



**THE INSTITUTE OF CHARTERED  
ACCOUNTANTS OF NIGERIA**

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# **PATHFINDER**

**MAY 2023 DIET  
SKILLS LEVEL EXAMINATIONS**

**Question Papers**

**Suggested Solutions**

**Marking Guides**

**and**

**Examiners' Reports**

## **FOREWARD**

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

- (i) Candidates preparing to write future examinations of the Institute of Chartered Accountants of Nigeria (ICAN);
- (ii) Unsuccessful candidates in the identification of those areas in which they lost marks and need to improve their knowledge and presentation;
- (iii) Lecturers and students interested in acquisition of knowledge in the relevant subject contained herein; and
- (iv) The professional; in improving pre-examinations and screening processes, and thus the professional performance of candidates.

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

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

### **NOTES**

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

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**THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA****SKILLS LEVEL EXAMINATION – MAY 2023****FINANCIAL REPORTING****EXAMINATION INSTRUCTIONS****PLEASE READ THESE INSTRUCTIONS BEFORE THE COMMENCEMENT OF THE PAPER**

1. Check your pockets, purse, mathematical set, etc. to ensure that you do not have prohibited items such as telephone handset, electronic storage device, programmable devices, wristwatches or any form of written material on you in the examination hall. You will be stopped from continuing with the examination and liable to further disciplinary actions including cancellation of examination result if caught.
2. Write your **EXAMINATION NUMBER** in the space provided above.
3. Do **NOT** write anything on your question paper **EXCEPT** your examination number.
4. Do **NOT** write anything on your docket.
5. Read all instructions in each section of the question paper carefully before answering the questions.
6. Do **NOT** answer more than the number of questions required in each section, otherwise, you will be penalised.
7. All solutions should be written in **BLUE** or **BLACK INK**. Any solution written in **PENCIL** or **RED INK** will not be marked.

**TUESDAY, MAY 16, 2023****DO NOT TURN OVER UNTIL YOU ARE TOLD TO DO SO**

# THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

## SKILLS LEVEL EXAMINATION – MAY 2023

### FINANCIAL REPORTING

Time Allowed: 3¼ hours (including 15 minutes reading time)

**INSTRUCTION: YOU ARE REQUIRED TO ATTEMPT FIVE OUT OF SEVEN QUESTIONS IN THIS PAPER**

**SECTION A: COMPULSORY QUESTION (30 MARKS)**

#### QUESTION 1

- a. The following trial balance was extracted from the books of Adama Plc as at June 30, 2022:

	<b>N'000</b>	<b>N'000</b>
Freehold land and building at valuation 1/7/21	1,065,600	
Office equipment	865,800	
Delivery van	301,400	
Accumulated depreciation at 1/7/21:		
Office equipment		199,800
Delivery van		120,560
Ordinary share capital of 50k each fully paid		790,000
Bank balances	142,310	49,950
Investment income		65,246
Financial assets	244,200	
Dividend paid	119,880	
Cost of sales	995,003	
Distribution costs	161,128	
Gain on translation of foreign operations		47,108
Trade receivables/payables	579,065	353,846
Revenue		2,142,819
Intangibles	50,600	
Administrative expenses	173,727	
Interest on loan notes	14,763	
General reserve		109,809
Deferred tax at 1/7/21		100,078
Inventories at 30/06/2022	622,812	
Retained earnings		231,572
3% redeemable loan notes		843,000
Revaluation reserve-freehold land and buildings		80,500
Share premium		142,000
Suspense account		60,000
	<u>5,336,288</u>	<u>5,336,288</u>

