education Tax payable		
₦77,500,000 @ 2%		₦1,550,000

2010 Year of Assessment

Basis Period (1/1/09 – 31/12/09)	
Assessable Profit	60,000
Deduct: Capital allowances	(5,175)
Total Profit	54,825

Income Tax Payable

₦54,825,000 @ 30%	₦16,447,500

Tertiary Education Tax payable

₦60,000,000 @ 2%	₦1,200,000

MARKING GUIDE

			MARKS
(a)	Basis period for each Assessment Year (5 AYs) – ½ mark for each year	2½	
	Basis period for Capital Allowances for each Assessment Year – ½ mark for each year	2½	5
(b)	**2008 Assessment Year**		
	Cost of each asset – (1/9 mark for each cost)	3/9	
	Initial allowance – (1/9 mark for each allowance)	3/9	
	Annual allowance – (1/9 mark for each allowance)	3/9	
	Investment allowance	1/9	
	Total Annual Allowance (1/9 mark for each year)	2/9	
	2009 Assessment Year		
	Cost of each asset – (1/9 mark for each cost)	2/9	
	Initial allowance – (1/9 mark for each allowance)	2/9	
	Annual allowance – (1/9 mark for each allowance)	5/9	
	Total Annual allowance – (1/9 mark for each)	2/9	
	2010 Assessment Year		
	Annual allowance – (1/9 mark for each allowance)	4/9	
	2011 Assessment Year		
	Annual allowance – (1/9 mark for each allowance)	5/9	
	2012 Assessment Year		
	Annual allowance – (1/9 mark for each allowance) – for 4 allowances	4/9	
	Note	1	5

(c)			
	<u>2008 Year of Assessment</u>		
	Assessable Profit	½	
	Investment allowance	½	
	Companies Income Tax Payable	½	
	Tertiary Education Tax payable		
		½	2
	<u>2009 Year of Assessment</u>		
	Assessable Profit (1/9/08 – 31/12/08)	½	
	(1/1/09 – 31/08/09)	½	
	Companies Income Tax Payable	½	
	Tertiary Education Tax payable		
		½	2
	<u>2010 Year of Assessment</u>		
	Income Tax Payable	½	
	Tertiary Education Tax payable	½	
			1
			15

EXAMINER'S REPORT

The question tests the candidates' knowledge of computation of tax liabilities on commencement of business and rules of capital allowances.

Candidates demonstrated a fair understanding of the question and performance was also fair. The commonest pitfall was the inability of the candidates to compute capital allowances correctly.

Candidates are advised to pay attention to the intricacies of capital allowances computation.

SOLUTION 7

THE SETTLEMENT OF CHIEF SARKI OLIVER
COMPUTATION OF INCOME TAX PAYABLE BY THE TRUSTEES
FOR 2010 YEAR OF ASSESSMENT

	N'000	N'000
Trading income	250,000	
Less: Capital allowances	(64)	249,936
Rental income (gross)		225,000
Dividends (gross)		170,000
Interest on bank deposit (gross)		107,500
Sundry income		105,000
Total income		857,436
Deduct: Authorised payments:		
- Administrative and other expenses	32	
- Interest on debt repayment	25	
- Fixed annuity	41	
- Trustees remuneration - Fixed	50	
- Trustees remuneration – Variable (W1)	16,810	(16,958)
Total computed income		840,478
Deduct: Discretionary payments:		
Jimmy	30	
Ngozi	26	
Charles	15	(71)
Net computed income		840,407
Distribution to the beneficiaries:		
Jimmy [(1/5 x ₦840,407)	168,081	
Ngozi	168,081	
Charles	168,081	(504,243)
Amount taxable in the hands of the Trustees		336,164
Gross income in the hands of the Trustees		336,164
Deduct: Reliefs and Allowances		
Consolidated Relief Allowance:		
Higher of: N200,000 of (1% of ₦840,478,000)	8,404.78	
Plus: 20% of Computed Income (₦840,478,000)	168,095.60	176,500.38
Taxable income		159,663.62

TAX LIABILITIES:

	Tax Band	Tax Rate	Amount
		(%)	₦
	₦		
First	300,000	7	21,000.00
Next	300,000	11	33,000.00
Next	500,000	15	75,000.00
Next	500,000	19	95,000.00
Next	1,600,000	21	336,000.00
Above	156,463,620	24	37,551,268.80
	159,663,620		
Tax payable			38,111,268.80

b.

THE SETTLEMENT OF CHIEF SARKI OLIVER
COMPUTATION OF AMOUNT DUE TO THE BENEFICIARIES
FOR 2010 YEAR OF ASSESSMENT

	Jimmy	Ngozi	Charles	Total
	₦'000	₦'000	₦'000	₦'000
Discretionary payments	30	26	15	71
Share of net distributable income	168,081	168,081	168,081	504,243
Amount due to each beneficiaries	**168,111**	**168,107**	**168,096**	**504,314**

Workings

W1 - Variable Trustees' Remuneration

	₦'000	₦'000
Total Income		857,436
Less Expenses:		
Admin & Others	32	
Interest on debt repayment	25	
Fixed annuity	41	
Trustees' Remuneration Fixed	50	148
		857,288

∴ Variable Trustees' Remuneration

$$= \frac{2}{102} \times ₦857,288$$
$$= ₦16,809.57$$
$$= \underline{\underline{₦16,810}}$$

MARKING GUIDE

			MARK
	Heading	1/3	
	Trading income	1/3	
	Capital allowances	1/3	
	Rental income (gross)	1/3	
	Dividends (gross)	1/3	
	Interest on bank deposit (gross)	1/3	
	Sundry income	1/3	
	Administrative and other expenses	1/3	
	Interest on debt repayment	1/3	
	Fixed annuity	1/3	
	Trustees' remuneration – Fixed	1/3	
	Trustees' remuneration – Variable	1/3	
	Discretionary payments:		
	Jimmy	1/3	
	Ngozi	1/3	
	Charles	1/3	
	Distribution to the beneficiaries:		
	Jimmy [(1/5 x ₦840,407)	1/3	
	Ngozi	1/3	
	Charles	1/3	
	Gross income in the hands of the Trustees	1/3	
	Consolidated Relief Allowance		
	1% of Income	1/3	
	20% of Income	1/3	
	Tax liability	1	8
(b)	Discretionary payments – (½ mark each)	2	
	Share of net distributable income - (½ mark each)	2	
	Amount due to each of the beneficiaries - (½ mark each)	2	
	Heading		7
		1	
			15

EXAMINER'S REPORT

The question tests candidates' knowledge on the computation of tax liability relating to trust income.

Candidates demonstrated a poor understanding of the question and performance was also poor. The commonest pitfall was the inability of most of the candidates to arrive at the Computed Income.

Candidates are advised to pay attention to areas concerning Estates, Trusts and Settlements.

SKILLS LEVEL EXAMINATION – NOVEMBER 2015

PERFORMANCE MANAGEMENT

Time Allowed: 3 hours

ANSWER FIVE OUT OF SEVEN QUESTIONS IN ALL

SECTION A: COMPULSORY QUESTION (30 Marks)

QUESTION 1

The Board of Directors of Danda Company Limited is proposing the purchase of either of two machines that have been proved adequate for the production of an engineering product "Gee". The two machines are: ZIGMA 5,000 and DELPHA 7,000. Production in the first year would be affected by installation challenges and inadequate understanding of the operating instructions of the machines.

Information available from the production profile of the two machines are as shown below:

ZIGMA 5000:

Production Capacity: Year		Production Capacity (%)
1	-	60
2	-	90
3	-	100
4	-	100
5	-	50
6	-	30

Cost of machine is ₦16,500,000 while the life span is 6 years.

DELPHA 7000:

Production Capacity: Year		Production capacity (%)
1	-	50
2	-	100
3	-	100
4	-	100
5	-	80
6	-	50

Cost of plant is ₦18,300,000 while the life span is 6 years.

Other information relevant to the company's operations and administration are:

(i) Selling price per unit is ₦300.
(ii) Variable cost per unit is ₦150.
(iii) Annual fixed overhead exclusive of depreciation is ₦1,200,000.
(iv) Company depreciation policy is straight line basis.
(v) The budgeted production capacity is 100,000 units.
(vi) No opening or closing inventory is envisaged.
(vii) All sales are for cash.
(viii) All costs are for cash.

Required:

a. Prepare the **SIX** year profitability statement for the two machines. (6 Marks)
b. Prepare the **SIX** year cash flow statement for the two machines. (6 Marks)
c. What is the payback period for the two machines? (7 Marks)
d. Determine the Net Present Value (NPV) of the two machines if the acceptable discount rate for the company is 15%. (7 Marks)
e. Which of the two machines should the company acquire? (4 Marks)

(Total 30 Marks)

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

QUESTION 2

Pestel Limited produces cake and bread which it supplies to a major supermarket in Abuja. It holds no inventories because it adopts the Just-In-Time (JIT) system.
The standard cost of the wheat used in baking the products is ₦200 per kg. Each piece of cake uses 0.5kg of wheat while each loaf of bread uses 2kg of wheat.

The production levels for cake and bread for the month of October were as follows:

	Budgeted production (units)	Actual production level (units)
Bread	240,000	240,000
Cake	380,000	360,000

The actual cost of wheat in October was ₦232 per kg. 496,000kg of wheat was used to bake the bread and 190,000kg was used to bake the cake.

The global prices of wheat increased by 18% in the month of October.

At the beginning of the month, the supermarket group made an expected request for an immediate shape change to the cake resulting in 5% more wheat than previously required. This change also brought about production delays which caused a reduction in production by 20,000 units of cake in that month. The production director is given the task of purchasing relevant input materials and any production request which occur, although he does not take responsibility for setting standard costs.

Required:

(a) Compute the following variances for the month of October for each of the products and in total:
- (i) Material price planning variances, (4 Marks)
- (ii) Material price operational variances. (4 Marks)
- (iii) Material usage planning variances, (4 Marks)
- (iv) Material usage operational variances (4 Marks)

(b) What are the benefits of planning and operational variances to a management accountant?
(4 Marks)

(Total 20 Marks)

QUESTION 3

Casko Limited manufactures four products from a single chemical process and a single raw material. The production director is considering proposals to discontinue certain production process and has provided the following information:

- (i) The cost of raw materials for the year just ended was ₦1,320,000.
- (ii) The initial processing costs amounted to ₦2,564,600.
- (iii) All the four products W, X, Y and Z are produced simultaneously at a single split-off point.
- (iv) Product Y is sold immediately without further processing.
- (v) The other three products are subjected to further processing before being sold.
- (vi) It is the company's policy to apportion the cost prior to split-off point on a suitable sales value basis.
- (vii) The output, sales and the additional processing costs for the past year were as follows:

Products	Output (units)	Sales	Additional processing costs
		₦	₦
W	400,000	3,840,000	800,000
X	89,230	1,160,000	640,000
Y	5,000	160,000	-
Z	9,000	1,200,000	40,000

The proposal being considered by the management is to sell the products to other processors immediately after the split-off point without any of the present additional processing. The additional processing costs of products W,X and Z would either no longer be incurred or be charged to an alternative profitable use. The prices per unit to be obtained from the other processors would be: W: ₦6.40, X: ₦8, Y: ₦32, and Z: ₦100.

You are required to prepare a statement of:

a. i. The profit or loss on each of the four products. (10 Marks)

ii. The change in the profit or loss given in your solution to (i) above, if the proposals being considered were adopted. (8 Marks)

b. Identify **TWO** long-run pricing decision approaches that are relevant to a price setting firm. (2 Marks)

(Total 20 Marks)

QUESTION 4

The existing business of MOOJ Ltd. is very profitable, with forecasts for the next year showing that this trend of profitability will continue.

MOOJ Limited manufactures all of its own clothes, and then sells these direct to the public through 105 branches located around Nigeria. The branches are not run as profit centres; prices are set centrally for the clothes and the costs of each branch are monitored at the Head Office. Surprisingly, there is no minimum or maximum turnover requirement for each branch. In the company's view, this enables staff to focus on customer service without the concern of meeting a profit figure. The strategy obviously works well, given the company's results.

The existing Information Technology (IT) infrastructure is based around each shop maintaining its own inventory records. There is no Wide Area Network (WAN) and Head Office has few integrated systems.

The Directors recognise that the current IT infrastructure of MOOJ Limited is inadequate for Internet trading.

The Board of MOOJ Limited is currently discussing whether or not to start selling clothes on the Internet.

Required:

Identify and discuss the strategic and performance management issues that the Board of MOOJ Limited will have to address prior to a decision being taken regarding trading on the Internet. **(Total 20 Marks)**

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

QUESTION 5

KOMERE Limited operates a Standard Costing System. The standard cost information is presented in the standard costs cards below.

		₦
Direct Material:		
A	20kg at ₦100 per kg -	2,000
B	30kg at ₦80 per kg -	2,400
Direct Labour:		
Skilled -10hours at ₦40 per hour		400
Unskilled-10 hours at ₦25 per hour		400
Variable overhead cost- 10 hours at ₦20 per hour		200
		5,250

The actual results for the month of October 2015 is given below.

(i) Direct Material:

	Purchases	Amount (₦)	Consumed
Direct Material A	105,000kg	10,290,000	99,000 kg
Direct Material B	148,000kg	11,988,000	144,000kg

(ii) Direct Labour:

	Hours	Amount (₦)
Skilled labour	56,000	2,352,000
Unskilled labour	56,000	1,344,000

(iii) Variable overhead ₦1,064,000

(iv) Actual production 4,800 units

Required:

(a) Calculate all the relevant variances. (8 Marks)

(b) What are possible causes of the variances computed. (7 Marks)

(Total 15 Marks)

QUESTION 6

Tee Company makes and sells a product, the Green, which is nearing the end of its life. A replacement product, Brace, has been designed and test marketed and the company is trying to decide when to replace Green with Brace. Tee Company only has the capability to produce one of the two products at a time.

Sales of Green are expected to be 100,000 units in the first quarter of Year 7 and are forecast to fall after that so that each quarter's sales will be 10% less than those of the previous quarter. Green has a selling price of ₦14 per unit and its Contribution to Sales ratio (C/S ratio) is 40%. The fixed costs of making Green in Year 7 will be ₦200,000 per quarter.

Test market results for Brace were very good and demand for similar products is growing rapidly. Tee Company believes that sales of Brace can be predicted by the following equation:

$Y = 80,000 + 6,000\,T$

Where:

Y = Sales of Brace in units per quarter
T = Time, measured in quarters. For the first quarter of Year 7 (that is, January to March Year 7), T = 1; for the second quarter of Year 7, T = 2; etc

The selling price of the Brace will be ₦16 and its contribution per unit will be ₦6.
Fixed costs will increase to ₦240,000 per quarter if Green is replaced by Brace.

To avoid disruption of the production of Tee's other products, the changeover between Green and Brace must take place on either 1 January Year 7 or 1 July Year 7. The costs of changeover will differ depending upon which date is chosen and the following information is available.

(i) Some of the machinery used to make the Green will no longer be required for the Brace. The written down value of this machinery will be ₦250,000 at 1 January Year 7, and ₦220,000 by 1 July Year 7. Its net realisable value at 1 January Year 7 will be ₦140,000, but by 1 July Year 7 it will be ₦30,000.

(ii) Some redundancies will result from the change of products. Redundancy payments of ₦40,000 will be made if the changeover occurs on 1 January, but these will rise to ₦50,000 by 1 July. The five administration workers concerned are each paid ₦20,000 per annum and will not be replaced.

Their wages are not included in the costs given above.

Required:

a. Determine whether the company should continue to sell Green in Year 7 or introduce Brace in Year 7. (8 marks)

b. If the company were to replace Green with Brace in Year 7 recommend whether this should be with effect from 1 January or 1 July. (Include a schedule of relevant costs and revenues and provide explanations of your figures). (7 marks)

(Total 15 Marks)

QUESTION 7

Stuck Ltd manufactures industrial glues and solvents in a single large factory. Approximately 400 different inputs are used to produce the 35 specialist outputs, which range from ultra-strong glues used in aircraft manufacture to high-impact adhesives that are required on construction sites.

Two years ago, with the company only just breaking even, the directors recognised the need for more information to control the business. To assist them with their strategic control of the business, they decided to establish a Management Information System (MIS). This is now operational but provides only the following limited range of information to the directors via their networked computer system:

(i) A summary business plan for this and the next two years. The plan includes details of the expected future incomes and expenditure on existing product lines. It was produced by a new member of the accounting department without reference to past production data;

(ii) Inventory balances on individual items of raw materials, finished goods etc. This report is at a very detailed level and comprises 80% of the output from the MIS itself; and

(iii) A summary of changes in total demand for glues and solvents in the market place for the last five years. This information is presented as a numerical summary in six different sections. Each section takes up one computer screen so only one section can be viewed at a time.

