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**ICAN Students' Journal**

(ISSN: 1119 - 9636) is published quarterly by the Institute of Chartered Accountants of Nigeria, Plot 16, Professional Centre Layout, Idowu Taylor Street, Victoria Island, P.O. Box 1580, Lagos.

Tel: 7642294, 7642295,

Fax: 2610304

E-mail: info.ican@ican.org.ng

corporateaffairs@ican.org.ng;

ICAN Website: www.ican-ng.org

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*Correspondence should be addressed to:*

**The Corporate Communication and Marketing Directorate, ICAN**  
corporateaffairs@ican.org.ng

Designed by Media Softdigital Solutions ☎ 0802 343 8749

Printed by Negro Invest. + Print Ltd Tel: 08033192409, 08055437712

# Editor's Note

# News



# FEATURES

## Financial Statement Analysis (1) IAS 33 EARNINGS PER SHARE

By Ben Ukaegbu

### Introduction

The IASB Conceptual Framework states that the objective of preparing financial statements is to provide users with information which will help them to make decisions about providing resources to an entity. Faced with a set of financial statements, users will need to analyse the information provided and draw some conclusions about the financial performance and financial position of the entity concerned. There are several ways in which financial statements might be analysed. In practice, one of the most common methods is the technique known as ratio analysis, which involves the calculation of a number of accounting ratios. However, there is no universal standard of calculating these ratios and the only ratio addressed by the International Financial Reporting Standard (IFRS) is the Earnings Per Share (EPS) – IAS33, which is the subject of this paper. EPS is widely used as a means of assessing a company's performance and it also feeds into the Price/Earnings (P/E) ratio which is extensively used as an indicator of investment potential. Given the role of EPS ratio in financial statement analysis, it is especially important that it should be calculated in accordance with a clear and consistent set of rules. To ensure that EPS figures are calculated on a consistent basis, IAS33 prescribes the way in which a company's EPS should be calculated. The fact that EPS is the only ratio which is defined by IFRS and has an entire standard devoted to it is a strong indication of the importance which is attached to this particular ratio.

### Purpose of EPS calculation

The main purpose of computing earnings per share (EPS) is to determine the amount of profit in a given period accruing to a holder of one ordinary (equity) share in a company. EPS is widely used by the investment community as a measure of a company's financial performance. IAS 33 requires that basic earnings per share should be calculated by dividing the net profit or loss for the period that is attributable to ordinary (equity) shareholders by the weighted average number of ordinary shares in issue during the period.

### Scope of IAS 33

The standard applies only to listed companies (i.e., publicly traded companies whose shares are quoted on the stock exchange) and entities that are in the process of issuing ordinary shares or potential ordinary shares in public

securities markets. A potential ordinary share is a financial instrument (such as an option and a warrant) that gives the holder the right to acquire ordinary shares.

For companies that have no discontinued operations, IAS 33 requires disclosure of basic EPS and diluted EPS to be stated on the face of the statement of comprehensive income together with comparative figures for the previous period.

### Calculation of EPS

The calculation of EPS can be expressed using the following formula:

$$\text{EPS} = \frac{\text{Earnings}}{\text{Number of shares in issue}}$$

*Earnings* are defined as the net profit (or loss) after deducting tax, minority interests (in the case of consolidated companies) and preference dividends.

*Number of shares in issue* is the weighted average number of ordinary shares outstanding and ranking for dividend in the period.

### Illustrative example 1 – Calculation of basic EPS

Company A has reported a profit before tax of N4,000,000 for the year ended 31 December 2014. Income tax on the profit is charged at 35%. The company has in issue N5,000,000 ordinary shares of 50 kobo and 8% N2,500,000 preference shares of N1.00 each.

**Required:** Calculate the basic EPS figure to be reported on the company's statement of comprehensive income for the year ended 31 December 2014.

### Solution

#### Calculation of earnings

	N000
Profit before tax	4,000
Less: Tax at 35%	(1,400)
Profit after tax	2,600
Less: Preference dividend (8% N2,500,000)	(200)
	2,400
	=====

#### Number of shares in issue

$$\left( \frac{\text{₦}5,000,000}{\text{₦}0.50} \right) = 10,000,000 \text{ shares}$$

#### Basic EPS for year ended 31 December 2012

$$\left( \frac{\text{₦}2,400,000}{10,000,000} \right) = 24 \text{ kobo}$$

#### Issue of shares during the reporting period

Whenever additional shares are issued during the reporting period, the calculation of the weighted average number of shares used in the EPS formula would need to be revised. Additional issue of shares during the reporting period may occur in the following ways:

- (i) Issue of shares at full market price
- (ii) Bonus (scrip) issue
- (iii) Rights issue

#### (i) Issue of shares at full market price

Whenever a company issues shares at full market price, its intention would be to increase its earnings (profits) capacity. However, if the issue of shares was made some time during the reporting period, then the number of shares used as the denominator in the EPS formula is calculated on a weighted average basis. This is done to take account of the time period that the funding from the additional shares is deemed to contribute to the increase in earnings.

#### Illustrative example 2 – Calculation of basic EPS (additional issue of shares during the period)

Using the information in illustrative example 1, suppose Company A issued a further 2,000,000 ordinary shares on 1 July 2014 and made a profit after tax of ₦3,225,000 for the year ended 31 December 2014.

**Required:** Calculate the basic EPS figure to be reported on the company's statement of comprehensive income for the year ended 31 December 2014.

#### Solution

##### Calculation of earnings

	N000
Profit after tax	3,225
Less: Preference dividend (8% ₦2,500,000)	( 200 )
	3,025
	=====

#### Number of shares in issue

Shares in issue – 1 Jan – 31 Dec 2014	10,000,000
Additional issue – 1 Jul – 31 Dec 2014 (2,000,000 $\frac{1}{2}$ )	<u>1,000,000</u>
	11,000,000
	=====

#### Basic EPS for year ended 31 December 2014

$$\left( \frac{\text{₦}3,025,000}{11,000,000} \right) = 27.5 \text{ kobo}$$

#### (ii) Bonus (scrip) issue

A bonus issue represents new shares to existing ordinary shareholders through converting accumulated reserves into issued share capital without receiving any cash resources from the shareholders. The effect of bonus issue is that the earnings for the reporting period are spread over a larger number of shares when calculating the EPS.