**Additional information:**

- (i) The value of the freehold land and buildings includes a land element of ~~₦~~266,800,000 and the estimated remaining life of the buildings at July 1, 2021 was 25 years. Depreciation on buildings is charged 65% to cost of sales and 35% to administrative expenses.
- (ii) The revenue includes ~~₦~~69,250,000 for an item of office equipment disposed on November 30, 2021. The equipment had a carrying value of ~~₦~~46,060,000 at the date of sale. The equipment cost ~~₦~~75,000,000 when it was acquired three years ago.
- (iii) Included in the cost of sales is ~~₦~~82,600,000 incurred in the manufacture of a new office equipment which was put to use by Adama PLC on February 1, 2022.
- (iv) All office equipment is depreciated at 15% per annum using reducing balance method and charged to cost of sales while depreciation of all motor vehicles is at 20% per annum on straight line basis and charged to distribution costs. Depreciation is to be charged in full in the year of acquisition and no charge in the year of disposal.
- (v) Following the conclusion of a winding-up proceedings on one of Adama PLC's customer, it was resolved to write-off the sum of ~~₦~~26,450,000 due from the customer and to make allowance for doubtful receivables of 2½% on the continuing trade receivables.
- (vi) The financial assets are equity instruments held at fair value through profit or loss and have suffered impairment loss of ~~₦~~12,700,000 at the year end.
- (vii) The 3% redeemable loan notes was issued on October 1, 2021 under terms that provided for a large premium on redemption in 2025. These terms were interpreted by the finance director to mean that the loan notes have effective interest rate of 6½% per annum.
- (viii) The income tax expense for the year ended June 30, 2022 is estimated at ~~₦~~143,552,000 while the deferred tax payable for same period amounted to ~~₦~~12,520,000. There was an over provision of ~~₦~~25,664,000 in respect of income tax for the previous trading year.
- (ix) The suspense account balance represents the corresponding credit entry for shares issued at premium of 15 kobo per share arising on issue of 400,000 ordinary shares made during the year.
- (x) The directors recommended a 20 kobo final dividend per ordinary share for the year and to transfers ~~₦~~38,900,000 to the general reserve.

**Required:**

Prepare for Adama PLC the following financial statements:

- i. Statement of profit or loss and other comprehensive income for the year ended June 30, 2022. (10 Marks)
  - ii. Statement of changes in equity for the same period (4 Marks)
  - iii. Statement of financial position as at June 30, 2022 (10 Marks)
- b. Some new trainee accountants in your organisation were engaged in a discussion in which they proclaimed that Earnings Per Share (EPS) and Return on Capital Employed (ROCE) are the best ratios for analysing financial performance of any entity. The finance director, who overheard their discussion have requested you as the Chief Accountant to prepare a brief on the aforementioned ratios which would be used during the forthcoming in-house training.

**Required:**

Prepare a memo to the finance director explaining the ratios and highlighting the limitations of each of the ratios as a tool for analysing financial performance.

(6 Marks)

**(Total 30 Marks)**

**SECTION B: OPEN-ENDED QUESTIONS (40 MARKS)**

**INSTRUCTION: YOU ARE REQUIRED TO ATTEMPT ANY TWO OUT OF THREE QUESTIONS IN THIS SECTION**

**QUESTION 2**

- a. The Conceptual Framework for Financial Reporting sets out the concepts that underlie the preparation and presentation of financial statements and it also considers the various users of these financial statements.

**Required:**

Identify and discuss the information needs of the different users of financial statements. (10 Marks)

- b. Companies and Allied Matters Act (CAMA) 2020 is the primary source of company law which establishes the requirements for financial reporting by all companies in Nigeria.

**Required:**

Briefly explain **FIVE** issues which must be contained in a directors' report in accordance with CAMA 2020. (5 Marks)

- c. Babanriga Nigeria Limited acquired a factory machine for ₦10million on January 1, 2019. The machine had estimated life and residual value of 10 years and ₦2million respectively. It is depreciated on a straight line basis. In lieu of depreciation, the tax authority allows a tax expense of 40% of the cost of this type of machine to be claimed against income tax in the year of purchase and 25% per annum of its tax base subsequently on reducing balance basis. The prevailing company income tax rate is 30%.

**Required:**

Calculate the deferred tax charge or credit which will be recorded in Babanriga Nigeria Limited Statements of profit or loss and other comprehensive income for the year ended December 31, 2021 and the deferred tax balance in the statement of financial position at that date. (5 Marks)

**(Total 20 Marks)****QUESTION 3**

Olu Nigeria PLC has a subsidiary, Oba Limited, which it acquired on January 1, 2022. The financial statements of the companies are detailed below:

**Statements of profit or loss for the year ended September 30, 2022**

	<b>Olu PLC</b>	<b>Oba LTD</b>
	<b>₦'000</b>	<b>₦'000</b>
Revenue	446,250	233,100
Cost of sales	<u>(330,750)</u>	<u>(174,600)</u>
Gross profit	115,500	58,500
Other income	40,250	-
Distribution costs	(10,250)	(11,100)
Administrative expenses	(31,650)	(14,760)
Finance costs	<u>(8,575)</u>	<u>(7,200)</u>
Profit before taxation	105,275	25,440
Income tax expense	<u>(28,670)</u>	<u>(5,790)</u>
Profit for the year	76,605	19,650
Other comprehensive Income:		
Gain on revaluation of property	<u>26,600</u>	<u>5,000</u>
Total comprehensive Income	<u>103,205</u>	<u>24,650</u>