Required:

(a) Comment on the weaknesses in the information currently being provided to the directors of the company. (9 Marks)

(b) Suggest how the information may be improved, with particular reference to other outputs which the MIS might usefully provide to the directors. (6 marks)

(Total 15 Marks)

Formulae

Learning curve

$Y = a x^b$

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 = Fixed Cost when Q = quantity

$MR = a - 2bQ$

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

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

where

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

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

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

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

Annuity Formula

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

Where r = discount rate

n = number of periods

Annuity Table

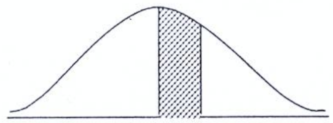
Periods

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

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

NORMAL DISTRIBUTION

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



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

SOLUTIONS

SOLUTION 1

(a) DANDA COMPANY LIMITED

Profitability Statement – ZIGMA 5000

Year	1	2	3	4	5	6
Capacity (%)	60	90	100	100	50	30
Units	60,000	90,000	100,000	100,000	50,000	30,000
	₦'000	₦'000	₦'000	₦'000	₦'000	₦'000
Sales	18,000	27,000	30,000	30,000	15,000	9,000
Variable cost	(9,000)	(13,500)	(15,000)	(15,080)	(7,500)	(4,500)
Fixed Cost	(1,200)	(1,200)	(1,200)	(1,200)	(1,200)	(1,200)
Depreciation	(2,750)	(2,750)	(2,750)	(2,750)	(2,750)	(2,750)
Net profit	5,050	9,550	11,050	11,050	3,550	550

Profitability Statement - DELPHA 7000

Year	1	2	3	4	5	6
Capacity (%)	50%	100%	100%	100%	80%	50%
Units	50,000	100,000	100,000	100,000	80,000	50,000
Sales	15,000	30,000	30,000	30,000	24,000	15,000
Variable cost	(7,500)	(15,000)	(15,000)	(15,000)	(12,000)	(7,500)
Fixed Cost	(1,200)	(1,200)	(1,200)	(1,200)	(1,200)	(1,200)
Depreciation	(3,050)	(3,050)	(3,050)	(3,050)	(3,050)	(3,050)
Net profit	3,250	10,750	10,750	10,750	7,750	3,250

b. Cash flow Statement – Zigma 5000

Year	1	2	3	4	5	6
	₦'000	₦'000	₦'000	₦'000	₦'000	₦'000
Profit	5,050	9,550	11,050	11,050	3,550	550
Add back deprecation	2,750	2,750	2,750	2,750	2,750	2,750
	7,800	12,300	13,800	13,800	6,300	3,300

Cash flow Statement – DELPHA 7000

Year	1	2	3	4	5	6
	₦'000	₦'000	₦'000	₦'000	₦'000	₦'000
Profit	3,250	10,750	10,750	10,750	7,750	3,250
Add back deprecation	3,050	3,050	3,050	3,050	3,050	3,050
	6,300	13,800	13,800	13,800	10,800	6,300

ALTERNATIVE SOLUTION

SECTION A

DANDA COMPANY LIMITED

1(a) The six year profitability statement for the two machines.

ZIGMA 5000

Year	1	2	3	4	5	6
Production units	60,000	90,000	100,000	100,000	50,000	30,000
Contribution margin (₦)	150	150	150	150	150	50
	₦'000	**₦'000**	**₦'000**	**₦'000**	**₦'000**	**₦'000**
Total contribution	9,000	13,500	15,000	15,000	7,500	4,500
Less other fixed overhead	(1,200)	(1,200)	(1,200)	(1,200)	(1,200)	(1,500)
Less depreciation	(2,750)	(2,750)	(2,750)	(2,750)	(2,750)	(2,750)
Annual profit	5,050	9,550	11,050	11,050	3,550	550

DELPHA 7000

Year	1	2	3	4	5	6
Production units	50,000	100,000	100,000	100,000	80,000	50,000
Contribution margin (₦)	150	150	150	150	150	150
	₦'000	**₦'000**	**₦'000**	**₦'000**	**₦'000**	**₦'000**
Total contribution	7,500	15,000	15,000	15,000	12,000	7,500
Less other fixed overhead	(1,200)	(1,200)	(1,200)	(1,200)	(1,200)	(1,500)
Less depreciation	(3,050)	(3,050)	(3,050)	(3,050)	(3,050)	(3,050)
Annual profit	3,250	10,750	10,750	10,750	7,750	3,250

b. The six year cashflow statement for the two machines

ZIGMA 5000

Year	1	2	3	4	5	6
Production units	60,000	90,000	100,000	100,000	50,000	30,000
Contribution margin (₦)	150	150	150	150	150	50
	₦'000	**₦'000**	**₦'000**	**₦'000**	**₦'000**	**₦'000**
Total contribution	9,000	13,500	15,000	15,000	7,500	4,500
Less other fixed overhead	(1,200)	(1,200)	(1,200)	(1,200)	(1,200)	(1,500)
Annual net cash flow	7,800	12,300	13,800	13,800	6,300	3,300

DELPHA 7000

Year	1	2	3	4	5	6
Production units	50,000	100,000	100,000	100,000	80,000	50,000
Contribution margin (₦)	150	150	150	150	150	150
	₦'000	**₦'000**	**₦'000**	**₦'000**	**₦'000**	**₦'000**
Total contribution	7,500	15,000	15,000	15,000	12,000	7,500
Less other fixed overhead	(1,200)	(1,200)	(1,200)	(1,200)	(1,200)	(1,500)
Annual profit	6,300	13,800	13,800	13,800	10,800	6,300

Note: Deprecation is added back because it does not involve movement of cash.

c. **Payback period - ZIGMA 5000**

Year	Cashflow	Cashflow
	₦'000	**₦'000**
0	(16,500)	(16,500)
1	7,800	(8,700)
2	12,300	3,600

PBP = $1 + \frac{8{,}700}{12{,}300} X \ 12$

1 year 8 months

Payback period – DELPHA 7000

Year	Cashflow	Cashflow
	₦'000	**₦'000**
0	(18,300)	(18,300)
1	6,300	(12,000)
2	13,800	1,800

PBP = $1 + \frac{12{,}000}{13{,}800} X \ 12$

1 year 10 months

d. (i) **Net Present Value of ZIGMA 5000**

Net Year	**Net Cash flow**	**Discount factor (15%)**	**PV ₦'000**
0	(16,500,000)	1.000	(16,500,000)
1	7,800,000	0.870	6,786,000
2	12,300,000	0.756	9,298,800
3	13,800,000	0.658	9,080,400
4	13,800,000	0.572	7,893,600
5	6,300,000	0.497	3,131,100
6	3,300,000	0.432	1,425,600
		NPV =	21,115,500

(ii) **Net Present Value of DELPHA 7000**

Net Year	**Net Cash flow**	**Discount factor (15%)**	**PV ₦'000**
0	(18,300,000)	1.000	(18,300,000)
1	6,300,000	0.870	5,481,000
2	13,800,000	0.756	10,432,800
3	13,800,000	0.658	9,080,400
4	13,800,000	0.572	7,893,600
5	10,800,000	0.497	5,367,600
6	6,300,000	0.432	2,721,600
		NPV =	22,677,000

e. Using the payback period appraisal approach, Zigma 5000 capital outlay will be recovered in 1 year and 8 months while Delpha 7000 capital outlay will be recovered in 1 year and 10 months. This means that the company may prefer Zigma 5000 which has a shorter payback period.

Using the Net Present Value (NPV) approach, Delpha 7000 returned a positive NPV of ₦22.677m as against a positive NPV of ₦21.116m returned by Zigma 5000. With the wealth created by Delpha 7000 of ₦2.677m as against that of Zigma 5000 which is ₦21.116m, Delpha 7000 should be acquired.

Marking Guide

DANDA COMPANY LIMITED		Mark	Mark
(a)	Zigma 5000: Any 15 ticks @ 1/5 mark/tick	3	
	Delpha 7000: Any 15 ticks @ 1/5 mark /tick	3	
			6
(b)	Zigma 5000: Any 15 ticks @ 1/5 mark/tick	3	
	Delpha 7000: Any 15 ticks @ 1/5 mark/tick	3	
			6
(c)	Zigma 5000: Any 7 ticks @ ½ per tick	$3^1/_2$	
	Delpha 7000: Any 7 ticks @ ½ per tick	$3^1/_2$	
			7
(d)	NPV Zigma 5000: Any 14 ticks @ ¼ per tick	$3^1/_2$	
	NPV Delpha 7000: Any 14 ticks @ ¼ per tick	$3^1/_2$	
			7
(e)	Zigma 500 under PBP or		
	Delpha 700 under NPV		4
	Recommendation as regards choice of machine		30

EXAMINER'S REPORT

The question tests candidates' knowledge of the preparation of profitability statement and cash flow statements and the computation of Net Present Value (NPV) and Payback Period. It also requires candidates to offer advice based on the results of the computations.

Candidates are expected to demonstrate their ability to distinguish between Cash Flow items and those of profitability statements, correctly compute NPV and Payback periods of the two machines and advise management.

Most of the candidates attempted the question and performance was above average.
Candidates understood the preparation of profitability statement and cash flow statement but were deficient in the preparation of NPV and payback period.

However, many candidates had problem in the treatment of Non-Cash Flow items. A few of them also applied wrong discounting factors in the determination of NPV.
Candidates are advised to ensure adequate preparation and clearly understand questions before attempting them. The understanding of the various project appraisal techniques should also be ensured.

SOLUTION 2

PESTEL LIMITED
Computation of Ex-ante and Ex-post Standards

Ex-ante
Standard cost per cake:
0.5kg @ ₦200 per kg = ₦100
Standard cost per loaf of bread
2kg @ ₦200 per kg = ₦400

Ex-post
Standard cost per cake:
(1.05 x 0.5) 0.525kg @ (200 x 1.18) ₦236 per kg = ₦123.9
Standard cost per loaf of bread:
2kg @ (₦200 x 1.18) ₦236 per kg = ₦472

a(i) **Material Price Planning Variance (Bread)**

		₦
Ex-ante	496,000kg@ standard of ₦200/kg	99,200,000
Ex-post	496,000kg@ standard of ₦236/kg	117,056,000
		17,856,000 A

Material Price Planning Variance (Cake)

		₦
Ex-ante	190,000kg@ standard of ₦200/kg	38,000,000
Ex-post	190,000kg@ standard of ₦236/kg	44,840,000
		6,840,000A

Total Material Price Planning Variance

		₦
Ex-ante	686,000kg@ standard of ₦200/kg	137,200,000
Ex-post	686,000kg@ standard of ₦236/kg	161,896,000
		24,696,000A

a(ii) **Material Price Operational Variance (Bread)**

		₦
Ex-post	496,000kg@ standard of ₦236/kg	117,050,000
Actual	496,000kg actually cost ₦232/kg	115,072,000
		1984,000 F

Material Price Operational Variance (Cake)

		₦
Ex-post	190,000kg@ standard of ₦236/kg	44,840,000
Actual	190,000kg actually cost ₦232/kg	44,080,000
		760,000F

Total Material Price Operational Variance

		₦
Ex-ante	686,000kg@ standard of ₦236/kg	161,896,000
Actual	686,000kg actually cost ₦232/kg	159,152,000
		2,744,000F

a(iii) **Material Usage Planning Variance (Bread)**

		Kg
Ex-ante	240,000units@ standard of 2kg/unit	480,000
Ex-post	240,000units@ standard of 2kg/unit	480,000
		Nil variance

Material Usage Planning Variance (Cake)

		Kg
Ex-ante	360,000units@ standard of 0.5kg/unit	180,000
Ex-post	360,000units@ standard of 0.525kg/unit	189,000
		9,000A
	@ standard price	₦200
		1,800,000A

Total Material Usage Planning Variance

		Kg
Ex-ante	600,000units@ standard (240,000 x 2 + 360,000 x 0.5)	660,000
Ex-post	600,000units@ standard (240,000 x 2 +360,000 x 0.525)	669,000
		9,000A
		₦200
	Standard Price	₦1,800,000A

a(iv) **Material Usage Operational Variance (Bread)**

		Kg
Ex-ante	240,000units@ standard of 2kg/unit	480,000
Actual	240,000units actually consumed 2kg/unit	496,000
		16,000A
	@ standard price	₦200
		3,200,000A

Material Usage Operational Variance (Cake)

		Kg
Ex-post	360,000units@ standard of (0.525/kg)	189,000
Actual	360,000units actually took	190,000
		1,000A
	Standard price	₦200
		200,000A

Total Material Usage Operational Variance

		Kg
Ex-post	600,000units@standard (240,000x2 + 360,000 x 0.525)	669,000
Actual	600,000units actually took (436,000 +190,000)	686,000
		17,000A
	Standard Price	₦200
		3,400,000A

(b) Benefits of Planning and Operational Variances

i. They indentify variances due to poor planning and put a realistic value to variances resulting from operations.

ii. They are used to update standard costs and revise budgets.

iii. Performance of managers is assessed on realistic variance computations using ex-post standard costs that are more realistic than ex-ante standard costs.

iv. Standard costing and variance analysis are more realistic and meaningful in changing conditions.

v. Operational variances provide an up to date guide to current levels of operating efficiency as the standards have been recomputed using up to date information.

vi. Standard costing becomes more acceptable and thus have positive effect on motivation.

vii. Systematic method of reviewing standards is provided as well as the assumptions contained within them.

viii. It allows management to assess effectiveness of planning process.

x. Improvements can be made to standard setting process.

ALTERNATIVE SOLUTION TO 2(a)

Alternative Method

The material price planning variance (MPPV) could be calculated using the revised quantity rather than the actual quantity. Similarly, the material usage operational variance (MUOV) could be calculated using the revised price rather than the original standard price. **Full credit will be given** where this alternative method is used instead. However, it should be used for both the MPPV and the MUOV, otherwise the figures will not reconcile.

A step-by-step workings of the alternative method are now provided

Material Planning Variances

		₦	₦
Original budget (Ex-ante):			
Bread	₦200×2kg× 240,000	= 96,000,000	
Cake	₦200 × 0.5kg × 360,000	= 36,000,000	132,000,000
Revised budget (Ex – post):			
Bread	₦236* ×2gk × 240,000	113,280,000	
Cake	₦236*×0.525kg** × 360,000	44,604,000	157,884,000
Total material planning variance			25,884,000(A)

* ₦236 = ₦200 × 1.18

** 0.525kg = 0.5kg ×1.05

Note: The question does not ask for the total planning variance. It is included for educational purposes.

a) i) **Material Price Planning Variances (MPPV)**

MPPV = (OSP – RSP) ×RSQ × AQP

where

OSP = original standard price per unit of the raw material
RSP = revised standard price per unit of the raw material
RSQ = revised standard quantity of raw material allowed per unit of output
AQP = actual quantity of output produced

Bread	(₦200 – ₦236) ×2kg× 240,000	₦17,280,000(A)
Cake	(₦200 – ₦236) × 0.525kg × 360,000	₦6,804,000(A)
		₦24,084,000(A)

iii) **Material Usage Planning Variances (MUPV)**

MUPV = (OSU – RSU) × OSP, where

OSU = original raw material usage. That is, the total quantity of raw materials allowed by the original standard, for actual output produced.
RSU = revised standard raw material usage for actual production

	₦	₦
Bread [(240,000 × 2kg) – (240,000 × 2kg)] × ₦200	0	
Cake [(360,000 ×0.5kg) – (360,000 × 0.525kg)]× ₦20	1,800,000(A)	1,800,000(A)

Check:

	₦
MPPV	24,084,000(A)
MUPV	1,800,000(A)
Total material planning variance	25,884,000(A)

Material Operational Variances

	₦
Ex-post budget as above	157,884,000
Actual material cost = ₦232 × (496,000kg + 190,000kg)	159,152,000
Total material operational variance	1,268,000(A)

Note: Once again this total is not required by the question.

ii) **Material Price Operational Variances (MPOV)**

MPOV = (RSP – AP) × AQ Purchased:

Bread	(₦236 – ₦232) × 496,000kg	₦1,984,000(F)
Cake	(₦236 – ₦232) × 190,000kg	760,000(F)
		2,744,000(F)

iv) **Material Usage Operational Variances (MUOV)**

MUOV = (RSQ – AQ used) × RSP

Bread:	[(240,000 × 2kg) – 496,000kg] × ₦236	₦3,776,000(A)
Cake:	[(360,000 × 0.525kg) – 190,000] × ₦236	236,000(A)
Total MUOV		₦4,012,000(A)

Check:

	₦
MPOV	2,744,000(F)
MUOV	4,012,000(A)
Total material operational variance	1,268,000(A)

Note:
In the above solution, deliberate effort has been made to put the planning variances together and the operational variances together.

Marking Guide

ai)	Material Price Planning Variance		Mark	Mark
	Bread	Ex- Ante	½	
		Ex Post	½	
		Summation	½	
	Cake	Ex-Ante	½	
		Ex-Post	½	
		Summation	½	
	Total	Ex Ante	½	
		Ex post	½	
		Summation	½	
				4

Any 8 out of 9 ticks. Maximum of 4 marks

aii)	Material Price Operational Variance		Mark	Mark
	Bread	Ex- Ante	½	
		Actual	½	
		Summation	½	
	Cake	Ex-Ante	½	
		Actual	½	
		Summation	½	
	Total	Ex Ante	½	
		Actual	½	
		Summation	½	4

Any 8 out of 9 ticks. Maximum of 4 marks

aiii)	Material Usage Planning Variance		Mark	
	Bread	Ex- Ante	½	
		Actual	½	
		Summation	½	
	Cake	Ex-Ante	½	
		Actual	½	
		Summation	½	
	Total	Ex Ante	½	
		Actual	½	
		Summation	½	4

Any 8 out of 9 ticks. Maximum of 4 marks

aiv)	Material Usage Operational Variance		Mark	
	Bread	Ex- Post	½	
		Actual	½	
		Summation	½	
	Cake	Ex-Post	½	
		Actual	½	
		Summation	½	
	Total	Ex Ante	½	
		Actual	½	
		Summation	½	4
	Any 8 out of 9 ticks. Maximum of 4 marks.			4
2(b)	One full mark for any four points 1 x 4			
		Total		20

EXAMINER'S REPORT

The question tests candidates' knowledge on planning and operational variances. The benefit of determining such variances are also tested.