Since bonus issue does not increase the earnings capacity of the company, it is not necessary to calculate the number of shares on a weighted average basis. However, IAS 33 requires previous periods' EPS figures to be adjusted to take account of the bonus issue, using the following factor:

$$\text{Bonus adjustment factor} = \frac{\text{Number of shares before bonus issue}}{\text{Number of shares after bonus issue}}$$

#### Illustrative example 3 – Calculation of basic EPS (issue of bonus shares during the period)

Continuing with the previous examples, suppose that the additional shares on 1 July 2014 was a 1-for-4 bonus issue and that the profit after tax and preference dividend was ₦3,205,000 for the year ended 31 December 2014.

**Required:** Calculate the basic EPS figure for the year ended 31 December 2014.

#### Solution

##### Number of shares in issue

Shares in issue – 1 Jan – 31 Dec 2014	10,000,000
Bonus issue (1-for-4)	<u>2,500,000</u>
	12,500,000
	=====

#### Basic EPS for year ended 31 December 2014

$$\left( \frac{\text{₦}3,025,000}{12,500,000} \right)$$

#### Revised basic EPS for year ended 31 December 2013

$$24 \frac{4}{5} \quad 19.2 \text{ kobo}$$

#### (iii) Rights issue

A rights issue involves raising new share capital by means of an offer to existing ordinary shareholders, thus enabling them to buy more shares, usually at a price (known as exercise or rights price) that is lower than the current market price of the shares. The additional shares under a rights issue, unlike a

bonus issue, provide the company with cash resources that are used to increase its earning capacity.

The computation of EPS involving rights issue can be accomplished with the following set of calculations:

(a) Earnings (profit after tax) attributable to ordinary shareholders

(b) Theoretical ex-rights price and rights adjustment (bonus element), where

*Theoretical ex-rights price* =

$$\frac{\text{Fair value (market value) of current shares} + \text{Cash receipts from rights issue}}{\text{Number of shares before rights issue} + \text{Additional shares issued}}$$

*Rights adjustment factor* =

$$\frac{\text{Fair value (market value) of current shares (actual cum-rights price)}}{\text{Theoretical ex-rights price}}$$

(c) The number of shares outstanding up to the date of rights issue weighted by the rights adjustment factor

(d) The number of shares outstanding after the rights issue calculated on a weighted average basis

**Basic EPS for the current period**  $\frac{a}{c + d}$

**Previous period's EPS** is adjusted by the inverse of the rights factor:  
 $\frac{\text{Theoretical ex-rights price}}{\text{Actual cum-rights price}}$

#### Illustrative example 4 – Calculation of basic EPS (rights issue)

Company B reported profit after tax of N1,760,000 for the year ended 31 December 2014. The company had 5,000,000 ordinary shares in issue at the beginning of the year and made a 1-for-5 rights issue on 1 September 2014 at a price of N4.50. The market price of the share before the rights issue was N6.30.

The basic EPS for the year ending 31 December 2013 was 27.5 pence.

**Required:** Calculate the basic EPS figure to be reported on the company's statement of comprehensive income for the year ended 31 December 2014.

#### **Solution**

Theoretical ex-rights price

	Number of shares		N000
Market capitalisation before issue	5,000,000	N6.30	31,500
Cash raised from rights issue	<u>1,000,000</u>	N4.50	<u>4,500</u>
	6,000,000		36,000
	=====		=====

$$\left( \frac{\text{N}36,000,000}{6,000,000} \right) = \text{N}6.00 \text{ per share}$$

#### **Weighted average number of shares**

Period of year	Fraction of year	Shares in issue	Rights factor	Number of shares
1 Jan – 30 Sept 2014	8/12	5,000,000	6.30	3,500,000
1 Oct – 31 Dec 2014	4/12	6,000,000	6.00	<u>2,000,000</u>
				5,500,000
				=====

#### **Basic EPS for year ended 31 December 2014**

$$\left( \frac{\text{N}1,760,000}{5,500,000} \right) = 32 \text{ kobo}$$

#### **Revised basic EPS for year ended 31 December 2013**

$$27.5 \times \left( \frac{6.00}{6.30} \right) = 26.2 \text{ kobo}$$

#### **EPS as a measure of the trend of a company's profits**

- The disclosure of a company's basic EPS is deemed to give a more reliable measure of the trend of a company's profits than the trend shown by the profits themselves. This is because the EPS takes into account any extra investment in the company's equity shares that would be expected to lead to higher earnings.

A comparison of absolute profits has no 'correction' for any additional investment that may have generated additional earnings. Thus, it would be quite possible for a company's profits to show an increasing trend and its EPS to show a decreasing trend. In these circumstances, the trend of EPS is a more reliable measure of performance.

- It is worth noting that a comparison of two companies' EPS is not meaningful (i.e., if two companies' EPS are the same, it does not mean they are performing equally. This is because the EPS takes no account of each company's share price. This problem can be corrected by calculating and comparing each company's P/E ratio (market price/EPS).

#### **References**

IAS 33 Earnings Per Share

*Dr. Ben Ukaegbu is Director, Technical & Education at The Institute of Chartered Accountants of Nigeria (ICAN)*



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15	Foresight Professional Institute	24 Road Opposite H Close, Festac Town, Lagos	foresight_professional@yahoo.com	08033164620
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37	Students SWOT Associate, Enugu	3, Independent Layout, PRODA office, Opposite Hotel Presidential, Enugu	chineduokolo15399@yahoo.com	08060844790, 08034924565

## Mrs Temitope Yusuf, FCA

Senior Manager, PricewaterhouseCoopers (Pwc)

### In a nutshell how is your typical work day like?

First, I would say that PWC is neither hell nor haven, but it is a serious work station. My typical day is very busy. I set out early in the morning and may not be back home until night. I manage a portfolio of clients through teams. On a daily basis I relate with different people with different personality traits. There may be differences of perceptions but you must get the job done and done properly.

### What were the key expectations that motivated you to seek a career in accounting giving that it is perceived as a man's job?

My father had his own firm for a number of years. So I was quite exposed to the audit practice at an early age. When I was getting into SS1 it was a huge debate. The school felt that I had very good grades and should very well be in the science class. But my dad seriously wanted someone to follow his footsteps and he made me tow the accounting line. I have no regrets whatsoever. Over time I have found out that I have very good analytical skills, which could very well have worked for me if I had taken the science option. I think that is what has made me to excel in this profession that I have chosen.