**Statement of financial position as at September 30, 2022**

	<b>Olu PLC</b>	<b>Oba LTD</b>
<b>Non-current assets:</b>	<b>₦'000</b>	<b>₦'000</b>
Property, plant and equipment	253,750	82,530
Intangibles	31,420	-
<b>Current assets</b>		
Inventories	72,200	30,440
Trade receivables	65,250	25,560
Cash and bank balances	<u>12,550</u>	<u>6,450</u>
	<u>435,170</u>	<u>144,980</u>
<b>Equity and liabilities</b>	<b>₦'000</b>	<b>₦'000</b>
Ordinary shares of ₦1 each	100,000	40,000
Retained earnings	235,600	50,550
<b>Non-current liabilities</b>		
10% Loan notes	30,000	32,600
Deferred tax	6,400	4,180
<b>Current liabilities</b>		
Trade payables	34,500	11,860
Income tax payable	<u>28,670</u>	<u>5,790</u>
	<u>435,170</u>	<u>144,980</u>

**Additional information:**

- (i) Olu PLC acquired its 70% interest in Oba Limited through a share exchange of three shares in Olu PLC for five shares in Oba Limited. At the acquisition date, the shares of Olu PLC were sold at ₦8.10 each at the Nigerian Exchange (NGX). The parent company is yet to record this share issue in its books.
- (ii) At the acquisition date, the fair value of Oba Limited's assets were equal to their carrying amounts except for an item of plant which had a fair value of ₦30,000,000 in excess of its carrying amount. This fair value increase have not been adjusted for in the books of Oba Limited. The said plant has a remaining life of five years at acquisition date.
- (iii) During the year Oba Limited transferred goods worth ₦40,000,000 to Olu PLC. Those goods were invoiced at cost plus 25% and only a quarter of the goods have been sold by Olu PLC at the year end.
- (iv) Included in the other income was ₦6,550,000 received from Oba Limited as interest paid on loan granted by Olu Plc. The loan was fully repaid before September 30, 2022.
- (v) An impairment test carried out revealed loss in value of goodwill at the acquisition date of ₦28,000,000.
- (vi) It is the group's policy to value non-controlling interest at their fair value. The prevailing market price per ordinary share of Oba Limited at January 1, 2022 was ₦5.05.

- (vii) The gain on revaluation of property arose from an independent valuation of the groups property in September 2022.
- (viii) The administration expenses of Oba Limited included ₦10,000,000 paid as management fees to Olu Plc and the income have been duly accounted for in the books.
- (ix) Except where indicated, income and expenses accrue evenly over the period.

**Required:**

- a. Prepare the consolidated statement of profit or loss and other comprehensive income for Olu group for the year ended September 30, 2022. (12 Marks)
- b. Calculate the goodwill on acquisition and the Non-controlling interest at the reporting date. (4 Marks)
- c. IFRS 10 - Consolidated Financial Statements states that a parent must present consolidated financial statements in which it consolidates its investments in subsidiaries.

**Required:**

State **FOUR** exceptions to the above pronouncement of IFRS 10. (4 Marks)  
**(Total 20 Marks)**

**QUESTION 4**

- a. Accounting for deferred tax is based on the identification of the temporary differences.

**Required:**

Explain the term “Temporary difference” and discuss the **TWO** different types. (3 Marks)

- b. State and briefly explain **FIVE** components of tax expense or income. (5 Marks)
- c. Buga Nigeria Limited had an accounting profit before taxation of ₦196,800,000 for the year ended September 30, 2022. The following balances were extracted from the company’s books as at September 30, 2022.

<b>Non-current assets</b>	<b>₦'000</b>	<b>₦'000</b>
Freehold property		236,700
Office equipment	205,000	
Tax allowed depreciation	<u>(22,500)</u>	182,500
<b>Current assets</b>		
Trade receivables	174,250	
Interest receivable	3,250	
<b>Current liabilities</b>		
Fine payable	32,500	
Interest payable	10,850	

### Other information

- (i) Interest income is taxed while interest expense is allowable on a cash basis. There were no opening balances on interest receivable and interest payable.
- (ii) The trade receivables above is shown net of an allowance for doubtful balances of ₦16,750,000. This is the first year that such an allowance has been recognised. A deduction for debts is only allowed for tax purposes when the debtors is in the process of winding-up.
- (iii) The balances in respect of office equipment are after charging accounting depreciation of ₦28,250,000 and tax allowable depreciation of ₦22,500,000 respectively.
- (iv) The freehold property was purchased on October 1, 2021 for ₦263,000,000 and is being depreciated for accounting purposes on a 10% per annum. Buga Nigeria Limited is in a position to claim ₦94,600,000 as accelerated depreciation on cost as taxable expense in this year's tax computation.