Candidates are expected to compute the material price planning variances, material price operational variances, material usage planning variances and material usage operational variance for the two products – bread and cake. They are also expected to discuss the benefits of planning and operational variances.

Candidates understood the question and performance was above average.

Many candidates were unable to properly distinguish between planning and operational factors. Figures which should have been used for computing planning variance were used for operational variance and vice versa.

Candidates are advised to master this core section of the syllabus on variance and its uses as it is of vital importance to management decision making.

SOLUTION 3

CASKO LIMITED

Total Cost

	₦		₦
Material	1,320,000.00	Joint Cost (JC)	3,884,600.00
Processing cost	2,564,600.00		
	3,884,600.00		3,884,600.00

a(i) **Statement of profit or loss on each of the four products**

Products	W	X	Y	X	Total
Units	400,000	89,230	5,000	9,000	503,230
	₦	₦	₦	₦	₦
Sales	3,840,000.00	1,160,000.00	160,000.00	1,200,000.00	6,360.000.00
App. of JC	(2,345,418.87)	(708,511.95)	(97,725.79)	(732,943.40)	(3,884,600.00)
*APC	(800,000.00)	(640,000.00)	-	(40,000.00)	(1,480,000.00)
Profit	694,581.13	(188,511.95)	62,274.21	427,056.60	995,400.00

*Additional Processing Cost (APC)

a(ii) **Method I: Using change in contribution**

Products	W	X	Y	X	Total
Units	400,000	89,230	5,000	9,000	503,230
	₦	₦	₦	₦	₦
SP/Units	6.40	8.00	32.00	100.00	
Sales value	2,560,000.00	713,840.00	160,000.00	900,000.00	4,333,840.00
Joint cost					3,884,600.00
Revised Profit					449,240.00
Old profit					995,400.00
Net profit					(546,160.00)

METHOD II COST- BENEFIT ANALYSIS APPROACH		
	₦	₦
New sales value	4,333,840.00	
Old sales value	6,360,000.00	
		(2,026,160.00)
Additional cost:		
Old	1,480,000.00	
Savings from selling off immediately	0	
		1,480,000.00
Net Effect		(546,160.00)

By adopting the alternative strategy, the total contribution of the firm will reduce by ₦546,160.00.

(b) The long-run approaches to pricing decisions are:

i. Pricing customized products

ii. Pricing non-customized products

iii. Target costing for pricing non-customized products.

Marking Guide

A(i)	Profit or Loss of Products		Mark	Mark
	Unit	4 ticks	½ each	
	Sales values	5 ticks	½ each	
	Apportionment of Joint Cost	5 ticks	½ each	
	Additional cost	4 ticks	½ each	
	Profit	5 ticks	½ each	10
	Any 20 ticks @ ½			
Method I		Mark	Mark	
A(ii)	Unit cost	5 ticks	½ each	
	Selling price	4 ticks	½ each	
	Application of joint costs	5 ticks	½ each	
	Joint cost	1 tick	½ each	
	Profit	1 tick	½ each	
	Revised profit	1 tick	½ each	
	Net	1 tick	½ each	
	Effect	1 tick	½ each	8
	16 ticks @ ½ mark			
OR				
Method II				
	New sales value			
	Old sales value			
	Loss in sales			
	Saving at split point			
	Net effect			
	Any 4 ticks at 2 marks			8 marks
b)	Any 2 ticks equals 2 marks			2
	Total			20

EXAMINER'S REPORT

The question tests the ability of candidates in the preparation of product production cost statements of joint products up to split-off point and product profitability on further processing thereafter.

The question also requests for approaches to long-run pricing decisions.

Candidates are expected to correctly determine and apportion joint cost and the Profit or Loss on Products W, X Y and Z. They are also expected to give consideration to additional processing costs after split-off point and advise on the proposal.

About 70% of the candidates attempted the question and understood its requirements.

However, 40% of them had challenges with the Joint cost apportionment process. Poor presentation of results also affected them. Many candidates were not well acquainted with approaches to pricing decisions.

Candidates are advised to ensure adequate practice with related Institute's Past Question Papers and Study Packs.

SOLUTION 4

MOOJ LIMITED

Internet Trading is a form of e-commerce involving buying and selling of goods and services through electronic retailing for improving overall performance.

The Board of Directors of MOOJ Limited should consider the following factors prior to a decision being taken regarding trading on the internet:

i. **SET-UP COST**

It can be fairly expensive for MOOJ Limited to establish a website for selling its own clothes and taking payments by credit card, debit card, interswitch on payPal. Irrespective of the level of profitability of MOOJ Limited, there is still need for a thorough Cost-Benefit-Analysis (CBA) before making such a decision.

ii. **TYPE OF BUSINESS**

Some products and services are easier to sell than the others on the internet. For example, Computer firms like HP, Dell, Toshiba, etc, 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 online. No matter how much detail about clothing items is provided on the website or how many photographs are provided, there are difficulties in selling goods by catalogue. For MOOJ Limited that intends to sell clothing by internet, it has to budget for larger amount of sales returns, but there are no minimum or maximum turnover requirements for each branch of MOOJ Limited. Hence, there is no concern for profit figure. This approach needs to be changed if the Board of Directors of MOOJ Limited would make a decision on internet business.

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 revisit the website.

iv. **TIME TO ESTABLISH THE SYSTEM**

It takes time to establish a website that customers know about and want to visit coupled with the fact that there is no Wide Area Network (WAN) and the head office has few integrated system.

v. **INADEQUATE IN-HOUSE SKILLS**

MOOJ Limited might not employ individuals with the knowledge or skills to maintain a website. Also, the Directors recognize that the current Information Technology (IT) infrastructure of MOOJ Limited is inadequate for internet trading.

vi. **SECURITY**

Internet is not a secure environment and hackers can fiddle with important data. Therefore, platform must be encrypted and password protected.

vii. **DYNAMIC ENVIRONMENT**

Internet environment is constantly changing at a rapid pace. If the firm is unable to cope with latest trend and technology, the business will be left behind.

viii. **USER INTERFACE**

The design should be user-friendly.

ix. **ETHICS & CORPORATE IMAGE**

Internet business is built on trust between the customers and the firms. There is a need for the company to establish good corporate image and ethics of selling quality products and ready to replace any defective products.

x. **EASY SHOPPING**

Shopping on internet is more comfortable to customers hence may likely attract more customers than shops.

Marking Guide	Mark	Mark
Brief Explanation of Internet Trading:		
This is a form of e-commerce involving		
Sales of goods and services	1	
Through Electronics retailing	1	
For improving overall performance	1	2
Any two point of 1 mark each		

IDENTIFICATION/STATING

1.	Set up cost	1
2.	Type of nature of business	1
3.	On going operating cost	1
4.	Time to establish the system	1
5.	No in-house skills	1
6.	Security concern/issues	1
7.	Dynamic environment	1
8.	User interface	1
9.	Ethics and corporate image concern	1
10.	Easy shopping	1

1 mark for each point stated up to maximum of 6 points (1 x 6) 6

DISCUSSION/EXPLANATION

Discussion of the points listed under identification of the 6 points selected by the candidates.

Two mark for each item discussed up to maximum of 6 points 2 x 6 12

20

EXAMINER'S REPORT

The question tests candidates' knowledge on strategic and performance management matters relating to trading on the Internet.

Candidates are expected to discuss on set-up cost, types of business, dynamic environment for internet trading, security issues, staff training, user interface, ethical issues and corporate image concern and feasibility of easy shopping.

Candidates understood the question and performance was above average.

A few candidates displayed inadequate knowledge of Information Technology and requirements of Internet trading.

Candidates are advised to update their knowledge on current developments in IT and its effect on management operations and performance.

SOLUTION 5

a) i) Material Price Variance

=	AQP (SP – AP)	
A	105,000(100 – 10,290,000/105,000)	= ₦210,000 (F)
B	148,000(80 – 11,988,000/148,000)	= ₦148,000 (A)

ii) Material Usage Variance:

=	SP(SQ – AQ used)	
A	100[(4,800 × 20kg) – 99,000]	= ₦300,000 (A)
B	80[(4,800 × 30kg) – 144,000]	= ₦0

iii) **Material Mix Variance**

Material	Actual Qty @ Std mix	Actual Qty @ actual mix	Std Price	Mix Variance
	(a)	(b)	(c)	(a – b) × (c)
A	97,200*	99,000	₦100	₦180,000(A)
B	145,800**	144,000	₦80	₦144,000(F)
	243,000kg	243,000kg		₦36,000(A)

$* = {}^{20}/_{50} \times 243{,}000$, $** = {}^{30}/_{50} \times 243{,}000$

iv) **Material Yield Variance**

Material	Std Qty @ Std mix	Actual Qty @ Std mix	Std Price	Mix Variance
	(a)	(b)	(c)	(a – b) × c
	Kg	Kg	₦	₦
A	96,000	97,200	100	120,000(A)
B	144,000	145,800	80	144,000(A)
	240,000*	243,000		264,000(A)

* 4,800 × 20 = 96,000
4,800 × 30 = 144,000
240,000

v) Labour Rate Variance

=	AH(SR – AR)	
Skilled	56,000(₦40 – ₦2,352,000/56,000)	= ₦112,000(A)
Unskilled	56,000(₦25 – ₦1,344,000/56,000)	= ₦56,000(F)

vi) Labour Efficiency Variance

=	SR(SH – AH)	
Skilled	₦40[(4,800 × 10hrs) – 56,000]	= ₦320,000(A)
Unskilled	₦25[(4,800 × 10hrs) – 56,000]	= ₦200,000(A)

vii) Labour Mix Variance

	Actual Hrs @ Std mix	**Actual Hrs @ actual mix**	**Std rate**	**Mix Variance**
	(a)	**(b)**	**(c)**	**(a – b) × c**
	(Hours)	**(Hours)**	**₦**	**₦**
Skilled	56,000	56,000	40	0
Unskilled	56,000	56,000	25	0
	112,000	112,000		0

viii) Labour Yield Variance

	Std Hrs @ Std mix	**Actual Hrs @ Std mix**	**Std rate**	**Yield Variance**
	(a)	**(b)**	**(c)**	**(a – b) × c**
Skilled	48,000	56,000	40	320,000(A)
Unskilled	48,000	56,000	25	200,000(A)
	96,000	112,000		520,000(A)

xi) Variable Overhead Expenditure Variance

=	AH(SR – AR)	
=	56,000(₦20 – ₦1,064,000/56,000)	= ₦56,000(F)

x) Variable Overhead Efficiency Variance

=	SR(SH – AH)	
=	₦20[(4,800 × 10hrs) – 56,000]	= ₦160,000(A)

b) **Possible causes of variances**

i) Material Price Variance

Material A: The favourable variance could be due to:

- efficient negotiation;
- lower grade of raw material bought at lower price which possibly resulted in adverse:
  - material usage variance
  - material yield variance
  - labour efficiency variance

Material B: The variance is adverse and could be due to:

- unexpected increase in market price
- inaccurate standard, etc

ii) Material Usage Variance

Material A: The adverse usage variance could be due to:

- inferior raw material – as noted above
- inexperienced operatives
- poor supervision, etc

iii) Labour rate variance

- Skilled labour – The adverse variance may be due to:
  - employment of superior skilled labour paid at higher rate;
  - unexpected higher rate in the market, etc
- Unskilled labour – The favourable rate variance may be due to:
  - effective negotiation
  - lower grade of labour, etc

iv) Labour efficiency variance

- Skilled labour – The adverse variance may be due to:
  - poor quality raw materials and the resultant high rate of rework;
  - machine malfunctioning
  - power failure
  - poor supervision, etc
- Unskilled labour – The adverse variance may be due to the same reasons as enumerated under skilled labour above.

v) Variable overheads variances.
All the variable overheads variances are likely to be due to the same reasons as listed under labour.

Note: credit will be given for alternative relevant points

b) **ANALYSIS OF VARIANCES**

Variance Type	**Amount**	**Reasons for Variance**
Direct Material		
Price variance for Material A	₦210,000F	Savings of ₦2 (₦100 – ₦98) in Material price for 105,000kg purchased
Direct Material		
Price variance for Material B	₦148,000A	Higher cost than budgeted (₦81 – ₦80) = ₦1 for the quantity purchased which is 148,000kg
Direct Material		
Mix variance for Material A	₦180,000A	Use of 99,000kg of A instead of 97,200kg meaning additional usage of 1,800kg at ₦100/kg
Direct Material		
Mix variance for Material B	₦144,000F	Used 144,000kg instead of 145,800kg meaning a savings in use of 1,800kg at ₦80/kg
Direct Material		
Yield variance for Material A	₦120,000A	Company should have used 96,000kg instead of 97,200kg meaning over used of 1,200kg at ₦100
Direct Material		
Yield variance for Material B	₦144,000A	The 4,800 units are produced from 145,800kg instead of 144,000kg meaning over usage of 1,800kg at ₦80/kg

Variance Type	**Amount**	**Reasons for Variance**
Direct Material		
Usage variance for A	₦300,000A	The sum of the yield and mix variance of Material A
Direct Material		
Usage variance for B	NIL	The sum of the yield and mix variance of Material B
Direct labour		
Rate variance for skilled labour	₦112,000A	The result of rate difference of ₦2.. (₦42 – ₦40) for 56,000hour
Direct labour		
Rate variance for unskilled labour	₦56,000F	The savings from lower rate of ₦1 i.e. (₦25 – ₦24) for the number of hours of 56,000 hours worked
Direct labour		
Mix variance for skilled labour	NIL	Hours planned was utilized
Direct labour		
Mix variance for unskilled labour	NIL	Hours planned was actually used
Direct labour		
Yield variance for skilled labour	₦320,000A	Expected mix of hours for the actual production is 48,000 hours but 56,000 hours used resulting in 8,000 difference at ₦40 per hour
Direct labour		
Yield variance for unskilled labour	₦200,000A	Expected mix of hours for actual production is 480,000hours but 56,000 hours was used resulting in 8,000hours at ₦25per hour

Variance Type	Amount	Reasons for Variance
Direct labour		
Efficiency variance for skilled labour	₦320,000A	Sum of mix and yield variance on skilled labour
Direct labour		
Efficiency variance for unskilled labour	₦200,000F	Sum of mix and yield variance on unskilled labour
Variable overhead expenditure variance	₦56,000F	Actual rate is ₦19/hour while the standard rate is ₦20/hour, meaning that a savings of ₦1 for the hours used which is 56,000 hours
Variable overhead efficiency variance	₦160,000A	Expected number of hours to be used in producing 4,800 units is 48,000 hours, but used 56,000 hours i.e. 8,000 hours more at rate of ₦20

Marking Guide		Mark	Mark
(a)	Calculation of relevant variance		
	Direct Material Variances		
	Direct Material Price Variance for A	½	
	Direct Material Price Variance for B	½	
	Direct Material Mix Variance for A	½	
	Direct Material Mix Variance for B	½	
	Direct Material Yield Variance for A	½	
	Direct Material Yield Variance for B	½	
	Direct Material Usage Variance for A	½	
	Direct Material Usage Variance for B	½	
	Any six 6 of Direct Materials Computed @$^1/_2$		3

Direct Variances	Mark	Mark
Direct Labour Rate Variance for Skilled	½	
Direct Labour Rate Variance for Unskilled	½	
Direct Labour Mix Variance for Skilled	½	
Direct Labour Mix Variance for Unskilled	½	
Direct Labour Yield Variance for Skilled	½	
Direct Labour Yield Variance for Unskilled	½	
Direct Labour Efficiency Variance for Unskilled	½	
Direct Labour Efficiency Variance for Unskilled	½	
Any 6 of direct Labour Variance computed @ ½		3
Variable Overhead Variance		
Variable Overhead Expenditure Variance	1	
Variable Overhead Efficiency Variance	1	2
	(A)	8

(b) **Reasons/Explanations of Direct labour Variances**

Ability to explain the reasons for any six of the variance computed above for Direct Materials attracts ½ marks each.		3
Reasons/Explanations of Variable Overhead Variances		
Ability to explain the reasons for the variable overhead Expenditure and variable overhead efficiency variances Attract ½ mark each.		1
	(B)	7
Grand total (A) + (B)		15

EXAMINER'S REPORT

The question tests candidates' knowledge on standard costing and variance analysis, its interpretation and possible reasons for the variances.

Candidates are expected to compute the price usage, mix and yield components of direct material variances. They are also expected to compute the rate, efficiency, yield and mix components of direct labour variances.

Candidates are also expected to determine the expenditure and efficiency components of variable overhead variance. They are also to interprete and offer possible reasons for the variances.

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

Many candidates could not clearly give possible reasons for the variances computed. Some others could not also correctly computer the direct material mix and yield variances.

Candidates are advised to thoroughly master variance analysis.

SOLUTION 6

TEE COMPANY

(a) Green Product

	Sales in unit	**Contribution per unit**	**Total contribution**
		₦	**₦**
Quarter			
1	100,000	5.6	560,000
2	90,000	5.6	504,000
3	81,000	5.6	453,600
4	72,900	5.6	408,240
		Total contribution	1,925,840
	Less Administrative Worker's expenses (₦20,000 x 5)		(100,000)
			1,825,840

Note: Fixed cost is not relevant in decision making **Brace Product**

	Sales (Y = 80,000 +6,000T) units	**Contribution ₦**	**Total contribution ₦**
1	86,000	6	516,000
2	92,000	6	552,000
3	98,000	6	588,000
4	104,900	6	624,000
		Total contribution	2,280,000
	Incremental fixed cost (₦40,000 x 4)		(160,000)
			2,120,000

Based on the above analysis, Brace Product should be introduced in Year 7 to produce additional contribution of ₦294,160 i.e. ₦2,120,000 – ₦1, 825,840.