### Has your expectation been met?

It was obvious in our time that when you had professional qualification like ICAN, it would give you a head start professionally. It puts you above your peers. The expectation was that you would start off with a good job where

you could get trained and developed. I think I got that. Since then it has been real development for me in an all round manner. You get exposed to a variety of clients, diverse people and you get exposed to various mentors that help you to develop both the technical competence and soft skills. This has been more satisfying over and above the remuneration that I get. So in a nutshell my expectations have been met and are still being met.

### Can you say that membership of ICAN has influenced your career progression?

Yes, particularly as an offshoot. I qualified to become an associate before I completed my degree in the university. The moment I got out of

school, I had offers from the top accounting firms in Nigeria and this launched my career the way I wanted it to. While my schoolmates were juggling careers and struggling with getting professionally certified, I was already settled in my own career and in fact, already in motion. Yes, I pursued a few other certifications to consolidate and develop other skills that would make me better. Starting with ICAN qualification took off the pressure from me and allowed me to concentrate on building my career.

**International Financial Reporting Standards (IFRS) and International Public Sector Accounting Standards (IPSAS) are two key developments shaping the profession today; do you believe that wholesale adoption of**



**these tenets could make any significant impact in Nigeria or they are just business fads that would soon fizzle away?**

I would not think of them as the 'fashion' of business. When you really think about the objective of IFRS and IPSAS which is to bring about convergence in reporting standards in a global way, one can see that they have come to stay. The idea is that when you

picture. We have a big role to play to ensure that the correct pictures are painted to stakeholders. We also have a role to play in holding on to our tenets of integrity. Once every professional accountant begins to uphold the tenets of integrity and accountability in all their

**The future accountant is someone that can analyse data, any type of data, in such a way as to paint a true and fair picture to stakeholders that need information.**



read a set of reports whether in Europe, America, Africa or Asia you get the same understanding of those reports. What I realize is that some companies in some industries have understood the concepts and have been able to adopt the principles, for instance banks and financial institutions, have had a significant change by adopting IFRS. But if you check, some other firms like small manufacturing companies have not witnessed any significant impact. It also depends on the nature of transactions that they undertake. But they are a way forward for financial reporting in Nigeria to align with the world in terms of our reporting standards and they have come to stay.

**Do you think accountants can play a serious role in the anti-corruption fight of the government?**

Definitely they have a big role to play. The accounting profession is founded on integrity, which is why you see people in business and commerce quarrel with accountants. I spoke about painting a picture earlier. We have the responsibility to paint the true

dealings the country will be a better place.

**Notwithstanding your love for the profession and a successful career so far, has there been any time you wished you were in another profession?**

Not at all. I love accounting and the challenges that come with it excite, rather than discourage me. I am someone that feels I can achieve whatever I set my mind to. My focus has been on accounting and I don't mind the little inconveniences that come with it. Every profession comes with a baggage. My concentration is on the job all the time maybe that's why I don't notice the challenges. Even if in the future I decide not to do accounting job anymore whatever I do will be influenced by accounting because of the robust training and development I have received. I no longer see myself just as an accountant, I see myself as someone who is a manager of people and resources. When you start thinking like that there is a whole vista of opportunities open to you. If you ask

me if I wished I was in another profession my answer would be a capital no because this one provides the type of opportunities that I don't think exists anywhere else.

**Giving the current and expected developments in the field, what will be the profile of the accountant of the future?**

The future accountant is not one that punches numbers. It is not someone that sits in the room with ledgers. Those days have passed. The future accountant is someone that can analyse data, any type of data, in such a way as to paint a true and fair picture to stakeholders that need information. Being an accountant opens you up to managing resources, especially information and earning the trust of the people. In addition to the technical skill, the future accountant needs to have softer skills e.g. emotional intelligence, leadership and communication skills, etc which are very key to success. Gone are the days when the accountant is locked in a room punching figures. The future accountant will need to relate more



with stakeholders, get their trust to present true and fair picture of the state of affairs in organisations.

**How would you describe accounting to a ten year old child and how would you encourage such child (especially a girl) to become an accountant?**

I would say accounting is the art of painting a picture with financial information. An accountant harnesses various financial information in the environment and with it, tells a true story.

**Has gender affected you negatively in your career considering that accounting is regarded largely as a man's job?**

It is known worldwide that women are relatively more meticulous than men. Again, women do well at multi tasking. Most career women effectively

**You know that accounting involves much multi tasking. So I think the female population has a better inclination to be accountants than male.**

combine the role of a professional with being a mother (sometimes grandmother), wife, sister, niece, cousin, etc without any role clashing with the other. You know that accounting involves much multi tasking. So I think the female population has a better inclination to be accountants than male. But on a personal note I have not been in anyway daunted by being a female. I have never stopped to think about it because there are so many female accountants doing very well. The reality of today's workplace is that organisations consider diversity in order to harness the benefits of both genders. Being female helps you

become a good accountant.

**So, how do you balance your roles as a Chartered accountant, administrator, wife and mother?**

I do not see it as a challenge but what you have to deal with on a daily basis as part of life. So I no longer bother about work life balance; I see it more as work life integration.

Work and life, everything comes in a list and I am constantly prioritizing

**What about when there is a clash?**

No matter how the clash happens, one aspect must be more important than the other at a given time. What I ask myself is which matter is most important at the given time and I give my attention to it. However it could be a tough exercise. I won't say it's a stroll in the park. But as much as possible I get the support. I outsource as much as



according to need and the situation on ground. If I have to attend my son's PTA meeting at 10 am and that is top priority then I will go for that meeting and if I have to shift my work hours to 8pm, it would be done. In a way I integrate my work and my life and am constantly evaluating my priorities at every point in time to determine which should be addressed at any given time. If a meeting with a client is most important at any particular time, I give attention to it and move work down the ladder. But if family is top priority I elevate it and move work down. There is no fixed way of doing it. It all depends on what is at stake at any particular time.

I can and delegate those that could be delegated especially issues that will not represent the best use of my time. However, I cannot do what I do without the support of my husband. He has been very supportive even when I had to do a lot of travels in my career, he has been the pillar beside me. I constantly run my juggling with him to get his encouragement and this strengthens my resolve.