### Required:

- i. Prepare a tax computation and calculate the current tax expense. (4 Marks)
  - ii. Calculate the deferred tax liability as at September 30, 2022. (6 Marks)
  - iii. Show the movement on the deferred tax account for the year ended September 30, 2022 given that the opening balance was ₦8,100,000. (2 Marks)
- (Total 20 Marks)**

## **SECTION C: OPEN-ENDED QUESTIONS (30 MARKS)**

**INSTRUCTION: YOU ARE REQUIRED TO ATTEMPT ANY TWO OUT OF THREE QUESTIONS IN THIS SECTION**

### QUESTION 5

- a. IFRS 9 - Financial Instruments defined a financial instrument as contract that gives rise to both a financial asset in one entity and a financial liability or equity instrument in another entity.

### Required:

- i. Explain the terms "financial asset" and "financial liability". (3 Marks)
- ii. Describe with examples **THREE** categories of financial assets in accordance with IFRS 9. (7 Marks)

- b. Olisa Nigeria PLC issued a stepped bond on January 1, 2018 with an issue value of ₦10million. The bond pays a coupon rate of 5% interest for the first two years and 7% interest for the next two years. The interest on the bond is paid annually on the anniversary of the bond issue. The bond has an effective interest rate of 5.94234% and is expected to be redeemed at par after four years.

**Required:**

Calculate the amortised cost of the bond at the end of each year over its life.

(5 Marks)

**(Total 15 Marks)**

**QUESTION 6**

- a. IAS 2 - Inventories sets out the requirements to be followed when accounting for inventory and specifies two methods of recording inventory so as to allow the calculation of cost of sales.

**Required:**

- i. Explain the term ‘Perpetual inventory system’ and identify **FIVE** possible cause of differences between the balance on the inventory account and the physical inventory counted. (5 Marks)
- ii. State the disclosure requirements for inventory in notes to the financial statements. (5 Marks)
- b. Many accountants believe that Block-Chains Technology will enhance the recording of financial transactions globally.

**Required:**

Explain the term “Block-Chain Technology” and state **THREE** disadvantages of adopting the technology. (5 Marks)

**(Total 15 Marks)**

**QUESTION 7**

- a. The Conceptual Framework for Financial Reporting states the qualitative characteristics of financial information. Identify and explain **FIVE** qualitative characteristics of general-purpose financial statements. (10 Marks)
- b. IAS 16 prescribes the principles and the valuation methods in recognising items of property, plant and equipment in financial statements of an entity.

Describe the **TWO** methods of valuation recognised in IAS 16 on property, plant and equipment. (5 Marks)

**(Total 15 Marks)**

## SECTION A

### SOLUTION 1

a. (i)

#### Adama PLC

##### Statement of profit or loss and other comprehensive income for the year ended June 30, 2022

	Note	₦'000
Revenue	1	2,073,569
Cost of sales	2	<u>(1,038,553)</u>
Gross profit		1,035,016
Other income	3	88,436
Administrative expenses	4	(184,910)
Distribution cost	5	(261,673)
Impairment loss on financial assets	6	<u>(12,700)</u>
Operating profit		664,169
Finance cost	7	<u>(41,096)</u>
Profit before taxation		623,072
Income tax expenses	8	<u>(30,330)</u>
Profit for the year		<u>592,742</u>

(ii)

#### Adama PLC

##### Statement of Changes in Equity for the year ended June 30, 2022

	Ordinary share	Share premium	General reserve	Rev reserve	Foreign exchange reserve	Retained earnings	Total
	₦'000	₦'000	₦'000	₦'000	₦'000	₦'000	₦'000
Balance b/f	590,000	142,000	109,809	80,500	47,108	231,572	1,153,881
Profit for the year	-	-	-	-	-	592,742	592,742
Issue of shares	200,000	60,000	-	-	-	-	260,000
Transfer to Reserve	-	-	38,900	-	-	(38,900)	-
Dividend paid	-	-	-	-	-	(119,880)	(119,880)
Balance to SOFP	<u>790,000</u>	<u>202,000</u>	<u>148,709</u>	<u>80,500</u>	<u>47,108</u>	<u>665,534</u>	<u>1,933,851</u>