(b) **Brace Product**

(i) Analysis of Revenue and cost if changeover is on the 1st of January

	₦
Contribution for the quarter	516,000
Realizable value of non count asset	140,000
Redundancy cost	(40,000)
Savings in Administrative worker's salary	100,000
	716,000

Brace Product

(ii) Analysis of cost and revenue if the changeover is on the 1st of July

	₦
Contribution for the quarter	588,000
Realizable value of asset	30,000
Redundancy cost	(50,000)
Savings in Administrator worker's salary	50,000
	618,000

Note (i) Written down value of asset is a combination of historical cost and depreciation that are both irrelevant. Therefore, assets that are no longer required will have only realizable value to the holders.

(ii) Savings in Administrative workers' salary will be 100% saved, if changeover takes place in January 1st. In contrast, if changeover takes place on 1st July, only 50% will be saved.

	Marking Guide	Mark	Mark
(a)	Green product		
	Green – Sales in units	$^4/_5$	
	Contribution	$^4/_5$	
	Total contribution	$^4/_5$	
	Summation	$^1/_5$	
	Admin worker's expenses	$^1/_5$	
	Grand total	$^1/_5$	3
	Brace		3
	Conclusion		1
	Computation of additional contribution		1
b)	Brace product		
	Schedule of revenue cost changeover		
	Contribution for the quarter	$^1/_2$	
	Realizable value of non-current asset	$^1/_2$	
	Redundancy cost	$^1/_2$	
	Savings in Adm cost	$^1/_2$	
	Summation	$^1/_2$	2.5
	Schedule of revenue cost 1 July		
	Contribution	$^1/_2$	
	Realization value noncurrent	$^1/_2$	
	Redundancy cost	$^1/_2$	
	Savings in Admin cost	$^1/_2$	
	Summation	$^1/_2$	2.5

Correct recommended decision	1	
Correct analysis of additional contribution	1	
Grand total		15

EXAMINER'S REPORT

The question tests candidates' knowledge of the application of Marginal costing technique and relevant costing principles for decision making.

Candidates are expected to compute the outcomes of two options on continued sale and timing of a product and recommend appropriate decisions for profit maximization. The application of relevant costing principles is also required in making the changeover decision.

Candidates did not clearly understand the question as only about 10% of the candidates attempted it. The few candidates who attempted it could not correctly interpret the result. Poor presentation was also common with many candidates.

Candidates should properly master the application of marginal costing techniques to management problems and the variations in its applications.

SOLUTION 7

STUCK LIMITED

(a) A Management Information System is an approach a company uses (in this case, Stuck Limited) when making various business decisions. Business owners and managers are responsible for operational, technical and strategic decisions.

Using Management Information System (MIS) helps to make the best decisions possible. Looking at the information currently being provided to the Directors of Stuck Limited, the following weaknesses are inherent:

(i) **CAPTURING OF INCOMPLETE INFORMATION**

The information was produced by a new member of the accounting department without reference to past production data. This means that the expected income and expenditure is unreliable and unrealistic because there was no reference to past production data which would ultimately lead to inconsistency of information;

(ii) **INACCURACY OF INVENTORY REPORT**

One important quality of information is accuracy and completeness. However, the inventory report comprises 80% of the output from the MIS itself; and

(iii) **LACK OF INTEGRATED IT INFRASTRUCTURE AND BREVITY OF SUMMARY**

Another essential quality of information is brevity. Management may not have time to react and evaluate appropriately too much information as it may result in information overload. However, the information should be brief and concise.

(b) The output or report emanating from the MIS can be improved if the following reports are embedded in the system and provided to the Directors:

(i) **Periodic reports**: These are presented in predetermined format at specified intervals of time. They are normal output of any data processing system;

(ii) **Triggered reports**: They are reports on specific situation. By their very nature, the marketing task and the marketing decisions require a host of triggered reports on various situations and subjects. In fact, the competence of the MIS gets tested by its capacity to give the right triggered report;

(iii) **Demand reports**: These are the answers provided by the system to specific queries raised by the marketing decision makers; and

(iv) **Exception reporting mechanism**: In exception reporting, information is filtered to report only on data that is outside of a normal condition. Exception reports help managers save time as they help management to focus on situations that require immediate decisions or actions.

Marking Guide		**Mark**	**Mark**
a)	Definition of MIS	$1^1/_2$	$1^1/_2$
	Weaknesses of the Present System		
	i) Capturing of Incomplete Information	$2^1/_2$	
	ii) Inaccuracy of Inventory report	$2^1/_2$	
	- Lack of integrated IT infrastructure	$2^1/_2$	$7^1/_2$
b)	Improvement of MIS		
	i) Periodic Reporting	2	
	ii) Giving right Triggered Reports	2	
	iii) Provision of Reports on demand	2	
	iv) Exception report mechanism	2	6
	Any two points at 3 marks each (2 x 3)		15

EXAMINER'S REPORT

The question tests candidates' knowledge of Management Information Systems (MIS), its weaknesses and how such weaknesses can be addressed to improve management information and control.

Candidates are expected to discuss the challenges of MIS in the company and the types of report needed to enhance management decision making process.

Candidates did not clearly understand the (b) part of the question which requires suggestions for improving the information process.

Performance was below average.

Candidates are advised to step up their MIS knowledge in order to perform better.
The use of the Institutes Study Pack for their preparations should not be neglected.

SKILLS LEVEL EXAMINATION - NOVEMBER 2015

PUBLIC SECTOR ACCOUNTING & FINANCE

Time Allowed: 3 hours

SECTION A: COMPULSORY QUESTION (30 Marks)

QUESTION 1

Top-Hill State Investment Agency, a government business entity provided the following transactions for the financial year ended December 31, 2014.

a. On January 1, 2014, the company acquired machinery on lease which had a fair value of ₦500,000 and NIL residual value at the end of its economic life of five years. Lease payment of ₦139,778 was first made on January 1, 2014. Lease payment is to be made on the first day of the financial year. The implicit interest rate was put at 8%.

b. Top-Hill State Investment Agency also incurred borrowing costs of ₦5million during the financial year ended December 31, 2014 out of which ₦1.2million related specifically to the construction of a qualifying asset. It is the policy of the Agency to capitalise borrowing cost according to IPSAS 5 on 'Borrowing Costs'.

c. Top-Hill State Investment Agency uses cost-model to account for its investment properties. At the end of 2013 financial year, investment properties had a carrying value of ₦4.5million. The Agency depreciates investment properties using 25% on reducing balance. The fair value of the properties on December 31, 2014 was put at ₦4.2million.

Required:

i. Explain how the newly leased machinery should be treated in the Financial Statements (Extracts) of the Agency.

ii. State the amount to be taken to the Statement of Financial Performance (Extracts) and Statement of Financial Position (Extracts) for the year ended December 31, 2014.
(20 Marks)

iii. Explain how the ₦5million borrowing costs should be treated in the financial statements (Extracts) and state the amount to be taken to the Statement of Financial Performance (Extracts) and Statement of Financial Position (Extracts) for the year ended December 31, 2014.
(4 Marks)

iii. Identify and explain the accounting entries that would be required as at December 31, 2014 to account for the Investment Properties. (6 Marks)

(Show workings) **(Total 30 Marks)**

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

(40 MARKS)

QUESTION 2

Mr. Betta Tomoro is a staff of Goodlife Local Government Council of Welfare State. He has been in the local government council's employment for twenty-five (25) years. Recently, he attained the age of fifty-two (52) years. He had risen to the post of an Assistant Director on grade level 15, step 2. Mr. Betta Tomoro and his employer had contributed the sum of ₦8.5million under the old Pension Scheme and Pension Reform Act 2014. Monthly contribution is sent to his Pension Fund Administrator (PFA), Diversity Pension Managers Limited.

It is the practice of the Pension Fund Administrator to send to Mr. Betta Tomoro the records of his pension on monthly basis. However, in April 2015, no further record was received by Mr. Betta Tomoro concerning his pension fund. This resulted in his visit to the Pension Fund Administrator's office to inquire about the sudden stoppage of his pension fund.

During cross-examination at the Court of Competent Jurisdiction to hear pension-related offences, it was found out that five staff of Diversity Pension Managers Limited had bought mansions in Victoria Garden City and other houses in London valued at ₦380million. They jointly floated a company, Owo-mugun Limited with all operational infrastructure in place, all valued at ₦175million. They also had ₦18million in various local and international bank accounts.

After two hearings on the allegations of criminal misappropriation of clients' pension monies filed against these staff, judgement was reserved by the court for December 15, 2015.

Required:

a. In line with the Pension Reform Act 2014, identify **TWO** acts that constitute criminal offences. (4 Marks)

b. If by December 15, 2015, the five staff are found guilty of misappropriation of clients' pension fund, state **THREE** penalties provided to be imposed on them as provided in the Pension Reform Act 2014. (6 Marks)

c. Identify **THREE** Courts of Competent Jurisdiction that can hear pension-related cases as provided in the Act. (3 Marks)

d. If Mr. Betta Tomoro preferred to withdraw his service voluntarily from Goodlife Local Government Council at the age of forty-five (45) years, what provisions would be available to him concerning his pension contribution? (3 Marks)

e. Assuming the prevailing interest rate is 21.5%, compute the total amount payable by the convicts, (including interest) if the entire amount misappropriated is ordered to be refunded by the court. (4 Marks)

(Total 20 Marks)

QUESTION 3

Cash management is one of the challenges of Treasuries all over the world.

a. Identify any **FOUR** objectives of cash planning and management. (2 Marks)

b. Discuss any **FIVE** weaknesses in the current system of cash management in Nigeria. (10 Marks)

c. Irepodun State is inhabited by 8,000,000 citizens. The State is expected to generate revenue from different sources. The following details are provided for the 2015 fiscal year.

   (i) The number of taxable adults residing in the State is 3,500,000. The rate of tax payable per resident is ₦20,000 per taxable adult on average per annum.

   (ii) There are 22,500 industries which are expected to pay land use charges of ₦10,000 per industry.

   (iii) There are 2,300,000 residential buildings expected to pay land use charge of ₦4,500 per house per annum.

   (iv) The modern markets built by the State Government will generate ₦12,000 per annum per stall and ₦5,000 per annum per seller and hawker operating in the markets. There are 3,000 modern stalls and 250,000 sellers and hawkers that are assumed to be operators of the markets in any year. The local governments within the areas of location of the markets are entitled to 50% of revenue generated from the markets.

   (v) There are 5,000 mass transit buses owned by the State Government, each of which generates ₦5,000 per business day. Assume 28 business days in a month.

   (vi) The State expects the following additional revenue in the year:

	₦'Million
Statutory allocation from the Federation Account	25,000
Miscellaneous Revenue	3,000

Required:

Compute the revenue budget of Irepodun State Government for the fiscal year 2015. **(Show your workings)** (8 Marks)

(Total 20 Marks)

QUESTION 4

The following information has been extracted from the books of Egbin Electricity Board, a public sector owned electricity generating company, for the year ended December 31, 2014:

	₦'000
Accumulated Depreciation, January 1, 2014	45,224
Sale of Electricity	114,392
Purchase of Electricity	95,784
Meter reading, billing and collection of electricity	1,624
Non-Current Assets Expenditure	84,102
Debtors for electricity consumption read in the year and other sales	12,006
Training and welfare	692
Stock and work in progress	1,234
Rents, Rates and Insurance	2,126
Electricity Estimated unread consumption	7,222
Administration and General Expenses	1,476
Electricity Council Grant	21,556
Preparation of Electricity Council's Expenses	362
Bank Balance and Cash	1,284
Depreciation for the year	3,634
Hire purchase and deferred payment installations not yet due	2,672
Interest and Financing Expenses	2,434
Creditors and accrued liabilities	13,926
Profits on contracting and sale of appliance poles A/c	534
Reserves	23,116
Rental of Meters Application, etc.	556
Distribution cost	4,476
Customer Service	1,810

Required:
Prepare in vertical form the Statement of Financial Performance and Statement of Financial Position of the Egbin Electricity Board, for the year ended December 31, 2014.

(Total 20 Marks)

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

(30 MARKS)

QUESTION 5

a. The functions of the office of the Auditor-General for the Federation is to audit the accounts of all Accounting Officers and all persons entrusted with the collections, receipts, custody and issue or payment of the Federal Government moneys or with the receipt collection issue, sale transfer of delivery of any stamps, securities, stores, or other property of the Government of the Federation and for the certification of the annual accounts of the Government.

   In the light of the above, state three audit objectives of:

   i. Treasury Accounts.
   ii. Agency Accounts.
   iii. Government Enterprise Accounts. (9 Marks)

b. i. State **THREE** tests to be carried out when auditing a revenue collector. (3 Marks)

   ii. Identify any **THREE** internal control questionnaires to evaluate the operation of imprest accounts. (3 Marks)

(Total 15 Marks)

QUESTION 6

Inspite of the abundant human and natural resources with which Nigeria is endowed, the country is conspicuously listed among developing countries of the world. In the light of the foregoing,

a. Explain **FOUR** features of a developing economy with particular reference to Nigeria. (8 Marks)

b. Discuss **THREE** allocation “roles of government” in the context of a developing economy. (7 Marks)

(Total 15 Marks)

QUESTION 7

In order to achieve some development objectives, nations place emphasis on priority programmes like the provision of basic infrastructure and development projects, all of which require appropriate funding.

Required:

a. By means of specific relevant examples, distinguish between "**basic infrastructure**" and "**development projects**". (3 Marks)

b. Discuss **TWO** development objectives which the priority programmes you refer to in (a) above are planned to achieve. (4 Marks)

c. Identify **TWO** sources of funding for these priority projects stating **TWO** distinct characteristics of each source identified and **TWO** factors that facilitate the commercial viability of the projects. (8 Marks)

(Total 15 Marks)

SOLUTIONS

SOLUTION 1

TREATMENT OF LEASED ASSET (MACHINERY)

(i) Newly Leased Machinery should be treated as follows in the Financial Statements (Extract)

Finance Lease

- Leases shall be recognised as assets acquired under finance lease term.
- Associated costs or lease obligations to be treated as liabilities (in their statement of financial position).
- The assets and liabilities shall be recognised as amount equal to the fair value of leased property, if not, the lessees' incremental borrowing rate of interest shall be used.
- Contingent rents recognized as an expense in the period.

JOURNAL ENTRIES STATING THE AMOUNT TO BE TAKEN TO STATEMENTS OF THE FINANCIAL PERFORMANCE AND POSITION

	Details	Dr ₦	Cr ₦
i.	Lease PPE (Machinery)	602,723.00	
	Interest Suspense	96,167.00	
	Lease Liability		698,890.00
	Being Lease Assets and Associated Liability recognised at the beginning of the year		
ii.	Lease Liability	139,778.00	
	Bank		139,778.00
	Being 1st Installment paid in January 1, 2014		
iii	Interest Expense	19,233.00	
	Interest Suspense		19,233.00
	Being Interest due as at December 31, 2014		
iv	Depreciation Charges	120,545.00	
	Accumulated Depreciation		120,545.00
	Being Depreciation Charges for the year ended December 31, 2014		

Top-Hill State Investment Agency
Statement of Financial Performance for the year ended December 31, 2014

	N
Expenditure	
Depreciation Charges	120,545.00
Interest Expense	19,233.00

Top-Hill State Investment Agency
Statement of Financial Position as at December 31, 2014

Non Current Assets	**₦**	**₦**
Lease PPE (Machinery	602,723.00	
Less: Accumulated Depreciation	120,545.00	482,178.00
Current Assets		
Interest Suspense		76,934.00
Non Current Liabilities		
Lease Liability (Machinery)		559,112.00

Workings

a)

Year		DF (8%)	DCF
	N		N
1/1/2014	139,778.00	1.0000	139,778.00
1/1/2015	139,778.00	0.9259	129,420.00
1/1/2016	139,778.00	0.8573	119,832.00
1/1/2017	139,778.00	0.7938	110,956.00
1/1/2018	139,778.00	0.7350	102,737.00
	698,890.00		**602,723.00**

The present value of the minimum lease payment ₦602,723.00 exceeds the fair value of the asset which is ₦500,000.00, by ₦102,723.00.

b)

Lease Liability (Machinery)	₦ 698,890.00
Less: Payment (January 1, 2014)	₦139,778.00
Bal. December 31, 2014	₦559,112.00

c)	Interest Suspense	₦96,167.00
	Less: Interest Expense	₦19,233.00
	Bal. December 31, 2014	₦76,934.00

(ii) **How borrowing costs should be treated in the financial statements (Extracts):**

- Borrowing costs should be recognized as an expense in the period in which they are incurred except to the extent that they are capitalized.

- Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalized as part of the costs of that asset.

Amount to be stated in the Financial Statements (Extracts):

- Amount to be taken to the statement of financial performance is ₦3,800,000 (to be expended).

- Amount to be taken to the statement of financial position is ₦1, 200,000 cost relating to the construction of a qualifying asset (to be capitalized)

iii) Cost-model method was used for the value of the old investment (See Journal i) while Fair-value model was used for the reinstatement of the investment properties of ₦4,200,000.00 as at December 31, 2014 (See Journal ii).