**When not working, what do you do?**

I spend time with my kids; play with them. I read novels a lot and I spend time with friends as much as I can.

# The Examiner

Our goal is to ensure success in ICAN exams. We have, therefore, provided solutions to some past questions to guide candidates in future exams. Although these suggested solutions have been published under the Institute's name, they do not represent the views of the Council of the Institute. ICAN will, therefore, not enter into any correspondence about them.

## PILOT QUESTIONS PUBLIC SECTOR ACCOUNTING AND FINANCE SECTION A (COMPULSORY)

### Question 1

#### Construction Contract

In a bid to reduce unemployment through the creation of jobs for the citizenry of the Federal Republic of Nigeria, an Indigenous Cement Company, Tedango Plc. established a Cement Company in Kokori, Koko State of Nigeria.

The company's operation, aside from providing employment for the people of the area, caused some degree of environmental challenges, resulting in health hazards to the inhabitants of the area. The only bridge that linked Kokori with other towns and villages in the area was damaged by the heavy vehicular traffic caused by the activities at the Cement Plant.

In order to mitigate the hazards caused the community by this damaged bridge, the Ministry of Works and Services was contracted to construct a 'long-lasting' bridge to replace the damaged one. The Ministry is predominantly funded by appropriation and is empowered to undertake limited construction work on a commercial basis for private entities. With the authority of the Honourable Commissioner for Works and Services, the Ministry entered into a fixed price commercial construction contract for N90million to build the bridge. There was no tender publication for the job and the ministry was the only bidder for the construction work.

The initial amount of revenue agreed in the contract was N90 million. The contractor's (Ministry of Works and Services) initial estimate of contract costs was N80 million. It will take three (3) months to construct the bridge. By the end of the first month, the Ministry's estimate of contract costs has increased to N80.5 million.

In the second month, the client (Tedango Plc) approved a variation resulting in an increase in contract revenue of N2million and estimated additional contract costs of N1.5 million. At the end of the second month, costs incurred included N1million for standard materials stored at the site to be used in the third month to complete the project.

The Ministry determines the stage of completion of the contract by calculating the proportion that the contract costs bear for work performed to date bear to the latest estimated total contract costs. A summary of the financial data during the construction period is as follows:

	1st Month N'000	2nd Month N'000	3rd Month N'000
Initial amount of revenue agreed in contract	90,000	90,000	90,000
Variation	-----	2,000	2,000
Total Contract Revenue	90,000	92,000	92,000

Contract costs incurred to date	20,930	61,680	82,000
Contract costs to complete	59,570	20,320	-----
Total Estimated Contract Costs	80,500	82,000	82,000
Estimated Surplus	9,500	10,000	10,000
Stage of Completion	26%	74%	100%

NB: The stage of completion for the 2nd month (74%) was determined by excluding from contract costs incurred to date the value of standard materials stored at the site for use in the third month.

The bridge was completed and delivered to the client, TEDANGO Plc. at the end of the agreed three month period of construction.

#### Required:

- Calculate the amounts of revenue, expenses and surplus to be recognized in the statement of financial performance in the three years in accordance with IPSAS 11 on Construction Contract. (20 Marks)
- Assuming that the contractor and the contractee are citizens of Nigeria, do you think that the contract award complied with the Public Procurement Act of 2007? (4 Marks)
- What are the provisions of IPSAS 11 on recognition of Contract Revenue and Expenses? (6 Marks)

Total 30 Marks

## SECTION B (Answer any two questions)

### Question 2

- State and explain the functions of:
  - The Joint Tax Board (5 marks)
  - State Board of Internal Revenue (5 marks)
- The total assessable income of an individual taxpayer is the aggregate total of his incomes from all sources after allowable deductions, including losses.
  - State any five sources of an individual taxpayer's assessable incomes (5 marks)
  - State any five Personal Reliefs/Allowances an individual taxpayer can claim. (5 marks)

Total 20 marks

### Question 3

The following balances were extracted from the books of Economy Improvement and Sustenance Commission as at 1st January and 31st December, 2013:

	1st Jan 2013 N'000	31st Dec 2013 N'000
Property, Plant and Equipment	160,000	
Loans outstanding	32,000	
Accumulated Depreciation	40,000	

Capital Fund	8,000	
Bank Balance	4,800	
Investment	8,000	8,000
Current Liabilities	20,000	17,600
Current Assets	12,000	14,800
Revenue Balance	84,000	-

b. Transaction during the year 2013 were:

	₦'000
Recurrent Expenditure	68,000
Subvention from Ministry of Finance	12,000
Income from service	26,000
Transfer to capital Fund	1,600
Income from seminars	56,000
Interest on Loan	7,200
Subvention from Federal Government	11,600
Capital Expenditure during the year	12,000
Investment Income	280

c. The following information were also provided but have not been incorporated in the above balances:

- A property which cost ₦1.2million with an aggregate Depreciation of ₦400,000 was disposed of during the year for ₦2.88million. Profit on disposal should be transferred to Capital Fund.
- Additional Loan of ₦10.4million was raised during the year.
- Interest on loan of ₦7.2million was still outstanding as at year end.
- Additional Inventories of training materials were purchased during the year. This represents an increase in the current assets.
- Decrease in current liabilities during the year represents payment made to training facilitators.
- Capital expenditure should be charged to Capital Fund.
- Depreciation on Property, Plant and Equipment is charged to Capital Fund at 10% on cost.

You are required to prepare for the commission:

- Revenue Account for the year ended 31st December 2013
- Capital Fund Account for the year ended December 31st 2013
- Statement of Financial Performance for the year ended 31st December 2012.