(iii)

### Adama PLC

#### Statement of Financial position as at June 30, 2022

<b>Non-Current Asset:</b>	Note	N'000
Property, plant & equipment	9	1,751,367
Financial assets		231,500
Intangibles		<u>50,600</u>
Total non-current assets		<u>2,033,467</u>
<b>Current Assets:</b>		
Inventory		622,812
Trade receivables	10	538,800
Bank balance		<u>142,310</u>
Total current asset		<u>1,303,922</u>
Total assets		<u>3,337,389</u>
<b>Equity and liabilities:</b>		
<b>Equity:</b>		
Ordinary shares of ₦0.50 each		790,000
Share premium		202,000
General reserve		148,709
Revaluation reserves on land and buildings		80,500
Foreign exchange reserve		47,108
Retained earnings		<u>665,534</u>
Total equity		<u>1,933,851</u>
<b>Non-current liabilities:</b>		
3% Redeemable loan notes	11	869,333
Deferred tax provisions	12	<u>12,520</u>
Total non-current liabilities		<u>881,853</u>
<b>Current liabilities:</b>		
Trade payables		353,846
Bank overdraft		49,950
Current tax payables		<u>117,888</u>
Total current liabilities		<u>521,684</u>
Total liabilities		<u>1,403,537</u>
Total equity and liabilities		<u>3,337,389</u>

<b>Wk 1: Revenue</b>	N'000
Balance b/f	2,142,819
Proceeds on disposal	<u>(69,250)</u>
Statement of profit or loss (SOPL)	<u>2,073,569</u>

<b>Wk 2: Cost of sales</b>	N'000
Balance b/f	995,003
Depreciation on building (65% x (798,800/25yrs)	20,769
Capitalised cost of new office equipment	(82,600)
Depreciation on office equipment (Wk 4)	<u>105,381</u>
Balance to SOPL	<u>1,038,553</u>

<b>Wk 3: Other incomes</b>	N'000
Investment incomes	65,246
Profit on disposal of office equipment N69,250 – 46,060)	<u>23,190</u>
Balance to SOPL	<u>88,436</u>

<b>Wk 4: Administrative expenses</b>	N'000
Balance b/f	173,727
Depreciation on building (35% (798,800/25yrs)	<u>11,183</u>
Balance to SOPL	<u>184,910</u>

#### **Workings:**

<b>Wk 5: Distribution cost</b>	N'000
Balance b/f	161,128
Depreciation on delivery van (Wk 9)	60,280
Irrecoverable debt (Wk 10)	26,450
Allowance for receivables (Wk 10)	<u>13,815</u>
Balance to SOPL	<u>261,673</u>

<b>Wk 6: Financial assets</b>	N'000
Balance b/f	244,200
Impairment loss on financial assets (SOPL)	<u>(12,700)</u>
Balance c/f (SOFP)	<u>231,500</u>

<b>Wk 7: Finance cost</b>	N'000
Interest on loan notes (W11)	<u>41,096</u>

<b>Wk 8: Income tax expense</b>	N'000
Current year tax	143,552
Overprovision of previous year tax	<u>(25,664)</u>
Balance to SOFP	<u>117,888</u>

Decrease in deferred tax provision (100,078 – 12,520)	<u>(87,558)</u>
Balance to SOPL	<u>30,330</u>

**Wk 9: Schedule of movement in PPE for the year ended June 20, 2022**

	Land	Building	O/equip	Del. van	Total
Cost/valuation:	₦'000	₦'000	₦'000	₦'000	₦'000
Balance b/f	266,800	798,800	865,800	301,400	2,232,800
Additions	-	-	82,600	-	82,600
Disposal			(75,000)		(75,000)
Balance c/f	<u>266,800</u>	<u>798,800</u>	<u>873,400</u>	<u>301,400</u>	<u>2,240,400</u>
<b>Acc. depreciation:</b>					
Balance b/f	-	-	199,800	120,560	320,360
Current year charges	-	31,952	105,381	60,280	197,613
Disposal			(28,940)		(28,940)
Balance c/f	<u>-</u>	<u>31,952</u>	<u>276,241</u>	<u>180,840</u>	<u>489,033</u>
<b>Carrying amount:</b>					
Balance c/f	<u>266,800</u>	<u>766,848</u>	<u>597,159</u>	<u>120,560</u>	<u>1,751,367</u>
Balance b/f	<u>266,800</u>	<u>798,800</u>	<u>666,000</u>	<u>180,840</u>	<u>1,912,440</u>