SN	Details	Dr ₦	Cr ₦
I	Acc. Depreciation Account	1,125,000.00	
	Revaluation Account	3,375,000.00	
	Investment Property Account		4,500,000.00
	Being the close of the previous Investment Property Account		
Ii	Investment Property Account	4,200,000.00	
	Revaluation Account		3,375,000.00
	Revaluation Surplus Account		825,000.00
	Being reinstatement of the new value of the Investment Property		

Marking Guide		Marks	
i)	Identification and explanation of Characteristics of Finance Lease		
	Any three Characteristics multiply by 1 mark	3	
	Accounting entries through Journal entries or explanation		
	• Recognition of amount to be debited to PPE (Machinery)	½	
	Recognition of amount to be debited to Lease Suspense Acct	½	
	Recognition of amount to be credited to Lease Liability Acct	½	
	Journal Narration	½	
	• Recognition of amount of Lease Liability paid in the year	½	
	Recognition of amount credited to the bank	½	
	Journal Narration	½	
	• Recognition of amount of Interest Expense for the year	½	
	Recognition of amount debited to Interest Suspense Acct	½	
	Journal Narration	½	
	• Recognition of amount of Depreciation Charged for the year	½	
	• Recognition of amount credited to Accumulated Depreciation	½	
	• Journal Narration	½	
	Amount to be stated in Financial Performance		
	• Name of company and title of the Statement for the period	½	
	• Depreciation Charges	1	
	• Interest Expense	1	
	Amount to be stated in Financial Position		
	• Name of company and title of the Statement for the period	1	
	• Recognition of amount of Lease PPE in Non- Current Assets	½	
	• Recognition of amount of Acc. Depreciation in Non- Current assets	½	
	• Recognition of amount of Interest Suspense in Current Assets	½	
	• Recognition of amount of Interest Expense for the year	½	
	• Recognition of amount of Lease liability/Non- Current Liabilities	½	
Workings			
	• Present values of lease payments 5 @ ½	2½	
	• Basis of Lease Liabilities	1	
	• Computation of interest suspense 3 @ ½	1	
			20
ii)	Explanation of treatment in Financial Statements	2	
	Recognition of amount of to be taking Statement of Financial Performance	1	
	Recognition of amount of to be taking Statement of Financial Position	1	
			4
iii)	Explanation of models to be used for the exiting investment before Fair valuation	2	
	Explanation or Journal Entries		
	• Recognition of amount debited to Accumulated Depreciation	½	
	• Recognition of amount debited Revaluation Account	½	
	• Recognition of amount credited to Investment Property Account	½	
	• Journal Narration on previous Investment Property account	½	
	• Recognition of amount debited to Investment Property Account	½	
	• Recognition of amount Credited to Revaluation Account	½	
	• Recognition of amount credited to Revaluation Surplus Account	½	
	• Journal Narration on previous Investment Property account	½	
			6
Total Marks			**30**

EXAMINER'S REPORT

The question tests the application of IPSAS 5, 13 and 16 respectively as they relate to the treatment of Non-Current Assets under leasing by a government agency. All the candidates attempted the question but their performance was below average.

Candidates' major pitfall was their ignorance of the contents of the three tested IPSAs. Candidates are advised to familiarise themselves with IPSAS when preparing for their future examination.

SOLUTION 2

PENSION REFORM ACT, 2014

a) In line with the Pension Reform Act 2014, the following circumstances will constitute criminal offences are

i) A Pension Fund Administrator, Pension Fund Custodian that reimburses or pays for a staff, officer or director directly or indirectly a fine imposed under this Act commits an offence and is liable to a fine of not less than N5,000,000.00 and also forfeited the amount repaid or reimbursed to the staff or officers or directors.

ii) A Pension Fund Administrator, Pension Fund Custodian or person or body who misappropriates or diverts pension fund.

iii) A Pension Fund Custodian who contravenes the provisions of section 70 by utilizing any pension fund or assets in its custody to meet its financial obligation to any person whatsoever.

iv) A Pension Fund Administrator, Pension Fund Custodian or person or body who refuses to:

- produce any book, account, document or voucher
- give any information or explanation required by an examiner

v) A Pension Fund Administrator, Pension Fund Custodian or person or body who with intent to defraud

- produces any book, account, document or voucher
- gives any information or explanation, which is false or misleading in any material particular,
- supplies information which he knows to be false or supplies the information recklessly as to its truth or falsity

vi) Where a director, manager, secretary or other officers of body corporate who had knowledge or believed to have had knowledge of the commission of the offence and who did not exercise due diligence to ensure compliance with the Act shall be deemed to have committed the offence.

b) Where the five staff is found guilty of misappropriation of the clients' pension fund, the penalties to be imposed on them as provided in the Pension Act. 2014 are as follows:

i) Prison term of 10 years or a fine three times the amount misappropriated or both.

ii) Forfeiture of the entire assets and properties or funds with accrued interest or the proceeds of any unlawful activity under the Act in his/her possession.

iii) Refund of the amount so misappropriated or diverted.

c) Courts of Competent Jurisdiction are;

i) Federal High Court

ii) FCT High Court

iii) State High Court

iv) National Industrial Court

d) Conditions for withdrawal;

i) Mr. Better Tomoro can only withdraw his service voluntarily on attaining 50 years of age.

ii) He can only retire if he is less than 50 years (i. e.45 Years), on the advice of suitably qualified physician or properly constituted Medical Board, certifying that the employee is no longer mentally and physically capable of carrying out the function of his office or if the officer is retired due to his total or permanent disability either of mind or body.

iii) Where the employee retires before the age of 50 years in accordance with the terms and conditions of his employment.

Total Amount Payable by the convicts (including interest in accordance with Section100 Sub-sections 1-3.

Total Contribution by Mr. Betta Tomoro			**₦'Million**	**₦'Million**
i)	Section 100(1)	₦8.5 Million X 3		25.50
ii)	Section 100(2)			8.50
iii)	Properties forfeited Section 100(3)			
	Houses Victoria City & London		380.00	
	Owo-mugun Ltd		175.00	
	Fund in the Banks		18.00	
	Interest			
	April 1, 2015 to December 15, 2015			
	$\frac{8.5}{12}$ X 21.5% X ₦18million =		2.74	575.74
	Total Amount Payable			**609.74**

Marking Guide			**Marks**
a)	Identification of Acts that consistitute criminal offences 2 x 2		4
b)	Identification of Penalties 2 x 3		6
c)	Identification of courts of competent jurisdiction to hear pension related cases 1 x 3		3
d)	Any 3 provisions available for voluntary retirement at the age of 45 years 1 x 3		3
e)	Amount to be refunded as per section 100 (i) and (ii)	1	
	Amount to be forfeited as per section 100 (iii)	3	4
			20

EXAMINER'S REPORT

The question tests the application of the provisions of the Pension Reform Act, 2014 as it relates to acts that constitute criminal offences, misappropriation of clients' funds, courts of competent jurisdiction and provision for voluntary withdrawal from the scheme at an age below the Act's prescribed 50 years.

Candidate's commonest pitfall was their unfamiliar knowledge of the provisions of the new Pension Reform Act, 2014.

Candidates are advised to always prepare very well for future examination.

SOLUTION 3

CASH PLANNING AND MANAGEMENT

a) **The Objectives of cash planning and management are to:**

i. Facilitate budget execution by ensuring that fund is available at the right time.

ii. Enable government to anticipate the funding gap that may arise in government implementation so that adequate arrangements that would minimize borrowing cost can be put in place.

iii. Minimize idle cash by investing any surplus fund to yield good returns.

iv. Ensure that government contracts are awarded only when funds are available in line with 2007 Public Procurement Act.

v. Ensure effective monitoring and reconciliation of government relevant statutory accounts.

vi. Promote transparent and fraud resistant government operation

b) **Weaknesses on the current system of cash management in Nigeria are;**

i) **Inadequate Tracking and Monitoring of Independent Revenue**
As a result of poor supervision, inadequate monitoring and lack of sanctions against those that failed to make remittances of revenues as at when due, some of the anticipated revenue are hardly collected, accounted for and remitted to the Consolidated Revenue Fund (CRF) as appropriate. Moreover, revenue fees, Identity cards fees etc are hardly remitted to the designated account as provided for by the extant rules and circular.

ii) **Overdependence on Federation Account**
The Federal Government depends largely on earnings from the oil and gas sector of the economy. Consequently, its cash inflow largely depends on statutory allocations from the Federation Account.

iii) **Lack of Strong Inter-Agency Collaboration**
There is lack of strong inter-agency collaboration between revenue collecting, accounting and monitoring agencies. All the stakeholders in revenue generating and monitoring agencies appear to be working independently. Usually, there is the problem of information flow between the stakeholders, agencies that are critical to an effective cash management system i.e. FMF, OAGF, BOF, CBN, DMO, FIRS, NCS, NNPC, etc.

iv) **Existence of Idle Funds**

Substantial balances are usually available in the MDAs' Recurrent and Capital Accounts with Commercial Banks and yet contractors are not usually paid immediately as evidenced by the balances in their capital account. While idle funds are in bank account of MDAs, government still goes on borrowing through ways and means to finance expenditure warrants due to lack of a co-ordinated and integrated approach to cash management.

v) **Inability to effectively monitor oil revenue**

The Oil-revenue monitoring system is almost non-operational and ineffective. It is bedeviled by such constraints as the inadequacy of funds for the operation; lack of knowledgeable and skilled personnel. All of these, among others, have frustrated cash planning and management in the country.

vi) **Late Release of Warrants and Incessant Use of Authority to Incure Expenditure (AIE's)**

Expenditure warrants are sometimes released late especially at the beginning and end of the year. This practice not only causes distortion in cash flow management but elicit inexplicable spending. There is also incessant use of Authority to Incure Expenditure (AIEs) instead of Warrants for releases of funds which tends to put pressure on the available cash resources and distort cash flow plan. For instance, in 2005 fiscal year, 745 AIEs were issued for cash backing.

vii) **Direct Release of Funds to Beneficiary Rather than through Ministries, Departments and Agencies (MDAs)**

Certain commitments of Government are remitted directly to the beneficiary instead of channelling them through the MDAs resulting in non-reporting of such transactions in the transcript of accounts.

viii) **Unauthorized Use of Independent Revenue**

Some MDAs and foreign Missions usually draw from independent revenue to finance their operations, ostensibly due to non remittance of their allocations and refunds are not made to revenue when they eventually receive their allocations. This practice reduces the Independent Revenue and causes distortion in financial reporting.

ix) **Lack of effective structure for Cash Management**

There is inadequate structure to support cash management in terms of adequate calibre of staff, office equipment and full deployment of information and communication technology (ICT) in the Office of the Accountant- General of the Federation (OAGF). The current structure and staffing of funds division requires re-engineering for effective and efficient service delivery. At the MDAs, where Government programmes /projects are executed, there is no formal structure in existence for effective and efficient cash Management. As a result of this, there is no effective reconciliation of Appropriations vis-a-vis warrants/mandates issued and CBN Cash backings. Financial information generated in the current system is therefore grossly inadequate to assist stakeholders make timely and accurate decisions on Cash Management.

x) **Absence of Database of Accounts Maintained by MDAs**

Although the AGF approves banking relationship of MDAs with both commercial and central banks, yet, the OAGF has no database of these accounts. The Accountant-General of the Federation (AGF) as the Head of Treasury should have proper records of accounts maintained by MDAs for planning, control and monitoring purposes.

xi) **Inadequate Policy on Commercial Banking Relationship**

The MDAs maintain their recurrent accounts and some special accounts with commercial Banks, yet, there is no obligation for these banks to render returns of accounts held with them. A rendition of returns periodically will assist the OAGF to monitor the accounts of the MDAs.

xii) **Lack of Punishment for Non-Compliance with Extant Rules**

Although the organs of OAGF responsible for monitoring compliance with extant rules such as the Inspectorate Department, Treasury Internal Audit, etc sometimes render reports that show compliance failures yet, no specific punishment is given because these are not stated in the financial regulations.

c)

IREPODUN STATE GOVERNMENT

REVENUE BUDGET FOR 2015 FISCAL YEAR

	₦'Million	₦'Million
Statutory Allocation from Federation Account		25,000
Income Tax (W i)		70,000
Land Use Charges (Industrial Buildings) (W ii)		225
Land Use Charges (Residential Buildings) (W iii)		10,350
Stalls Revenue (W iv)	36	
Revenue from Sellers and Hawkers (W iv)	1,250	
Total Revenue from Stalls, Sellers & Hawkers	1,286	
Less: Local Governments entitlements		
(50% of ₦1,286 Million)	643	
Revenue from Stalls, Sellers & Hawkers due to State Government		643
Revenue from Mass Transit Buses (W v)		8,400
Miscellaneous Revenue		3,000
Total Revenue		**117,618**

Workings

		₦'Million
i)	Income Tax (3,500,000 X ₦20,000)	70,000
ii)	Land Use Charges (Industrial Buildings)	
	(22,500 X ₦10,000)	225
iii)	Land Use Charges (Residential Buildings)	
	(2,300,000 X ₦4,500)	10,350
iv)	Stalls Revenue (3,000 X N12, 000)	36
	Revenue from Sellers and Hawkers (250,000 X ₦5,000)	1,250
v)	Revenue from Mass Transit Buses	
	(5,000 X 28 X 12 X ₦5,000	8,400

Marking Guide			Marks
a)	Identification of objectives cash planning & management 4 x ½		2
b)	Discussion of any five weaknesses in the current system of cash management		
	Any 5 x ½ (Mentioning)		2½
	Discussion 5 x 1½		7½
c)	Computation of Revenue Budget 12 x ½	6	
	Working 6 x $^{1}/_{3}$	2	8
			20

EXAMINER'S REPORT

The question tests candidate's knowledge of cash planning and management and the preparation of Revenue Budget.

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

Candidate's commonest pitfall was their poor knowledge of the objectives and weaknesses of cash planning and management and inability to identify weaknesses in the current system of cash management.

Candidates are advised to prepare very well and to take time to differentiate million from billion in figure in future examination.

SOLUTION 4

FINANCIAL REPORTS OF EGBIN ELECTRICITY BOARD

Egbin Electricity Board
Statement of Financial Performance for the Year Ended December 31, 2014

	₦'000
Sales of Electricity	114,392
Less: Purchases of Electricity	95,784
Gross Profit	**18,608**
Profit on Contracting and Sale of Appliance Poles	534
Rental of Meter Applications	556
Total Profit (A)	**19,698**
Less: Expenditure	
Meter Reading Billing and Collection of Electricity	1,624
Training and Welfare	692
Rent, Rates and Insurance	2,126
Administration and General Expenses	1,476
Preparation of Electricity Council's Expenses	362
Depreciation	3,634
Interest and Financing Expenses	2,434
Distribution Cost	4,476
Customer Services	1,810
Total Expenditure (B)	**18,634**
Net Income (A – B)	**1,064**

Egbin Electricity Board
Statement of Financial Position as at December 31, 2014

	₦'000	₦'000
Non- Current Assets:		
At Cost		84,102
Less: Accumulated Depreciation		
₦(45,224,000 + 3,634,000)		48,858
Net Book Value		**35,244**
Current Assets:		
Stock and Work-in-Progress	1,234	
Debtors/ Receivables	12,006	
Electricity Estimated Unread Consumption	7,222	
Hire Purchase and Deferred Payment Installments	2,672	
Bank Balance and Cash	1,284	
	24,418	

Current Liabilities:		
Payables/Creditors and Accrued Liability	(13,926)	
Working Capital		10,492
Net Total Assets		**₦45,736**

Financed by:	**₦'000**
Electricity Council Grant	21,556
Reserves Brought Forward	23,116
Retained profit for the year	1,064
	₦45,736

Marking Guide		Marks	
i)	Statement of Financial Performance 17 ticks x ½	8½	
ii)	Statement of Financial Position 17 ticks x ½	8½	
iii)	Ascertainment of Gross profit	1½	
iv)	Ascertainment of Net profit	1½	
	Total Marks		**20**

EXAMINER'S REPORT

The question tests candidates' knowledge of the preparation of statement of financial performance and position for a government parastatal.

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

Candidates' major pitfall was their non-compliance with the requirements of the question.

Candidates are advised to always comply with the examination question's requirements.

SOLUTION 5

AUDIT OBJECTIVES AND TOOLS OF AUDIT

a) i) **Treasury Account Audit Objectives are to:**

- Ensure that all money is being received as and when due.
- Ensure that the money received is accounted for.
- Ensure that cash book and other relevant memorandum accounts are maintained.
- Confirm compliance with the year 2006 Financial Regulations.
- Guide against misappropriation.
- Ensure compliance with all relevant financial legislations.
- Ensure safety of government assets within each department.
- Guarantee the accuracy of the records.
- Confirm existence and ownership of the assets.

ii) **Agency Accounts Objectives are to:**

- Ensure compliance with all relevant legislations that set up the Agency.
- Ensure compliance with the prescriptions of the accounting manual.
- Ensure misappropriation is reduced to the barest minimum.
- Ensure safety of government assets within each Agency of Government.
- Ensure the reliability of the records and returns.
- Ensure that payments and receipts are in line with the trust deeds that established the agency.
- Ensure that returns are being rendered as at when due.
- Confirm existence and ownership of the Agency Assets.