**Show your workings**

**(20 Marks)**

#### Question 4.

The following information was obtained from the records of the Office of the Accountant-General of the Federal Republic of Lamard for the year ended 31st December 2013:

	2013 ₦M	2012 ₦M
Value Added Receipts	2,295,000	2,196,000
Miscellaneous Revenue	375,000	425,000
PIT- Direct Tax	10,500,000	7,200,000
Cost of collection (FIRS and Customs)	3,075,000	3,305,000
Personnel Costs	7,200,000	9,600,000
Share Of Statutory Allocation	13,500,000	8,450,000
CRF Charges	2,250,000	3,750,000
Grants and subvention from foreign donors	75,000	87,000
Rent Of Federal Government Properties	285,000	295,000
Overhead Charges	1,500,000	1,200,000

Subvention to Parastatals	1,800,000	1,900,000
Sale of Federal Government Properties	375,000	485,000
Repayment of Loans	870,000	243,000
Purchases and Construction of Non-Current Assets	2,500,000	2,700,000
Proceeds from Sales of Federal Government Properties in Lekki Peninsula	1,050,000	-
Purchase of Marketable Securities	500,000	300,000
Cash and Cash Equivalents 1st Jan. 2013	3,750,000	-
Proceeds from Loans and other Borrowings	3,000,000	1,000,000
Cash and Cash Equivalent 31st Dec., 2013	21,660,000	3,750,000

#### Required

Prepare a Cash flow Statement for the year ended 31st December 2013 using the Direct Method (Show Comparative figures);

**Total: 20 marks**

#### SECTION C (Answer any two questions)

##### Question 5

The Government in Nigeria, like in other countries of the world, performs some fundamental economic functions. Identify and discuss these functions.

**(15 marks)**

##### Question 6

Public debt is neither good nor bad. Present a balanced argument on this assertion.

**(15 marks)**

##### Question 7

"Planning-Programming –Budgeting System (PPBS) is said to be an attempt to introduce rational method of management into an area where considerable difficulties of measurement and evaluation exist".

Examine this viewpoint in the context of an appraisal exercise of a public sector programme like education.

**(15marks)**

#### ADVANCED TAXATION

##### QUESTION 8

(a) You are a Partner in B. N. Alkali & Co. Chartered Accountants. Salim, your Managing Partner held a meeting with Mr Peter, the Managing Director of P. A. Olayemi Nig Ltd on the 17th of May 2013 in relation to a new audit of the company.

The company is engaged in the production of tyres. In the course of discussion, the following tax matters occupied the mind of the Managing Director

- Payment of dividend by a Nigerian company
- Treatment of losses
- Incentives, with particular reference to Research and Development

The Managing Partner on coming back from the meeting presented you with the two tables shown below. The information contained in the tables were already agreed with the Federal Inland Revenue Service.

Table I: 2012 Assessment Year

	N'000
Assessable Profit	26,000
Loss b/f	9,000
Balancing charge	4,500
Capital Allowance	4,200

Table II: 2009 to 2011 Assessment Years

Year	Total Profit N'000	Tax N'000	Capital Reserves N'000	Dividend Paid N'000
2009	10,000	3,000	-	5,000
2010	-	-	-	5,000
2011	3,000	9,000	4,000	5,000

Required:

Write a letter to the Managing Director addressing the following issues:

(a) Write to the Managing Director:

- Explaining the provisions of the Nigerian Companies Income Tax Act Cap C21 LFN 2004 dealing with the three areas of interest identified by him (5 Marks)
- Determining the tax payable for the 2012 Assessment Year (5 Marks)
- Determining the adequacy of the taxes for all the years based on the dividend payments in the Assessment Years 2009 to 2011 (5 Marks)

(b) An old friend of the Managing Partner, Mr Bassey, called from the United States of America expressing his wish to return to the country hoping to benefit from the incentives available to companies engaged in Agriculture and Agro-Allied products as well as Export-oriented businesses in Nigeria

Required:

Your Managing Partner also requested you to explain to Mr Bassey, the conditions that need to be met to qualify a company for incentives in the following areas:

- Agriculture (2marks)
  - Solid Minerals (2marks)
  - Tourism (2marks)
  - Export Incentive (2marks)
  - Small Manufacturing Companies (2marks)
- (Total: 25 Marks)

## SOLUTIONS

### PUBLIC SECTOR ACCOUNTING AND FINANCE

#### SECTION A (COMPULSORY)

#### Question 1

##### CONSTRUCTION CONTRACT

a. Calculation Of Revenue, Expenses and Surplus to Be Recognized in the Statement Of Financial Performance

First Month	To Date N'000	Recognized in Prior Month N'000	Recognized in Current Month N'000
Revenue (N90,000,000 x 0.26)	23,400		23,400
Expenses (N80,500,000 x 0.26)	20,930		20,930
<b>Surplus</b>	<b>2,470</b>		<b>2,470</b>
<b>Second Month</b>			

Revenue (N92,000,000 x 0.74)	68,080	23,400	44,680
Expenses (N82,000,000 x 0.74)	60,680	20,930	39,750
<b>Surplus</b>	<b>7,400</b>	<b>2,470</b>	<b>4,930</b>
<b>Third Month</b>			
Revenue (N92,000,000 x 1.00)	92,000	68,080	23,920
Expenses (N82,000,000 x 1.00)	82,000	60,680	21,320
<b>Surplus</b>	<b>10,000</b>	<b>7,400</b>	<b>2,600</b>

b. The rule is that the contract should be advertised in National dailies. Such advertisement will be responded to through bids by various bidders. The bids shall be opened and the bidder with the best technical specification and pricing shall be chosen. This was not the case with the contract. The only contractor, Ministry of Works and Services was chosen without recourse to any other contractors, whether or not their bids could be better. The award does not comply with the Public Procurement Act, 2007.

- The provision of IPSAS 11 on recognition of Contract Revenue and Expenses are as follows:

**According to paragraph 30:** When the outcome of a Construction Contract can be estimated reliably, contract revenue and contract costs associated with the construction contract should be recognized as revenue and expenses respectively by reference to the stage of completion of the contract activity at the reporting date. According to paragraph 44, an expected deficit on a construction contract should be recognized as an expense immediately.

**According to paragraph 31:** In the case of a fixed price contract, the outcome of a construction contract can be estimated reliably when the following conditions are satisfied:

- Total contract revenue, if any, can be measured reliably;
- It is probable that the economic benefits or service potential associated with the contract will flow to the entity;
- Both the contract costs to complete the contract and the completion stage can be measured reliably;
- The contract costs attributable to the contract can be clearly identified and measured reliably so that actual contract cost incurred can be compared with prior estimates.

#### Section B

##### Question 2

##### a i The Joint Tax Board (JTB)

The Board is not concerned with assessment and collection of taxes but has the responsibility to advise the federal government on tax matters such as;

- Proposal for tax legislation.
- Tax arrangement between Nigeria and other Countries
- Conflict resolution between the states of the federation as they relate to tax matters.