<b>WK 10: Trade receivables</b>	<b>₦'000</b>
Balance b/f	579,065
Irrecoverable debt	(26,450)
Allowance for receivables (₦579,065 - 26,450 x 2 ½ %)	<u>(13,815)</u>
Balance to SOFP	<u>538,800</u>

<b>Wk 11: 3% Redeemable loan notes</b>	<b>₦'000</b>
Balance b/f	843,000
Interest on loan notes	(14,763)
Effective interest rate (843,000 x 9/12 x 6.5%)	<u>41,096</u>
SOFP	<u>869,333</u>

<b>Wk 12: Deferred tax liabilities</b>	<b>₦'000</b>
Closing deferred tax provision	12,520
Opening deferred tax provision	<u>(100,078)</u>
Decrease in deferred tax provision	<u>(87,558)</u>

**Wk 13: Proposed ordinary dividend**

The directors recommended a 20 kobo final dividend per ordinary share for the year.



(b) **Internal Memo**

**To:** Finance Director  
**From:** Chief Accountant  
**Subject:** Understanding Earnings Per Share (EPS) and Return On Capital Employed (ROCE)  
**Date:** May 16, 2023

Above subject refers.

Following your request, I have prepared a brief on the financial ratios Earnings Per Share (EPS) and Return on Capital Employed (ROCE).

**Earnings Per Share (EPS):**

Earnings are profits available for equity holder. Earnings per share is a measure of the amount of earnings in a financial period for each equity share. It is calculated by dividing net earnings(profit) by the number of ordinary shares outstanding. It is a useful measure for shareholders as it indicates the profitability available for each share they hold. It is used by investors as a measure of the performance of companies in which they invest or wish to invest.

**Limitations of EPS:**

- i. Not all entities use the same accounting policies. It may not always be possible to make meaningful comparison between EPS of different companies.
- ii. EPS does not take account of inflation, so that, growth in EPS over time might be misleading.
- iii. EPS measures an entity`s profitability, but this is only part of an entity`s overall performance.
- iv. It can be manipulated by changing the number of shares through stock splits or buybacks.
- v. EPS is not useful for companies with no earnings or negative earnings.
- vi. Diluted EPS is based on current and not on forecast earnings, therefore not a reliable predictor of future EPS.
- vii. The use of EPS as the main measure of an entity`s performance encourages management to make decisions which increase EPS in short run but damage the entity in the longer-term. That is encourages creative accounting.

**Return on Capital Employed (ROCE):**

ROCE is a profitability ratio that measures how effectively a company can generate profits from its capital employed by comparing net operating profit to capital employed. It is calculated by dividing earnings before interest and

tax (EBIT) by the total capital employed (shareholder's equity + non-current liabilities).

**Limitations of ROCE:**

- i. ROCE does not take into account the uniqueness of the methodology of depreciation of assets and the life cycle of the assets, thus, two companies with similar ROCE may have different risk profiles if one has older assets compared to the other.
- ii. It uses operating profit which can be subject to different accounting treatments and manipulations.
- iii. It does not consider the financing structure of a company. A company with high debt may show a high ROCE, even though it might be at a higher risk.
- iv. Like all ratios, it needs to be compared to industry average or the company's past performance for meaningful analysis.
- v. Definition of capital employed varies and confusion may arise when the return on capital is discussed unless terms are rationalised.
- vi. The return on capital is a misleading guide to efficiency unless assets are valued at current prices. Profit is counted in terms of current prices so it will be misleading if they are compared with capital computed on historic basis.

While both EPS and ROCE provide important insights into a company's financial performance, they should not be used in isolation. A comprehensive financial analysis should use a combination of financial ratios that considers liquidity, solvency, profitability, and efficiency. I hope this brief provides a balanced view of these ratios.

Thank you

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Chief Accountant

**Examiner's report**

The question tests candidates' knowledge of preparation of final accounts, part 'a' requires presentation of statement of profit or loss and other comprehensive income, statement of changes in equity and state and statement of financial position. Part 'b' is on explanation of Return on Capital Employed (ROCE) and Earnings Per Share (EPS).

Most candidates attempted the questions and performance was below average.

The common pitfalls were the inability of some candidates to determine the impairment loss on financial assets and to correctly calculate retained earnings while others could not prepare the non-current assets schedule. Also some

candidates were unable to state limitations of ROCE and EPS as a tool of financial analysis.