(iii) **Government Enterprise Accounts objectives are:**

- Confirm compliance with the laws that established the enterprises.
- Confirm compliance with the provisions of the accounting manual.
- Ensure safety of the enterprise assets.
- Ensure that receipts and payments are in line with the approved Budget.
- Guide against misappropriation.
- Confirm the existence of government enterprise assets.
- Prove ownership of assets.

b) i) The following relevant tests will be carried out when auditing a revenue collector

- Review the system for revenue collection.
- Review the cash book.
- Cast the cash book.
- Check for the type of receipts being issued, to confirm originality.
- Review and continue the preparation of bank reconciliation.
- Spot check on the revenue collector.
- Review the reports of internal and external auditors.
- Review to ensure that all money due is collected and accounted for.

(ii) The following are necessary questionnaires to review imprest accounts operation

- Will a bank account be opened for imprest over ₦20,000?
- Was the imprest cash book properly kept?
- Were imprest vouchers properly kept and classified?
- Was the imprest account correctly accounted for at the time of your check?
- Was the LPO register kept by the imprest holder and cash disbursement for LPO made by him?
- Were receipts issued for unspent cash returned?
- Was the reimbursement request checked?
- Were the classifications made to the appropriate Head and Subhead of expenditure?
- Were all standing imprests retired at the end of the year?
- Were all regulations regarding the control of expenditure and disbursement of public money observed by imprest holders?

	Marking Guide		Marks
a)	Objectives of;		
	i)	Treasury accounts	
		Any 3 x 1	3
	ii)	Agency accounts	
		Any 3 x 1	3
	iii)	Government Enterprise Accounts	
		Any 3 x 1	3
b)	i)	State three tests for auditing a revenue collector	
		Any 3 x 1	3
	ii)	List any three internal control questionnaire to evaluate imprest operation accounts	
		Any 3 x 1	3
			15

EXAMINER'S REPORT

The question tests candidates' knowledge on the objectives of auditing treasury, Agency and Government Enterprise accounts with the test to be carried out when carrying out revenue audit and the types of internal control questionnaire to evaluate the operation of imprest account.

About half of the candidates attempted the question and their performance was average. Candidates' commonest pitfall was their inability to interprete the questions correctly.

Candidates are advised to prepare very well for future examinations.

SOLUTION 6

FEATURES AND ROLES OF GOVERNMENT IN DEVELOPING ECONOMY

Nigeria is a nation endowed with abundant human resources, by reason of its size of population and growth rate of population. Perhaps much more, it has in abundance natural resources, notably vast land, crude oil deposits, bitumen, iron ore etc. Except for crude oil, these resources have remained largely unexploited, a situation which has kept or consigned Nigeria to be so classified as a developing nation.

a) Features of a Developing Economy

As a developing economy, Nigeria is characterized by the following features:

i) Low levels of living standard, characterized by low incomes inequality and widespread poverty incidence.

ii) Low levels of productivity of factor inputs, especially of the labour and capital resources.

iii) High rates of population growth and dependency burdens.

iv) Low levels of literacy, significant school dropout rates and inadequate and often irrelevant educational curricula and facilities.

v) Inadequate investment in human capital development and skill acquisition.

vi) High and rising levels of unemployment and underemployment.

vii) Technological dependence and low technological capability to harness sufficiently available resources.

viii) Heavy dependence on primary-product exports especially crude oil

b) Allocation roles of Government

A developing economy is generally characterized by the prevalence of imperfect markets and limited information. Hence, in some cases the market mechanism fails entirely, while in others it can function only in an inefficient way. This provides a fundamental basis for governmental intervention and role, especially in developing countries.

i) The allocation function relates to the provision of social goods, or the process by which total resource use is divided between private and social goods and by which the mix of social goods is chosen.

ii) Government has to provide for public goods such as national defence, basic infrastructure (roads, bridges, rail lines etc) and government administration. These goods cannot be provided through market mechanism but are essential for consumers. Government has to provide them by allocating resources to these public goods accordingly.

iii) Human capital investment, by way of substantial government expenditure in education and health, offers much the most important part of public capital formation. Allocation roles of government are particularly justified in view of positive externalities and quite promising social rate of returns derivable from these investments.

iv) Some development projects are of strategic importance to the economy e.g. iron and steel development projects, dams and irrigation projects, power supply etc. These projects have high prospects of promoting growth, employment generation and poverty alleviation, rapid industrialization and sustainable growth and development. Private sector investment may not be forthcoming and inadequate for these projects, requiring heavy capital outlay and involving long gestation period. In this type of investment, it makes economic sense for government to intervene by allocating public resources to the sector.

Marking Guide		**Marks**	
a)	Identification 1 x 4		4
	Explanation 1 x 4		4
b)	Basis for allocation		
	Role 1 x 1	1	
	Allocation roles 2 x 3	6	7
			15

EXAMINER'S REPORT

The question tests candidates' appreciation of the economic environment that defines a developing nation as well as the "allocation roles" of government in such economy. The requirements of the question include identification and explanation of the features of a developing economy; and the discussion of the roles of government in such economy, with particular reference to Nigeria.

It was a popular question as over four-fifths of the candidates attempted the question. The performance in the question was not impressive, very much below average. The candidates could not provide definite and satisfactory discussion of the allocation roles of government. What is required are not the general roles of government, but the allocation roles – excluding the distributive and stabilization roles of government, which many of them discussed.

Candidates are advised to be mindful of the requirements of questions and answer them accordingly. They should have indepth knowledge of each of the basic roles of government: the allocation roles, redistribution functions and economic stabilization, which are spelt out in the Study Pack of the Institute.

SOLUTION 7

APPROPRIATE FUNDING OF BASIC INFRASTRUCTURE AND DEVELOPMENT PROJECTS

(a) **Basic Infrastructure and Development Projects**

The provision of basic infrastructure and development projects constitute priority programmes usually planned and executed to achieve development objectives.

i) By basic infrastructure, it is meant the underlying amount of capital accumulation embodied in roads, railways, waterways, airways and other forms of transportation and communication, plus water supplies, financial institutions, electricity and public services such as health and education.

ii) Development projects are public project investments executed to achieve a set of development objectives, notably improved productivity and economic growth, employment generation and poverty alleviation etc. Examples of such projects include dam construction and irrigation projects, iron and steel development projects, supply of fertilisers and pesticides, small and medium scale enterprises schemes.

b) **Development objectives**

These priority programmes, whether economic infrastructure and development projects, are usually planned to:

i) Facilitate and integrate economic activities;
ii) Promote employment generation and for poverty alleviation;
iii) Influence the pace and diversity of economic development;
iv) Boost productivity performance in sectors of the economy, notably agriculture and industrial sector.

c) **Funding and Viability of Projects**

i) **Sources of funding**

These priority programmes are usually funded by:

- Borrowing from multilateral creditors such as the World Bank and its affiliates, International Monetary Fund, (IMF), African Development Bank (AfDB), International Fund for Agricultural Development (IFAD), etc.

- Issuance of debt instruments such as Treasury Bills, Treasury Certificates and Government.
- Budgetary allocation and deficit financing.
- Foreign Aid and Foreign Direct Investment (FDI).

ii) **Characteristics of sources of funding**

- Each source, as identified above, varies in terms of magnitude and adequacy of funds that could be raised. Borrowing from multilateral creditors is one source that guarantees substantial funding once the economic and technical viability of the programmes are assured.
- Each of the sources of funding has implications for debt burden over a period of time, coming by way of debt servicing and interest payment. This constitutes a disadvantage as far as borrowings from multilateral creditors are concerned.
- In terms of reliability of the source of funding, raising fund for such programmes is usually tied to some conditionalities for the multilateral creditors, while for some other sources, it is a matter of enabling environment, investment policies (for foreign direct investment), and fiscal policy and commitment (for budgetary allocation and deficit financing) and the capability of the capital market to raise sufficient fund from the financial instruments issued.

iii) Commercial viability of the projects

The possible factors that could facilitate or influence commercial viability of the projects are:

- Appropriate funding and timeliness in the flow of fund.
- Cost effectiveness of the projects, namely the prospect of attaining development objectives or maximum output of the project) at the least cost method.
- Availability of (or accessibility to) requisite inputs for project execution, namely appropriate technology, manpower resources relevant data and information, etc.
- Organisational capability and institutional framework for the management and execution of the projects.

Marking Guide			
			Marks
a)	Explanation		
	Basic infrastructure	1 ½	
	Development projects	1½	3
b)	Development objectives 2 x 2		4
c)	Sources of funding 1 x 2	2	
	Characteristics of sources of funding 1 x 2	2	
	Factors facilitating 2 x 2	4	8
			15

EXAMINER'S REPORT

The question tests candidates understanding of the notion of "public goods" as it pertains to basic infrastructure and development projects. Candidates are expected to provide details on public projects, their uses for development objectives, sources of funding and their commercial viability.

Majority of the candidates, about three quarters of the candidates attempted the question. The performance in the question was very poor. Most of the candidates could not provide satisfactory answers to the three aspects of the question, especially identification of sources of funding, their characteristics and facilitating factors of projects viability.

Candidates are advised to have a good grasp of this aspect of the syllabus, namely public expenditure/projects and financing. These are contained in the Study Pack of the Institute and standard texts on Public Finance.

SKILLS LEVEL EXAMINATION - NOVEMBER 2015

MANAGEMENT, GOVERNANCE AND ETHICS

Time Allowed: 3 hours

ANSWER FIVE QUESTIONS IN ALL

SECTION A: COMPULSORY QUESTION (30 Marks)

QUESTION 1

The finance director of Basket Company is preparing a proposal to present to the board of directors. He believes that the company is much too cautious in its policy of giving credit to customers. At the moment all customers are given 30 days' credit.

He believes that by increasing its exposure to credit risk, and increasing credit terms to 60 days, the company will achieve an increase in annual sales of up to 20%. He also thinks that some improvements in debt collection procedures will reduce the level of bad debts, although some bad debts cannot be avoided. He thinks that the value of sales where there is a default will fall each year from 2% of sales to 1.8% of sales.

He proposes that in order to increase annual sales and profits, the company should be willing to increase its risk appetite, and accept the risk of higher bad debts.

Required

(a) Using this example of managing credit risk, explain and illustrate the meaning of:

i. Exposure to risk
ii. Risk of losses
iii. Residual risk
iv. Risk appetite (10 Marks)

(b) There are different methods of managing and controlling risks. Explain and illustrate any THREE of the following approaches to risk management:

i. Risk diversification
ii. Risk transfer
iii. Risk sharing
iv. Risk hedging (15 marks)

(c) What is the main difference between a rules-based and a principles-based code of professional ethics for accountants? (5 marks)

(Total 30 Marks)

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

(40 MARKS)

QUESTION 2

Dolly Homes Plc is a real estate firm based in Abuja. The firm builds residential apartments and office blocks in five states of the federation. The objective of Dolly Homes Plc is to deliver high quality aesthetically designed and professionally built homes/offices to its customers at competitive prices. It employs several skilled and casual workers, construction supervisors, construction engineers, architects and quantity surveyors.

The company maintains a store in each of its building sites. Each store is manned by a store keeper and an assistant. Building materials are purchased centrally and delivered to building sites in accordance with material schedule prepared by the quantity surveyor.

Patronage of the company's products has been impressive, especially from middle and high income brackets. However, recently the company has been receiving several complaints about the poor quality of its products. Of all the complaints, the most alarming was the one reported by a legal practitioner who threatened legal action on behalf of his client for injuries sustained when the kitchen cabinet in his client's home collapsed.

An investigation by management revealed cases of theft of materials from the sites, outright diversion of materials and wastages arising from re-work of poorly finished homes. There were also reported cases of accidents and safety issues on the job, leading to employees' injuries, loss of man-hours and increasing medical claims.

Management has decided to establish a risk management programme to deal with the risk of theft, diversion and health and safety issues.

Required:

a. As an Accountant, develop a risk management programme to deal with the problems of Dolly Homes Plc. (8 Marks)

b. Advise management on the techniques to reduce the frequency of risk exposures in future. (6 Marks)

c. Suggest risk financing techniques to protect the company's Staff from injuries and accidents. (6 Marks)

(Total 20 Marks)

QUESTION 3

Kalu, a competent consultant and accountant, works in Bosun and Company Limited. The company realised that almost all of its newly employed entry level staff are deficient in business and professional ethics. Consequently, the Human Resources Manager recommended to the CEO that a training programme on business and professional ethics should be organised. Kalu is nominated as a resource person to speak at the training programme.

Required:

a. How should Kalu explain the nature and importance of business ethics and professional ethics? (6 Marks)

b. Advise Kalu on how he should analyse Kohlberg's theory of moral development in an attempt to explain to the trainee participants how people generally develop a sense of morality both in personal and professional life. (10 Marks)

c. Discuss any **TWO** of the criticisms of Kohlberg's theory. (4 Marks)

(Total 20 Marks)

QUESTION 4

INSURANCE FIRM AT A CROSS ROAD

Toyin Trust Insurance Company is one of the duly registered insurance companies in Nigeria. Ten years after it started operations in 1990, the company had become a household name in the market. Its strengths included timely payment of claims and introduction of quality products that captured changing customers' needs.

At inception, the company was owned one hundred per cent by foreigners. Consequently, five out of the seven directors were expatriates who were insurance practitioners with many years of experience in the global insurance industry. Similarly, most of the customers were either expatriates or foreign owned companies operating in Nigeria.

By year 2000, fundamental changes had occurred with respect to the ownership structure of the company. More than ninety per cent of the equity had been transferred to Nigerian investors. In 2009, the Board of Toyin Trust Insurance Company was dissolved. Chief Gbadamosi, a retired civil servant was appointed as the new Managing Director/CEO. He immediately embarked on a re-organisation of the company. New branches were established and many of the senior level managers were transferred out of the Head Office to manage the new branches. This prompted most of them to resign their appointments.

New staff were employed but they were mostly nominees of the new investors in the company. With in-experienced personnel manning sensitive positions in the company, the quality of services declined, premium collection also dropped by as much as 40%, as key customers moved their businesses to competitors.

Required:

a. Analyse the strengths of Toyin Trust Insurance Plc before 2000. (5 Marks)

b. Analyse the strengths and weaknesses of Toyin Trust Insurance Plc after 2000. (5 Marks)

c. Suggest essential strategies to sustain the company – Toyin Trust Insurance Plc. (10 Marks)

(Total 20 Marks)

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

QUESTION 5

The owner of ABC Company learnt from a conference he attended and also read in a professional magazine that weak corporate governance accounted for some recent corporate failures in Nigeria. In particular, it was alleged that many members of the board of companies do not have a clear knowledge of the responsibilities and duties of the board.

Required:

The Managing Director will soon address the board and he has requested you to prepare a paper detailing the responsibilities and duties of the board.

(15 Marks)

QUESTION 6

Explain briefly how the following key issues in corporate governance establish how well or badly a company is governed?

a. The role and responsibilities of the board of directors
b. The composition and balance of the board of directors
c. Financial reporting, narrative reporting and auditing
d. Directors' remuneration
e. Risk management and internal control **(Total 15 Marks)**

QUESTION 7

Ade John is a graduate of XYZ University. For his final project work in the Department of Electronics and Electrical Engineering, he designed a cell-phone that is rugged, cheap, handy and not sophisticated.

During his national service year, he kept toying with the idea of manufacturing the cell-phone. To ascertain that there is a market for the phone, he carried out a series of market surveys among rural farmers, artisans, market women, etc. Each time, he was convinced that a market actually exists for his design.

He also made contact with some manufacturers of cell-phone components. He entered into an agreement with CKT Japan to import cell-phone accessories to enable him assemble them in Nigeria. DAB phone is the first of its kind in the Nigerian market and production and assembly commenced in a small room in his uncle's house at Ikare.

The first batch of phones manufactured by DAB Company was supplied to cell-phone vendors in cities on 'sale or return' basis. To encourage distributors to accept the phones, a 15% margin was allowed. In addition, independent sales persons (hawkers) were given between 10 -12% margin to sell the product. In spite of the low price of DAB phones, demand was disappointing at the end of the first year. Nevertheless, Ade John is still optimistic about the commercial viability of the phone if only he could develop an effective strategy to market the DAB phones.

Required:

a. Identify and explain TWO reasons for the slow growth of sales of DAB phones. (4 Marks)

b. With the aid of an S-shaped growth curve, evaluate market development of DAB phones. (6 Marks)

c. Recommend the strategies that Ade John can use to improve sales. (5 Marks)

(Total 15 Marks)

SOLUTIONS

Solution 1

a. Explanation and Illustration of:

i. Exposure to Risk

- Exposure to risk is a situation in which an entity may suffer a loss or experience a negative impact due to the occurrence of unfavourable events or adverse changes in the environment.

EXAMPLES

- If the company suffers higher incidence of bad debts due to increased credit period, this will ultimately lead to loss of income and profit.
- There is also the risk of loss of income if customers are lost due to the fact that the credit period is too short.

ii. Risk of Losses

- This is the chance that negative events may occur in the organisation or environment which may lead to loss of income and ultimately profitability.

EXAMPLE

- In this case, if the credit period is increased, the risk of bad debt is heightened, which may ultimately lead to loss of income and profitability.

iii. Residual Risk

- This is the risk that subsists or remains after measures have been taken to control or reduce the risk in a situation.
- In the present case, an EXAMPLE of residual risk is the risk remaining after the improvement of the debt collection process as recommended by the Finance Director

iv. Risk Appetite

- The risk appetite of an organisation is the level of risk it is willing tolerate in order to earn profit. It varies from organisation to organisation.