The board is a creation of the Income Tax Management Act of 1961

##### ii State Board of Internal Revenue

Each state in the Federal Republic administers taxes on individuals resident within its territory under Personnel Income Tax Act 1993, using the machinery of the State's Board Of Internal Revenue which itself is a creation of law.

The functions of the Board include;

- Ensuring proper assessment, collection and enforcement of taxes as provided for under the relevant statutes within its jurisdiction;



- Recommending to the Joint Tax Board tax policies, reforms, legislations, and treaties, among others;
- Appointing, training, transferring, promoting and disciplining employees of the State Board of Internal Revenue;
- Controlling the management policies of the state service.

**b i Sources of an individual's assessable incomes**

- Gains and Profits from any trade, business or profession;
- Emoluments from employment – salaries, wages, fees and other payments resulting from employment;
- Interests and commissions, annuities and Royalties;
- Gains or profits resulting from rental of property
- Pensions, Incomes brought into Nigeria from abroad;
- Share options granted to employees. Liability will only arise when the option is exercised and not when it is granted;
- Post-Cessation receipts: These are received after discontinuance of such a business – bad debts recovered charge; and
- Any balancing charge.

**ii Personal Reliefs/Reliefs that can be claimed:**

- Personal allowance
- Child Allowance
- Dependant Relative Allowance
- Allowance for Life Assurance
- Rent Relief paid on annual rent paid by the claimant
- Capital Allowance
- Allowable Donations

**Question 3**

**Economy Improvement and Sustenance Commission**

**a. Revenue Account for the year ended 31st December 2013**

	N'000	N'000
<b>REVENUE</b>		
Subvention from Ministry of Finance		12,000
Income from service		26,000
Income from Seminars		56,000
Subvention from Federal Government		11,600
Investment income		<u>280</u>
		105,880
<b>Less</b> Recurrent Expenditure	68,000	
Interest on loan	14,400	82,400
		23,480
Transfer to Capital Fund		(1,600)
Revenue balance for the year		21,880
Revenue balance B/F.		84,800
<b>Revenue balance C/F.</b>		<b>106,680</b>

**b. Economy Improvement and Sustenance Commission  
Capital Fund For The Year Ended 31st December 2013**

	N'000	N'000
Transfer from Revenue Account		1,600
Profit on Disposal of Property		2,080
		3,680
<b>Less:</b>		
Capital Expenditure	12,000	
Depreciation	15,880	<u>(27,880)</u>
		(24,200)

Capital Fund B/F.	<u>8,000</u>
Capital Fund C/F.	<b>(16,200)</b>

**c. Economy Improvement and Sustenance Commission  
Statement Of Financial Position as at 31st December 2013**

Assets	N'000	N'000
<b>Non-Current Assets</b>		
Property, Plant and Equipments (w2) not shown		158,800
Accumulated Depreciation (w4) not shown		<u>(55,480)</u>
<b>Total Non-Current Assets</b>		<b>103,320</b>
<b>Current Assets</b>		
Bank Balance (w1) not shown	31,560	
Investment	8,000	
Current Assets (31/12/2013)	<u>14,800</u>	
	54,360	
Current Liabilities (w5) not shown		<u>(24,800)</u>
Net Current Assets		<u>29,560</u>
<b>Net Assets</b>		<b>132,880</b>
<b>Equity and Liabilities</b>		
Revenue balance		106,680
Capital Fund		<u>(16,200)</u>
Total Equity		90,480
<b>Non- Current Liabilities</b>		
Loans Outstanding		42,400
<b>Total Non- Current Liabilities</b>		<b>42,400</b>
<b>Total Equity and Liabilities</b>		<b>132,880</b>

**Question 4**

**Federal Republic of Lamard**

**Cash Flow Statement For The Year Ended 31st December 2013**

Receipts	2013 N'M	2012 N'M
Share of Statutory Allocation	13,500,000	8,450,000
Value added tax	2,295,000	2,196,000
Personal Income Tax - Direct Tax	10,500,000	7,200,000
Allocation for Collection Cost	3,075,000	3,305,000
Grants and Subvention Received	75,000	87,000
Miscellaneous Revenue	<u>375,000</u>	<u>425,000</u>
<b>Total Receipts</b>	<b>29,820,000</b>	<b>21,663,000</b>
Personnel Costs	7,200,000	9,600,000
Consolidated Revenue Charges	2,250,000	3,750,000
Overhead Charges	1,500,000	1,200,000
Subvention to Parastatals	1,800,000	1,900,000
<b>Total Payments</b>	<u>12,750,000</u>	<u>16,450,000</u>
<b>Net Cash Flow From Operating Activities</b>	<b>17,070,000</b>	<b>5,213,000</b>
<b>Cash Flow From Investing Activities</b>		
Sales of Federal Govt. Properties in Lekki Peninsula	1,050,000	
Purchases and Construction of Non-Current Assets	(2,500,000)	(2,700,000)
Purchases of Marketable Securities	(500,000)	(300,000)

Sales of Government Property	375,000	485,000
Rent of Government Property	285,000	295,000
<b>Net Cash Flow From Investing Activities</b>	<b>(1,290,000)</b>	<b>(2,220,000)</b>

#### Cash Flow From Financing Activities

Proceeds from Loans and other Borrowing	3,000,000	1,000,000
Repayment of loan	(870,000)	(243,000)
Net Cash Flow From Financing Activities	2,130,000	757,000
Net Increase In Cash And Cash Equivalent	17,910,000	3,750,000
Cash and Cash Equivalent 1st Jan.	3,750,000	-
<b>Cash and Cash Equivalent 31st December.</b>	<b>21,660,000</b>	<b>3,750,000</b>

### SECTION C

#### Question 5

(a) Allocation function. Allocation refers to any activities of government which affect the type, quantity and quality of goods and services being produced. Allocation by government includes funding public education, subsidizing health care services, subsidizing petroleum products and fertilizers, taxing cigarettes, regulating factory and automobile emissions, constructing road and setting prices for electric power supplied by private firms to mention a few.

Allocation activities of government generally are justified if public goods, merit goods on the basis or external effects. Public goods are goods or services having the properties that; (1) they cannot be provided to one citizen without being supplied also to others and (2) once provided for one citizen, the cost of providing them to others is zero. In this category are defence and streetlights.

Merit goods are goods which consumers will not buy in sufficient quantities if they are not compelled to do so through government. Examples are health care services, public education, safety features in a car and so on. Both public and merit goods are essential to human lives, but will not be produced at all or will not be adequately supplied if left to the private sector.