Candidates' are advised to pay attention to all areas of the syllabus and make use of ICAN pathfinder and study text for better performance in future examinations.

### Marking guide

	Marks	Marks
<b>a. i) Preparation of statement of profit or loss and other comprehensive income</b>		
- Title of the financial statement	$\frac{1}{4}$	
- Determination of revenue	<b>1</b>	
- Determination of cost of sales	<b>1 <math>\frac{3}{4}</math></b>	
- Determination of gross profit	<b>1 <math>\frac{1}{2}</math></b>	
- Determination of administrative expenses	<b>1 <math>\frac{1}{2}</math></b>	
- Determination of distribution costs	<b>1 <math>\frac{1}{2}</math></b>	
- Stating of profit before taxation	$\frac{1}{2}$	
- Calculation of income tax expense	<b>1 <math>\frac{1}{2}</math></b>	
- Stating of profit for the year	<u><math>\frac{1}{2}</math></u>	<b>10</b>
<b>ii) Preparation of statements of changes in equity</b>		
- Title of the financial statement	$\frac{1}{4}$	
- Determination of ordinary share capital	$\frac{1}{2}$	
- Determination of share premium	$\frac{1}{2}$	
- Determination of general reserve	$\frac{1}{2}$	
- Determination of revaluation reserve	$\frac{1}{2}$	
- Determination of foreign exchange reserve	$\frac{1}{2}$	
- Determination of retained earnings	$\frac{3}{4}$	
- Determination of total equity	<u><math>\frac{1}{2}</math></u>	<b>4</b>
<b>iii) Preparation of statement of financial position</b>		
- Title of the financial statement	$\frac{1}{4}$	
- Determination of non-current assets	<b>4</b>	
- Determination of current assets	<b>2</b>	
- Stating of total assets	$\frac{1}{4}$	
- Determination of equity	<b>1 <math>\frac{1}{2}</math></b>	
- Determination of non-current liabilities	$\frac{3}{4}$	
- Determination of current liabilities	<b>1</b>	
- Stating of total equity and liabilities	<u><math>\frac{1}{4}</math></u>	<b>10</b>
<b>b) Preparation of internal memo</b>		
- Presentation in memo format	$\frac{1}{2}$	
- Explanation of EPS	$\frac{1}{2}$	
- Explanation of ROCE	$\frac{1}{2}$	
- Stating 2 correct limitations of EPS	<b>2</b>	

- Stating 2 correct limitations of ROCE	2	
- Conclusion/Closing	$\frac{1}{2}$	<u>6</u>
<b>Total</b>		<u><b>30</b></u>

## **SOLUTION 2**

- (a) Users of financial information and their need. Financial statements meet the common needs of most users as individual primary users have different information needs. The users include:
- i. **Shareholders or investors**  
These are the providers of risk capital. They need information on the entity's financial performance and financial position which help them to assess its cash generation abilities and financial stability. They are very concerned about the risk inherent in and the returns provided by their investments in the entity;
  - ii. **Government**  
Governments and their agencies require information in order to regulate the activities of entities, assess taxation and provide a basis for national statistics to be used in allocating resources;
  - iii. **Employees**  
Employees are interested in information that helps them to assess the ability of their employer to provide remuneration, employment opportunities, and guaranteed retirement benefits. That is information about the stability and profitability of their employer and their long-term employment prospects;
  - iv. **Suppliers**  
Suppliers and other trade payables are interested in information that enables them to assess the ability of the entity to make payments when the obligation becomes due. That is, information that will enable them to decide whether to sell on credit to the entity;
  - v. **Customers**  
Customers are interested in information that will confirm the going concern status of the entity. This is so especially where they rely on the entity for special products or materials essential to their own existence;
  - vi. **Lenders**  
Lenders are interested in the information which will help them to determine whether their loans and interest thereof will be repaid at the repayment date. That is, information about the short- and long-term liquidity or solvency of the entity. Potential Lenders also seek such information to enable them to decide whether to lend or not to the entity;
  - vii. **Public**  
The general public is invested in information about trends and recent developments in the entity's prosperity and range of its activities so as to confirm whether the entity will continue to meet its social responsibility to its immediate community or the general public; and

viii. **Regulators**

Regulators are interested in information that will confirm the entity's compliance with relevant regulations, legislation and accounting standards guiding the entity's operation and reporting.