- In this case, the company currently grants 30 days credit while the Finance Director wishes that the company grant 60 days credit. This will increase the company's risk appetite on credits to customers.

b. Methods of Managing and Controlling Risks:

i. **Risk Diversification**

- This is the process of spreading an organisation's risk over different areas and sectors of operation with the belief that if returns from operations in some areas of operation or sectors fall below expectation, it will be made up with a higher than expected returns in other areas of operations or sectors, leading, on the average, to an expected return. This leads organisations to hold different portfolios of investments and operations .

- This strategy is most useful where the investments in the portfolio have different risk profiles.

- The company has the competencies to manage the different risks in the portfolio.
- Examples include when conglomerates operate in many sectors of the economy. If there is a slump in one sector, there may be a boom in another sector, thus helping the organisation to balance its income and ultimately, returns.

OR

- This is very common in the financial sector, where investors in financial instruments spread their risks by investing in various sectors of the economy and in different types of instruments in the hope of having a balanced return.

ii. **Risk Transfer**

- This is a risk management process where the organisation passes specific identified risks to some other entities that bear the risk. Thus the organisation protects itself from the risk through cover provided for it by these other entities.

- The returns from the risk must be far in excess of the premium paid for the cover, otherwise, it is not worthwhile.

- This is usually done through insurance cover for which the company pays an insurance premium to the insurer. The premium is the cost of the cover provided by the insurer.

iii. **Risk Sharing**

- This is risk management process whereby an entity assumes risks in conjunction with other entities. It also shares the returns with them.

- Organisations usually adopt this strategy when they enter into new areas of operations, new sectors or new geographical locations, where they have limited experience.

- This is usually done in the form of partnerships and joint ventures. The partner usually has more experience and expertise in the new area or sector.

- Multinational corporations usually appoint local partners when entering into new territories.

- Organisations also usually appoint technical partners for areas where they lack competence.

iv. **Risk hedging**

- This is a risk management process usually adopted in financial markets for management of financial risks whereby they create a transaction to absorb an exposure to another risk.
- It is used to limit or offset the probability of loss from fluctuations in prices.
- Examples include situations in which companies create financial market instruments to provide a cushion for the vagaries of the foreign exchange market. These instruments provide cover for the risk of foreign exchange losses.
- These instruments come in the form of derivatives such as options, futures and swaps.

c. What is the main difference between a rules based and a principle based code of professional ethics for accountants?

Rules-based code of professional ethics for accountants

- Consists of specific rules about how accountants should act in specific situations.
- Such rules are issued by professional regulatory bodies such as ICAN.

A principles-based code of ethics for accountants

- Specifies general principles of ethical behaviour that professional accountants are required to act in accordance with.
- Going by this type of code of ethics, accountants are required to exercise judgment/discretion in deciding whether in each case a particular course of action is 'proper' or 'ethical'.
- These general principles include the principles of integrity, objectivity, professional competence and due care, confidentiality, professional behaviour and technical standards.

Marking Guide		**Marks**	
1a	Explanation and Illustration of		
I	Exposure to risk:		
	Explanation	1.5	
	One example from the case	1	
			2.5
II.	Risk of Losses		
	Explanation	1.5	
	One example from the case	1	
			2.5
iii.	Residual risk		
	Explanation	1.5	
	One example from the case	1	2.5
iv.	Risk Appetite		
	Explanation	1.5	
	One example from the case	1	2.5
			10
1b	Explanation and Illustration of **THREE** of the following approaches to risk management:		
i.	Risk diversification		
	Explanation	3	
	One Illustration	2	
			5
ii.	Risk transfer		
	Explanation	3	
	One Illustration	2	
			5
iii.	Risk sharing		
	Explanation	3	
	One Illustration	2	5
iv.	Risk hedging		
	Explanation	3	
	One Illustration	2	
			5
(5 marks for each of any three above)			**15**

c. Rules-based code of professional ethics for accountants

• Specific rules	1 ½	
• Issued by professional regulatory bodies	½	
		2
A principles-based code of ethics for accountants		
• Specifies general principles of ethical behaviour	1	
• Requirement to exercise judgment/discretion	1	
• 2 examples of general principles	<u>1</u>	
		3
		5
Total		<u>30</u>

EXAMINER'S REPORT:

The question tests candidates' knowledge of and ability to illustrate concepts in the management of credit risk as well as different methods of managing and controlling risk. The third part of the question tests candidates understanding of rules-based and principles-based code of professional ethics.

Candidates' understanding of the question is fair and performance was just average. Many candidates were unable to define concepts in risk management or illustrate the concepts from the case study. More significantly, many candidates did not know the difference between rules-based and principles-based code of professional ethics.

Candidates at this level of the examination are advised to study to understand concepts and acquire skills to illustrate them from a body of materials.

SOLUTION 2

a. RISK MANAGEMENT PROGRAMME

- A Risk Management Programme is a procedure for identifying, evaluating, mitigating or accepting risks.
- A risk is any event or situation whose occurrence may lead to an adverse effect on the ability of the organisation to meet its strategic objectives.
- This effect is strategic in nature and as such the development of the approach to risk management is usually a responsibility of the board of the company.
- It usually comes in the form a framework comprising of a procedure for establishing the approach, committing resources and implementing systems for risk management.

b. Approach to Risk Management

- The Board and Top Management of Dolly Homes Plc must establish the objective of the risk management process to ensure the attainment of the vision of the organisation to deliver high quality, aesthetically designed and professionally built homes/offices to its customers at competitive prices.
- The board and top management must also ensure the attainment of these objectives by developing programmes to deal with the risk of poor quality output arising from theft and diversion of materials: and health and safety hazards of personnel.
- The management should also evolve a culture to prevent theft and diversion of materials and propagate a programme emphasising the importance of personnel safety and health.
- Policies should be formulated to cover theft and diversion of materials and safety and health of personnel.
- Specialist units should be established to manage materials control, personnel safety and health.
- The board and management should provide full support for the programme.
- This strategy should be clearly articulated and communicated to all levels in the organization.

Deployment of Resources

Resources are to be deployed to ensure that:

- Employees are trained in risk management;
- Internal control is strengthened to prevent theft and diversion of materials;
- Staff are trained in health and safety procedures;
- Specific staff to be responsible for the risk management process are identified; and

- A system is developed to alert management on impending risks and provide remedies promptly.

Implementation

- Risk assessment: This is the identification and evaluation of the impact of the various risks involved in the organisation – risk of theft of materials, diversion of materials and personnel safety and health hazards -- on the attainment of the strategic objective of the Dolly Homes Plc.
- Having assessed the high impact of the risk of theft and diversion of materials; and safety and health hazards on the attainment of the company's vision of providing high quality aesthetically designed and professionally built homes/offices to its customers at competitive prices, Dolly Homes Plc should:
  - Institute controls to mitigate risks; and
  - Monitor risks.

ANOTHER APPROACH

ISO 31000 Approaches to Risk Management

This is an approach developed by the International Organisation for Standardization. It has three components:

- Risk Architecture (equivalent to the approach above): It involves:
  - Allocation of roles and responsibilities to the board, management and staff, audit committee, and risk management committee.
- Risk Strategy (equivalent to the resource deployment above): Risk Strategy includes the risk appetite of the board and its risk management action plan. The board and management must provide resources to support the risk management system.
- Risk Protocols (equivalent to Implementation above): These are rules and procedures for implementation of the strategy and feedback processes.

2b. Techniques to reduce the frequency on such risk exposures in the future:

i. Theft of Materials
   - Provision of good custody for materials
   - Good internal control process for acquisition and receipt of materials
   - Education of staff on the risk to the reputation of the company caused by theft
   - Obtaining insurance for inventories (risk transfer)

ii. Diversion of Materials

- Provision of adequate security on each of the sites
- Quantity surveyors and engineers must provide adequate supervision at every stage of each project
- Improved internal control on the requisition process for materials from the store
- Obtaining insurance for inventories (risk transfer)

iii. Safety and health issues (risk mitigation)

- Provision of safety gears, such as helmet and boots
- Adoption of safe work processes
- Provision of safety equipment such as fire extinguishers on site
- Provision of first aid materials
- Provision of warning systems
- Provision of muster points in emergency situations

2c. Financing techniques to protect the company's staff from injuries and accidents:

- Provision of accident insurance cover for staff (risk transfer);
- Provision of life insurance policy cover for staff (risk transfer);
- Retainership of medical facilities; and
- Provision of safety equipment such as helmets and work boots in the work place (risk mitigation).

Marking Guide		Marks	
	Risk Management		
a.	Risk Management Programme		
	Explanation of Risk Management Programme		2
	Components of the Programme		
i.	Approach to Risk Management	2	
ii.	Deployment of Resources	2	
iii.	Implementation	2	
	OR		6
	ISO 31000 APPROACH TO RISK MANAGEMENT PROGRAMME		
I.	Risk Architecture	2	
II.	Risk Strategy	2	
III.	Risk Protocols	2	
			6

b. Techniques to reduce the frequency of such risk exposures in future:

i. Theft of Materials
(1 mark for each of any two points) 2

ii. Diversion of Materials
(1 mark for each of any two points) 2

iii. Safety and health issues
(1 mark for each of any two points) 2
6

c. Financing techniques to protect the company's staff from injuries and accidents:

- Provision accident insurance cover for the staff;
- Provision of life insurance policy cover for staff;
- Retainership of medical facilities;
- Provision of safety equipment such as helmets and work boots in the work place. 6
(2 marks for each of any three points)

Examiner's Report

The question tests candidates' ability to develop a risk management programme to deal with the specific situation faced by Dolly Homes Plc. Candidates are also expected to advise on the techniques to reduce the frequency of the risk exposures as well as suggest the risk financing techniques the company may use to protect its staff from the hazards of injuries and accidents.

About 60% of candidates' attempted the question and performance was below average. Many candidates who attempted the question did not understand what was required to develop a risk management programme. However some were able to suggest some common risk financing techniques.

Candidates are advised to study this section of the syllabus, as risk management constitutes a core skill of a chartered accountant.

SOLUTION 3

a

i. Nature of business ethics

- Business ethics describes the moral principles and values that guide how people and institutions behave in the world of business.
- It considers how the pursuit of self-interest/profit affects other parties through the actions of individuals or firms.
- When embodied in formal corporate code of ethics, it provides a reference point for employees and other stakeholders' behavior within business organisations.
- The business ethics of a business organisation will apply to all its employees.

ii. Nature of professional ethics

- It describes the moral principles and values that govern behaviour in the context of specific professions such as the legal profession, architecture and accountancy.
- Professional ethics are usually specified in the professional code of conduct that all members and students professing or aspiring to be part of specific professions must abide by.
- Adherence to ethical codes of specific professions is usually a requirement for membership.

iii. Importance of business ethics

- Long-term growth: business ethics facilitates long-term growth of business entities and also enhances their profitability.
- Cost and risk reduction: companies that appreciate the importance of a sound business ethics will spend less protecting themselves from internal and external behavioural risks, especially when supported by sound governance systems and independent research
- Sustainability: upholding sound business ethics would enable businesses to pursue their business goals in ways that would minimize their negative impact on the environment and all stakeholders..
- Limited resources: the planet has finite resources but a growing population; business ethics facilitates a responsible and sustainable use of natural resources. Without business ethics, these resources would be depleted for purely individual gain at huge cost both to current and future generations.
- Good and best practices in business: business ethics enhances good and best practices in business.

iv. Importance of professional ethics

- It protects the reputation of relevant professions
- Specifies how professionals should carry out their professional responsibilities.
- Defines professional-client relationship.
- Enhances good and best practices in relevant professions
- Ultimately, it enhances the interest of all stakeholders and the public.

3b. Analysis of Kohlberg's Theory of Moral Development as an explanation of how people develop a sense of morality in both personal and professional Life

To adequately explain Kohlberg's Theory of Moral Development, it is important for Kalu to first outline the three levels of morality identified by Kohlberg (Pre-conventional, conventional and post-conventional levels) and also clearly delineate the six stages of development involved. Here, he should be able to identify, correctly, the six cognate stages as they are related to the three levels of morality earlier identified. After this, it is essential for Kalu to explain to the trainee participants, details of each of these stages.

Below is a template that Kalu may wish to adopt.

Kohlberg's six stages of moral reasoning and development are categorised into three levels.

Levels of morality	Stages of moral reasoning and development
Pre-Conventional	**1** Obedience and punishment **2** Self-interest: individualism and exchange
Conventional	**3** Inter-personal accord and conformity: good boy, nice girl attitude **4** Maintaining social order
Post-conventional	**5** Social contract **6** Universal ethical principles

Pre-conventional level of morality

- The pre-conventional level of moral reasoning is common in children, although it can also be found in adults.
- Kohlberg called this level of reasoning pre-conventional because individuals at Stages 1 and 2 do not yet see themselves as members of society, and their moral reasoning is based entirely on self' or selfish consideration.

Stage 1: Obedience and punishment orientation

- Here, individuals judge right and wrong on the basis of the direct consequences, for them, of the actions they take. Thus, an action is bad if the individual knows that he (or she) will be punished for it and good if the individual knows that he will receive some benefit.

Stage 2: Individualism and exchange

- Individuals (usually children), recognise that different individuals have different points of view of what is right and what is wrong.
- Each individual is also free to pursue his or her own personal interests, and will therefore want to do what is in his or her own **best interest.**

Conventional level of morality

- The conventional level of moral reasoning is found in adolescents and adults.
- When individuals think in a conventional way, they judge the morality of actions by comparing them with the conventional views and expectations of society.

Stage 3: Good interpersonal relationships

- Here, individuals believe that they should live up to the expectations of family, friends and the community so as to earn social approval and avoid disapproval of other people

Stage 4: Maintaining social order

- The individual is concerned with society as a whole, and the need to maintain social order. The focus is on respect for social conventions, authority and obeying the law, because these are important for maintaining society.

Post-conventional level of morality

Stage 5: Social contract orientation

- At this stage, individuals hold the view that a good society is one in which there is a 'social contract' in which everyone works towards the common benefit of society.
- They recognize that people are different and have the right to their own views and opinions. At this stage people talk about 'morality' and 'rights' from their own individual perspectives, recognising that other people might disagree

Stage 6: Universal ethical principles

- Kohlberg suggested that most individuals do not get to this stage of moral development.
- Here, moral reasoning is based on abstract 'universal' ethical principles. The individual queries the validity of laws, and considers that laws are only valid if they are based on justice. Individuals have an obligation to disobey unjust laws.

3c. Criticisms of Kohlberg's Theory

- Some critics have argued against the view that post-conventional morality exists or is at a higher level of moral development. At Stages 5 and 6, individuals put their own principles above society and the law, which is a dangerous moral stance to take.
- Other critics have argued that Kohlberg's views have a cultural bias, because his ideas are based on Western philosophy. His views might not apply to non-Western philosophies and cultures.
- Carol Gilligan (1982) argued that Kohlberg's views have a gender bias, and were based on a male view of the world. While Kohlberg argued that moral thinking is based on reasoning linked to a sense of justice – rules, rights and abstract principles, Gilligan argued that for women, morality and ethical views are not based on these concepts of justice, but on concern for interpersonal relationships and the ethics of care and compassion.

Marking Guide **Marks**

---

a. Nature and importance of business ethics and professional ethics

- **Nature of business ethics**
  - guiding moral principles and values in business
  - considers the effect of the pursuit of self-interest/profit
  - code of ethics as a reference point
  - applicable to all employees

  1½

  (1/2 Mark for any 3 of the 4 points above)

- **Nature of professional ethics**
  - moral principles and values governing behavior ½
  - specified in the professional code of conduct ½
  - Adherence to ethical codes a requirement for membership ½

  1½

  3

- **Importance of business ethics**
  - Long-term growth
  - Cost and risk reduction
  - Sustainability
  - Limited resources
  - Good and best practices in business 1½

  (1/2 Mark for any 3 of the 5 points above)

- **Importance of professional ethics**
  - Protects the reputation of relevant professions
  - Specifies details of professional responsibilities
  - Defines professional-client relationship
  - Enhances good and best practices in relevant professions
  - Enhances the interest of all stakeholders and the public 1½

  (½ mark for any 3 of the 5 points above) 3

  6

b. Analysis of Kohlberg's Theory of Moral Development
- Outline of what Kalu should do ½
- Outline of Kohlberg's six stages of moral reasoning and development

Pre-Conventional
- Obedience and punishment ½
- Self-interest: individualism and exchange ½

Conventional
- Inter-personal accord and conformity: good boy, nice girl attitude ½
- Maintaining social order ½

Post-conventional
- Social contract ½
- Universal ethical principles ½

3½

EXPLANATION:

- **Pre-conventional level of morality**
- common in children, also found in adults ½
- moral reasoning based entirely on self' or selfish consideration ½

Stage 1: Obedience and punishment orientation
- conception of right and wrong based on direct consequences ½

Stage 2: Individualism and exchange
- recognition of different viewpoints on what is right and what is wrong ½
- freedom to pursue personal and best interests ½

- **Conventional level of morality**
- found in adolescents and adults ½
- based on conventional views and expectations of society ½

Stage 3: Good interpersonal relationships
- desire to earn social approval and avoid disapproval of other people ½

Stage 4: Maintaining social order
- concern with society as a whole, and the need to maintain social order ½

- **Post-conventional level of morality**

Stage 5: Social contract orientation
- everyone works towards the common benefit of society ½
- people talk about 'morality' and 'rights' from individual perspective ½

Stage 6: Universal ethical principles
- most individuals do not get to this stage of moral development ½
- moral reasoning is based on abstract 'universal' ethical principles and notions of justice ½

10

c. Any Two Criticisms of Kohlberg's Theory
- Doubt on the existence and status of post-conventional morality 2
- Kohlberg's cultural bias 2
- Kohlberg's gender bias

(2 marks for any two of the three points above) **4**

TOTAL **20**

EXAMINER'S REPORT

The question tests candidates' understanding of the nature and importance of business and professional ethics and also Kohlberg's Theory of Moral Development.