**(b) Redistribution function.** In a market economy, the distribution of income is based on each person's contribution to production. Granting the differences in natural and acquired abilities, distribution of income determined exclusively by the market will produce high inequality whereby some people are very wealthy, while others are very poor. To redistribute income, government uses taxes and transfer payments. To achieve rich-to-poor redistribution, tax

revenue is used to finance transfer payments in the form of free education, subsidised public health care services, and other pro-poor welfare programs.

**(c) Economic stabilization.** Economic stabilization policies are all policies designed to promote price stability, full employment and economic growth. It also involves government actions designed to ensure stability of foreign exchange rate and interest rate in the money market. The term macroeconomic stability is used to describe general stability of prices of goods and services, exchange rate and interest rate, and it is a vital prerequisite for economic growth and development.

**(d) Regulation of private business.** This function is performed through a regrowth of many specialized agencies of government. In Nigeria, for instance, the Standard Organization of Nigeria (SON) and National Food and Drug Commission (NAFDAC) were established by the Federal Government to ensure that high-quality and welfare-enhancing goods are produced as against goods that endanger

human lives.

**(e) Administration of justice.** The maintenance of the police and services rendered by the courts have important economic consequences. The police is maintained to protect human lives and properties, while the courts adjudicates to sanction breaches of contracts. The level of economic activities and standards of living will be low where people commit acts of illegality with impunity.

#### Question 6

(a) The benefits of public debt that should be identified and explained include the following:

- Rapid economic growth and welfare improvement would be achieved if borrowed funds are utilized to finance economically and socially viable projects.
- The confidence of local and foreign investors in the economy would be boosted if public debt is used to control inflation. New and additional investment would lead to creation of new jobs and greater output of welfare-enhancing goods and services.
- If borrowed funds are spent on public works, standards of living will improve, especially via creation of new jobs and the transformation of the environment.
- Public debt reduces income inequalities if it is spent on social, security and projects that are of more benefit to the lower income groups.
- Those who lend money to government by purchasing government securities, instead of keeping idle savings, will become richer as they acquire additional assets to boost their wealth portfolio.

(b) Disadvantages of public debt that should be identified and explained include the following:

- Excessive government borrowing within the economy tends to crowd out private investments. That is, government competes with private companies in the money market and deprive them loanable funds they needed to grow their activities.
- It imposes future obligation on tax payers when borrowed funds are diverted to prestigious or white-elephant projects that have no direct relevance to economic growth and development.
- Funding excessive interest rate on public debt in hard currency deprives the nation of foreign exchange needed to procure critical inputs, especially in a country like Nigeria that is highly import dependent with respect to inputs required in the industrial sector. This leads to declining industrial capacity utilization and loss of industrial jobs.
- Borrowing results in unbearable conditionalities of the International Monetary Fund (IMF), like trade liberalization, withdrawal of subsidies on essential products, expenditure reduction, non-increase of salary of public servants and other stiff conditions that carry grave repercussion on living standards of the people.
- It is an ineffective way of controlling inflation. As a matter of fact, debt servicing may create inflationary effects at a time of full-employment. Specially, the financing of domestic debt usually cause aggregate demand to increase when creditors bring the income generated through their investment in government securities into circulation.
- Debt-servicing problem is aggravated when short and medium-term loans are committed to long-term projects with amortization becoming due before projects are completed.

**(c) Concluding remarks**

Since debt has benefits and consequences as discussed, it is therefore, necessary that government should think very well before incurring debt. Thus, the net effect of debt depends on what the debt incurred is used for. If debt is used for investment purposes, it is likely that the debt will repay itself as well as be beneficial to the country. However, if debt is used for consumption purposes it creates a burden that needs to be settled over time. The conclusion therefore is that whether debt will be beneficial or have negative consequences depends on what the debt is used to finance.

**Question 7**

(a) Planning-Programming-Budgeting System (PPBS) is a framework for the presentation and analysis of information to assist in reaching decisions about resource allocation to a public sector programme, in this case education programme. It seeks to establish what a government department (e.g. state Ministry of Education) is aiming to achieve in terms of what its objectives are; what activities contribute to these objectives; what resources or inputs contribute to these activities; and what the outputs are (what is being achieved).

(b) Towards achieving the rational method of management into education programmes, which is usually bedeviled by difficulties of measurement and evaluation, PPBS proceeds by undertaking the following steps

- (i) Breaking down broad education programmes into detailed subprogrammes.
- (ii) Devising methods of measuring the level of output of the subprogrammes, and of evaluating the resources required to provide this output.
- (iii) Clarifying the objective laid down by the policy makers in respect of the broad education programmes, and possibly subprogrammes.
- (iv) Finding the least-cost ways of meeting these objectives- cost effectiveness analysis (CEA) of the objectives.
- (v) Clarifying the "opportunity costs" of these objectives and thus in turn helping to formulate future education policy objectives.

**Question 8**

- (a)  
(i) B. N. ALKALI & CO. CHARTERED ACCOUNTANTS

May 18, 2013  
The Managing Director  
Salim Nigeria limited  
2 Broad Street  
Lagos  
Dear Sir,

**RE: TAX MATTERS**

Further to our discussions at the last workshop, please find below our explanations on the three areas of interest as identified:

- **PAYMENT OF DIVIDEND BY A NIGERIAN COMPANY**  
Section 19 of CITA Cap C21 LFN 2004 states that where a dividend is paid out of profits on which no tax is payable due to:
  - 1) No total profits

- 2) Total profits which are less than the amount of dividend which is paid, whether or not the recipient of the dividend is a Nigerian company, by a Nigerian company, the company paying the dividend shall be charged to tax at 30%, as if the dividend is the Total Profits of the company for the year of assessment to which the accounts relate.

This means that dividends paid out of exempted profits from pioneer company, capital or reserves will be treated as business profits. This is an anti-avoidance provision which seeks to exclude dividends from a pioneer company, and Revaluation Reserves, and other Reserves as Franked Investment Income.