Many of the candidates attempted the question but their performance was slightly below average. While many of them had a fair understanding of Kohlberg's Theory of Moral Development, they did not show a good understanding of the nature and importance of business ethics and professional ethics.

Candidates should ensure that they have a clear understanding of basic concepts and theories in business ethics and professional ethics as these are relevant to the accounting profession.

SOLUTION 4

a. Analysis of the Strengths of Toyin Trust Insurance Plc before 2000

- Good reputation emanating from prompt payment of claims
- Innovativeness in introducing quality products to meet changing customers' needs
- Positive perception of the company due to its expatriate ownership
- Ready market provided by expatriates and foreign-owned companies operating in Nigeria
- Board of the company comprised mainly of insurance experts with many years of experience in the global insurance industry
- Experienced management staff
- Limited number of branches ensured effective control
- Possession of licence to practice as an insurer

b. Strengths and Weaknesses of Toyin Trust Insurance Plc after 2000

Strengths after 2000

- Indigenous board will have a better knowledge of the local environment
- New branches made the services of the company readily available in many places
- Investors whose relatives are employed will provide support for the company
- Retention of the company name will carry some goodwill in the market
- Retention of the licence of the old company enables it to operate in the insurance industry

Weaknesses after 2000

- The MD/CEO is inexperienced in the insurance industry
- All the experienced expatriates on the board left the company
- Experienced Managers resigned
- Inexperienced staff took over the management of branches leading to poor quality services
- Loss of innovativeness with the change in management
- Loss of profitability due to poor management
- Loss of foreign owned companies market

4c. Strategies for revival of the company

- Replacement of the MD/CEO with an experienced insurance expert
- Reconstitution of the board of the company to comprise of insurance experts and experts in others fields relevant to the operations of the company
- Training of board members on the roles and responsibilities of the board

- Recruitment of experienced insurance experts in the management cadre of the company
- Closure of some loss-incurring branches
- Training of staff to improve their performance
- Recapitalisation of the company to make up for losses
- Rationalise the newly employed staff that cannot add value to the company
- Formulate an efficient recruitment policy to ensure that staff will only be recruited on the basis of the needs of the organisation
- Development of good Human Resource Management policy
- Set up Research and Development Department to ensure development of innovative products to meet the changing needs of the market
- The company should engage in Corporate Social Responsibility (CSR) activities to boost its public image

Marking Guide		**Marks**	
a.	Analysis of the strengths of Toyin Trust Insurance Plc before 2000 (1 mark each for any 5 strengths)	5	
b.	Strengths and Weaknesses of Toyin Trust Insurance Plc after 2000 Strengths after 2000 (1 mark for each of any 2 strengths)	2	
	Weaknesses after 2000 (1 mark for each of any 3 weaknesses)	3	
d.	Strategies for revival of the company (2 marks each for any 5 strategies)	10	
	Total		**20**

Examiner's Report

The question is testing the ability of candidates to analyse the strengths and weaknesses of Toyin Trust Insurance Plc before and after the change in the ownership structure of the company in the year 2000. Candidates were also expected, on the basis of the scenario provided, to suggest strategies to sustain the company.

Most of the candidates attempted the question and showed good understanding of it. Performance was above average. However, some candidates did not know what constitutes the strengths and weaknesses of a company.

Candidates are advised to pay attention to the application of SWOT analysis to simple cases.

SOLUTION 5

a. Responsibilities and duties of the Board

The duties and responsibilities of the board may be broadly divided into 12 categories:

- Strategy and management
- Structure and capital
- Financial reporting and controls
- Internal controls
- Contracts
- Communication
- Board membership and other appointments
- Remuneration
- Delegation of authority
- Corporate governance matters
- Policies
- Other issues

Explanation

Strategy and management

The board is responsible for the overall management of the company or group. This involves:

- Approving the long-term objectives and commercial strategy
- Approving the annual budget and capital expenditure budget
- Oversight of operations
- Review of the performance of the company or group
- Decisions about expanding operations into new product areas or new markets, and decisions about closing down any significant part of operations.

Structure and capital

The board is responsible for decisions relating to

- Changes in the capital structure of the group, or its management and control structure
- Also decisions about any change in the company's status, such as going from private company to public company status

Financial reporting and controls

The financial responsibilities of the board include

- Approval of financial statements and results
- Approval of dividend policy
- Approval of treasury policies, such as foreign currency exposures and the use of financial derivatives

Internal controls
The board has the duty of

- Ensuring that there is a sound system of internal control and risk management by monitoring the systems that are in place.

Contracts
Part of the duties of the board is the

- Approval of major capital projects and strategically-significant contracts.
- Approval of loans or foreign currency transactions above a stated amount.
- Approval of all major acquisitions and disposals.

Communication
The board is also responsible for the

- Approval of all communications to shareholders and the stock market, and all major press releases.

Board membership and other appointments
The board is responsible for all

- Decisions about appointments to the board and appointment of the Company Secretary and company's external auditors.

Remuneration
The board takes all

- Decisions about the remuneration of directors and senior managers, including the approval of major share incentive schemes (which may also require approval by the shareholders).

Delegation of authority
The board is responsible for deciding

- What responsibilities should be delegated to board committees, and should decide on the division of responsibilities between the chief executive officer and the board chairman.

Corporate governance matters
The board is responsible for

- Corporate governance matters such as communications with the company's shareholders, deciding the balance of interests between the shareholders and other stakeholders and ensuring that independent non-executive directors continue to be independent.

Policies

- The board has the responsibility to approve company policies, such as health and safety policy and environmental policy.

Other issues

There are a number of other issues that the board should reserve for its own decision making. These may include:

- Decisions affecting the company's contributions to its employees' pension fund
- the appointment of the company's main professional advisers
- Decisions to prosecute defend or settle major litigation disputes involving costs or payments above a specified amount.

Marking Guide		**Marks**
a. Identification of the 12 categories of the duties and responsibilities of the Board		
• Strategy and management	½	
• Structure and capital	½	
• Financial reporting and controls	½	
• Internal controls	½	
• Contracts	½	
• Communication	½	
• Board membership and other appointments	½	
• Remuneration	½	
• Delegation of authority	½	
• Corporate governance matters	½	
• Policies	½	
• Other issues	½	5
(1/2 mark each for any 10 points)Explanation of any 5 of the categories identified at 2 marks each)		10
Total		15

Examiner's Report

The question tests candidates' understanding of the duties and responsibilities of the Board of Directors.

Many candidates attempted the question but performance was generally below average. Commonest pitfall is candidates' inability to clearly articulate the duties of the board.

Candidates should study the duties and responsibilities of the Board of Directors as discussed in the Institute's study pack on this subject.

SOLUTION 6

a. The roles and responsibilities of the board of directors

Corporate governance requires that the responsibility for strategic guidance of the company belongs to the board of directors. The board also has responsibility to monitor the management of the company as well as to ensure its accountability to the stakeholders of the company.

To achieve this requires that

- The board has a clear understanding of its responsibilities and effectively carry them out.
- The board provides suitable leadership to guide and control management.
- The board ensures it is accountable to its stakeholders, especially shareholders.

b. The composition and balance of the board of directors

- The composition and balance of the board of directors enable it to bring independence of thought and judgment to its decisions and provide different perspectives to enhance the quality of its decisions. The board should not be dominated by a powerful Chief Executive. The role of the Chairman of the board and that of the Managing Director/Chief Executive are separated.
- 'Balance of the board of directors' means that there is a suitable mix of executive and non-executive directors, such that no individual or small group can dominate the board.
- Members of the board should be people of different backgrounds in terms of education, experience, gender, professional qualification etc.

c. Financial reporting, narrative reporting and auditing

- Corporate governance requires that the board of directors is transparent and accountable to its shareholders and other stakeholders.
- Regular financial reporting, narrative reporting and auditing are central to the responsibility of the board of directors to be transparent and accountable.
- Auditing by independent external auditors ensures the integrity of financial reports.
- Lack of integrity of financial reports in the past has resulted in the failure of notable companies such as Enron and Worldcom.
- The Audit Committee of the board monitors financial reporting and auditing in the company.

Directors' Remuneration

- An essential element of corporate governance is the use of remuneration to encourage directors to achieve the objectives of the company. Such remuneration is more effective if linked to the performance of directors.
- There is a remuneration committee of the board to recommend the remuneration of executive directors and senior managers to the board.
- The remuneration committee is made up of non-executive directors who are independent and do not have personal interest in Directors' remuneration.

d. Risk Management and internal control

- Corporate governance is concerned with how risks associated with the company are managed.
- The board of directors determines the acceptable level of risk and ensures the company operates within the stated acceptable level.
- The board of directors puts in place a system of internal control to ensure the protection and effective utilization of resources.

Marking Guide	**Marks**
(a) The role and responsibilities of the board of directors	
(i) Explanation in the context of corporate governance	1
(ii) To establish how a company is governed	
• Clear understanding of responsibilities by the board	
• Suitable leadership by board	
• Accountability to Stakeholders	
(1 mark each for any two points in ii)	3
(b) The composition and balance of the board of directors	
(i) Explanation in the context of corporate governance	1
(ii) To establish how a company is governed	
• Board not dominated by a small group	
• Suitable mix of executive and non-executive directors'	
• Diversity of board members	3
(1 mark each for any two points in ii)	
(c) Financial reporting, narrative reporting and auditing	
(i) Explanation in the context of corporate governance	1
(ii) To establish how a company is governed	
• To ensure board transparency and accountability	
• Auditing by independent external auditors	
• Audit committee to monitor financial reporting	
• Lack of integrity of financial reports led to scandals in the past.	3
(1 mark each for any 2 points in ii)	

(d) Directors' remuneration

(i) Explanation in the context of corporate governance	1
(ii) To establish how a company is governed	
▪ Remuneration Committee responsible for recommending remuneration of direction.	1
▪ Remuneration Committee has no personal Interest in remuneration	1
	3

(e) Risk management and internal control

(i) Explanation in the context of corporate governance	1
(ii) To establish how a company is governed	
▪ Board determines acceptable level of risk	1
▪ Board ensures company operates with the tolerance level of risk	1
Board puts system of internal control in place	3
Total	15

EXAMINER'S REPORT

The question is testing the effect of some identified issues in corporate governance on how well or badly a company is governed. The issues listed are the role and responsibilities of the board of directors, the composition and balance of the board, financial reporting and auditing, directors' remuneration and risk management and internal control.

Over 95% of candidates attempted this question but performance was slightly below average. Candidates failed to realise that they were expected to apply their knowledge of the corporate. Governance issues to determine how well or badly a company was governed. Rather they simply listed the roles and responsibilities of the board and examined various issues that were not required in the question.

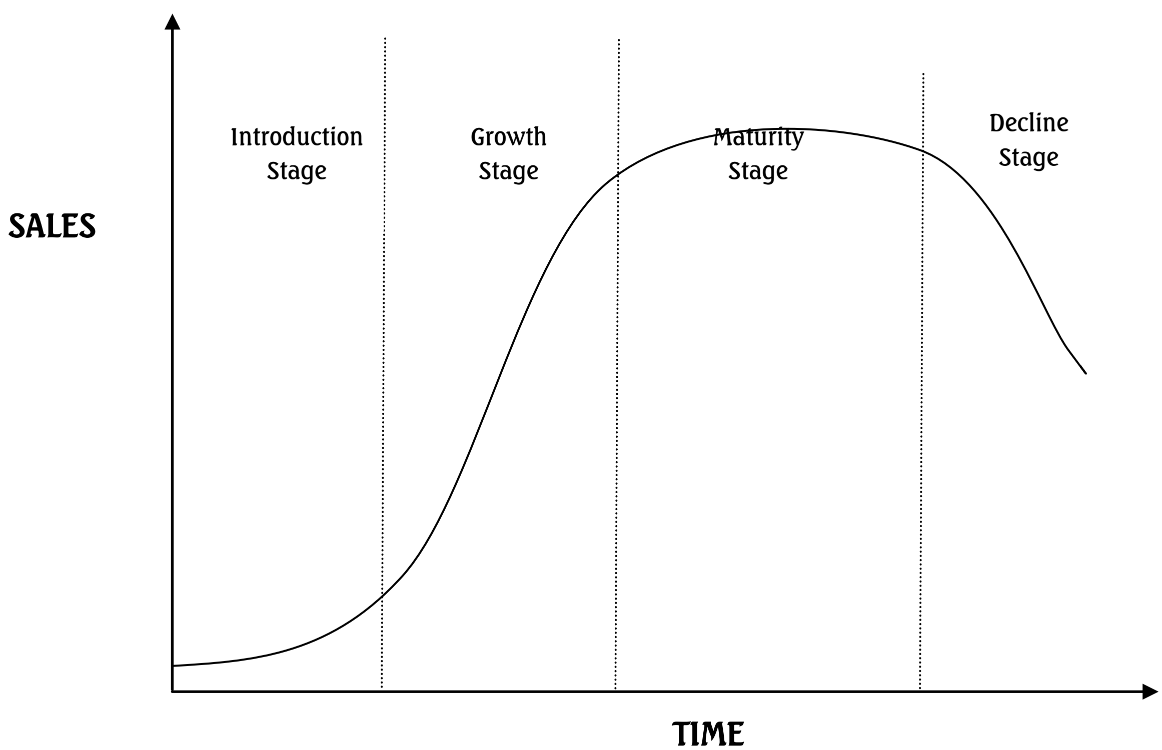
Candidates need to understand the demands of questions in order to earn marks.

SOLUTION 7

a. Reasons for slow growth of sales of DAB Phones

- DAB is a new product and as such its sales are expected to be slow at the introductory stage because only a small percentage of potential users (innovators) are expected to buy the product.
- The distribution of DAB phones was poorly developed. Using cell phone vendors and hawkers was inappropriate to reach the target market consisting of rural farmers, market women and artisans.
- DAB Company did not use a trained sales force to market the product aggressively. This is a typical strategy used to market new products.
- Advertising, sales promotion and publicity efforts were grossly inadequate or not used at all.

b.



(Note: S-shaped growth curve is the same as S-shaped product life cycle curve. The curve's origin is 0,0 point of the diagram).

(b) The market development of a new product goes through four stages- introductory stage, growth stage, maturity stage and decline stage.

- Introductory Stage. New product is introduced to the market. Sale is very slow since only a small percentage (about 7%) of users adopt the product. They are the innovators who are willing to take the risk of trying the new product.
- The next stage is the growth stage in which sales pick up and increase rapidly. The buyers at this stage are the early adopters and early majority.
- The growth stage is followed by maturity stage at which sales peak. At this stage, the late majority and laggards now patronize the product.
- At the decline stage, sales begin to slow down due mostly to the activities of competitors.
- DAB product is yet at the introductory stage. DAB company's current marketing strategies are inadequate. Except effective marketing strategies are put in place, the product might fail to enter the growth stage.

(c) Strategies that Ade John can use to improve sales.

- Product: Monitor the performance of the product in the market in order to continuously improve its quality.
- Price: Adopt penetration pricing strategy: This means using a low price strategy to encourage the target customers to try the product.
- The Distribution Channel should focus on rural farmers, market women and artisans.
- The present margin of 15% should be compared with the margin on competing products. DAB company should give a higher margin than competitors in order to encourage distributors to push the product.
- Distribution: DAB company should ensure that the product is available in all outlets on "sale or return" basis.
- Personal Selling: A small sales force should be recruited to introduce the product and its benefits to various sales outlets.
- Advertising on radio and television should be used to promote the product.
- Sales Promotion and Publicity: Publicity for the phones should be carried out at intervals.

Marking Scheme		Marks	
a.	Reasons for slow growth of sales		
	▪ DAB phones is a new product	2	
	▪ Distribution strategy of phones poorly developed	2	
	▪ Trained sales force not utilized		
	▪ Promotional activities inadequate		
			4
	(2 marks each for any 2 points)		
b.	Properly draw and labelled sales growth curve diagram		2
	• Explanation of each stage of growth curve		
	➢ Introduction	½	
	➢ Growth	½	
	➢ Maturity	½	
	➢ Decline	½	2
	Evaluation of market development		
	• Product in introduction stage		
	• Current strategies inappropriate for target market		
	• need for effective strategies		
	• Product might fail otherwise		
	(1 mark each for any 2 points)		2
c.	Strategies to improve sales		
	• Monitor and improve product quality		
	• Adopt penetration pricing strategy		
	• Develop distribution strategy		
	• Give high margin than competitors		
	• Recruit and utilize sales forces		
	• Utilize radio and television advertising		
	• Undertake regular sales promotion and publicity		5
	(1 mark each for any 5 points)		
	Total		15

EXAMINER'S REPORT

The question is testing candidates' knowledge of the S-shaped growth curve (or the S-shaped product life cycle curve) and their ability to identify and explain reasons for the slow growth of sales of DAB phones It also tests their ability to explain the market development of the phone and also recommend strategies that can be used to improve the sales of the product.

Only about 40% of candidates attempted the question and performance was below average. Many of the candidates had no knowledge of the growth curve which indeed is the same as the s-shaped product life cycle curve. As a result, they could not answer the other requirements of the question.

Candidates are advised to make effective use of the Institute's Study Pack on this subject.