· **TREATMENT OF LOSSES IN THE ASCERTAINMENT OF TOTAL PROFITS**

In ascertaining the Total Profits of any company, losses are deductible from the Total Assessable Profits from all sources. The conditions to be met for losses to be deductible as contained in Section 31 of CITA CAP C21 LFN 2004 are:

- 1) The Board must be satisfied that the loss has been incurred by the company in any trade or business during any preceding year of assessment.
- 2) The aggregate deduction from the assessable profits or income must not exceed the total amount of the loss.
- 3) The loss can be carried forward and deducted from the same trade or business up to the fourth year from the year of commencement. Where the company is engaged in an agricultural trade or business however, the losses can be carried forward indefinitely (without restriction to time).
- 4) The loss sustained by a Non-resident Company that indigenizes its Nigerian operations shall be deemed to be a loss of the re-constituted company in its trade or business during the year of assessment in which it commenced business, and it shall be deducted from the profits of subsequent assessment year(s)

· **TAX INCENTIVES WITH PARTICULAR REFERENCE TO RESEARCH AND DEVELOPMENT:**

Section 26 (1), (2) and (3) stipulate that:

- 1) In ascertaining the profits or loss of any company, from any source, chargeable to tax, there shall be deducted, the amount of reserve made out of the profits of that period.
- 2) The deduction shall not exceed an amount which is equal to 10% of total profits of the company for that year, before any deduction is made.
- 3) Where the company or organisation is engaged in Research and Development for commercial purpose, the incentive is 20% Investment Tax Credit on the qualifying expenditure for that purpose.

(ii) **TAX PAYABLE IN 2012 ASSESSMENT YEAR**

	N'000
Assessable profits	26,000
Add: Balancing charge	4,500
	30,500
Loss Relief	(9,000)
	21,500
Capital Allowance	(4,200)
Total Profits	17,300
Income tax payable @ 30%	5,190
Education tax 2% of N26,000.000	520
Total liability	5,710

iii)

- 1) 2009 - Since the dividend payable is less than the Total Profits, the dividend will only suffer withholding tax in the hands of the recipients.
- 2) 2010 - There was no Total Profits hence no Tax Payable. However dividend paid will be taken as business profits, and so will be regarded as Total Profits and taxed at 30%, resulting in the tax payable of N1, 500,000 payable.
- 3) 2011 - There was Total Profits of N3, 000,000 and a Tax of N9, 000,000. Since the Total Profits are less than the dividend paid, the dividend of N5, 000,000 will be treated as Total Profits and will be taxed at 30%, which is N1, 500,000. This means that additional tax of N600, 000 will be paid.

#### Summary of taxes payable

Year of Assessment	Total Profit N'000	Dividend N'000	Tax Paid N'000	Tax on Dividend N'000	Tax Underpayment N'000
2009	10,000	5,000	3,000	1,500	NIL
2010	-	5,000	-	1,500	1,500
2011	3,000	5,000	900	1,500	600
Total					2,100

We hope the above satisfies your enquiry. Please feel free to revert to us if you require further clarification.

Yours faithfully,  
B. N. ALKALI & Co.  
Chartered Accountants

(b) The following incentives are available for the various sectors of the economy as follows:

#### i. Agriculture

Without prejudice to government deregulation of the financial sector, banks have been enjoined to recognize the differences in the gestation periods within each category of agricultural loans ranging from 6 months to 10 years, for crops, livestock, fisheries, forestry and wild life.

In addition, the following incentives are also available;

- Companies in the agro-allied business do not have their capital allowance restricted to 60% but granted in full - 100%;
- Agro-allied plant and equipment enjoy enhanced capital allowances of up to 50%.

#### ii. Solid Minerals

Nigeria is richly endowed with a variety of solid minerals of various categories ranging from precious metals, stones and industrial Minerals such as Barytes, Gypsum, Kaolin and Marble.

The Ministry of Solid Minerals worked out a package of attractive incentives for potential investors in the solid minerals sector, including:

- 3 to 5 years tax holiday;
- Deferred royalty payments depending on the magnitude of the investment and strategic nature of the project;
- Possible capitalisation of expenditure on exploration and surveys;
- Provision of 100% foreign ownership of mining companies or concerns;
- In addition to roll-over relief under the capital gains tax (cgt), companies replacing their plants and machinery are to enjoy a once-and-for-all 95% capital allowance in the first year with 5% retention value until the asset is disposed of, etc.

#### iii. Tourism

The tourism sector was accorded preferred sector status in 1991. This makes it qualify for such incentives as tax holidays, longer years of moratorium and import duty exemption on tourism related equipment;

State governments are prepared to facilitate acquisition of land through the issuance of certificate of occupancy for the purpose of tourism development;

25% of income derived from tourists by hotels in convertible currencies are tax exempt provided such income is put in a reserve fund to be utilized within 5 years for expansion or the construction of new hotels, conference centres, etc that are useful for tourism development

#### iv. Export incentives for non-oil sector

Export proceeds can be retained in foreign currency in a domiciliary account with any authorised bank in Nigeria.

A special export development fund has been set up by the government to provide financial assistance to private sector exporting companies to cover a part of their initial expenses in some export promotion activities, including training courses, symposia, seminars and workshops, export market research, advertising and publicity campaigns in foreign markets, trade missions, etc.

There is also an export adjustment fund scheme which serves as supplementary export subsidy to compensate exporters for the high cost of local production arising mainly from infrastructural deficiencies, and other negative factors beyond the control of the exporter.

Finally, Nigerian government established in 1991, an export processing zone (EPZ), which allows interested parties to set up industries and businesses within demarcated zones, with the objective of exporting the goods and services manufactured or produced within the zones.

Calabar in cross river state has been designated as the primary EPZ territory in Nigeria. incentives within the territory include, tax holiday relief; unrestricted remittance of profits and dividends earned by foreign investors; no import or export licenses are required; up to 100% foreign ownership of enterprises; sale of up to 25% of production is permitted in domestic market; etc,

All exports under the Nigerian value added tax (vat) system are zero-rated and dividends received from investment in export-oriented businesses are to be free of tax.

#### v. Small Manufacturing Companies:

- Small manufacturing companies are those with less than N1million Turnover
- They are to pay income Tax at 20% for the first four years of commencing business
- Dividends from small manufacturing companies are exempted from tax for the four years of business operations
- No tax is payable on interest charged by banks for manufacturers of Export goods
- Dividend derived from manufacturing companies in the petrochemical and Liquefied Natural Gas Sub-Sectors are tax exempted
- There are no restrictions on Capital Allowance claimable by small manufacturing companies.



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