(b) **Content of director's report – CAMA 2020**

Every company must prepare a director's report which must contain the following:

- i. A fair view of the development of the business of the company and its subsidiaries during the year and of their position at the end of it;
- ii. The amount (if any) which the directors recommend should be paid as dividend and the amount (if any) which they propose to transfer to reserves;
- iii. The names of the persons who were directors of the company at any time during the year;
- iv. The financial activities of the company and its subsidiaries in the course of the year and any significant change in those activities during the year;
- v. Particulars of significant change (if any) in the non-current assets of the company in the financial year;
- vi. The difference between the market value of land and the amount at which it is recognised in the statement of financial position if in directors' opinion, the difference is of such significance that the attention of members or loan notes holders;
- vii. Details of directors in the company's shares and notes holders;
- viii. Particulars of any important events affecting the company, which has occurred since the end of the year;
- ix. An indication of likely future developments in the business;
- x. An indication of the activities (if any) of the company in the field of research and development;
- xi. Names of distributors of the company's product; and
- xii. Particulars of donations and gifts made for any purposes.

(c) **Babanriga Nigeria Limited**

**Computation of deferred tax charge/credit for the year ended December 31, 2021**

Date	Details	Carrying amount	Tax base	Temporary difference	Tax rate	Deferred tax
		₦'000	₦'000	₦'000	%	₦'000
1/1/2019	Cost	10,000	10,000	-	30%	-
31/12/2019	Depreciation	<u>(800)</u>	<u>(4,000)</u>	<u>3,200</u>	30%	<u>960</u>
31/12/2019	Tax base	9,200	6,000	3,200	30%	960
31/12/2020	Depreciation	<u>(800)</u>	<u>(1,500)</u>	<u>700</u>	30%	<u>210</u>

31/12/2020 Tax base	8,400	4,500	3,900	30%	1,170
31/12/2021 Depreciation	<u>(800)</u>	<u>(1,125)</u>	<u>325</u>	30%	<u>98</u>
31/12/2021 Tax base	<u>7,600</u>	<u>3,375</u>	<u>4,225</u>	30%	<u>1,268</u>

**In Summary:**

The deferred tax charges to be recognised in the statement of profit or loss and other comprehensive income will be ₦98,000.

The deferred tax balance to be shown in the statement of financial position will be ₦1,268,000.

**Examiner’s report**

The question tests candidates’ knowledge of information needs of different users of financial statements and contents of directors reports in accordance with the provisions of CAMA 2020 in parts a and b of the question, while part c requires the computation of deferred tax to be charged to statement of profit or loss and amount to be disclosed in the statement of financial position.

Most of the candidates attempted the questions and performance was above average.

Candidates performed well in parts a and b of the question but could not correctly calculate the deferred tax in the part c and this led to loss of marks.

Deferred tax has been favourite area of the examiners at this level of the institute examination, hence candidates are advised to pay attention to this area of the syllabus for better performance in future examinations.

**Marking guide**

	Marks	Marks
a) Conceptual Framework		
- Identification of five users of financial statements at ½ marks each	2½	
- Explanation of the information needs of the five users of financial statement at 1 ½ marks each	<u>7½</u>	10
b) Content of director’s report-CAMA 2020		
- Ten points at 1 mark each		<u>10</u>
<b>Total</b>		<b><u>20</u></b>

**SOLUTION 3**

a. **Olu Nigeria PLC**  
**Consolidated statement of profit or loss and other comprehensive income for the year ended September 30, 2022**

	₦'000
Revenue (446,250 + (233,100 x 9/12) - 40,000)	581,075.00
Cost of sales (330,750 + (174,600 x 9/12) - 40,000 + 6,000 + 4,500)	<u>(432,200.00)</u>
Gross profit	148,875.00
Other income (40,250 - 6,550 - 10,000)	23,700.00
Distribution cost (10,250 + 11,100 x 9/12)	(18,575.00)
Administrative expenses (31,650 + (14,760 x 9/12) + 28,000 - 10,000)	(60,720.00)
Finance cost (8,575 + (7,200 x 9/12) - 6,550)	<u>(7,425.00)</u>
Profit before taxation	85,855.00
Income tax expenses (28,670 + 5,790 x 9/12)	<u>(33,012.50)</u>
Profit for the year	52,842.50
Other comprehensive income:	
Gain on revaluation (26,600 + 5,000)	<u>31,600.00</u>
Total comprehensive income	<u>84,442.50</u>
<b>Profit attributable to:</b>	
Owners of parent (bal. figure)	55,006.25
Non-controlling interest (Wk 4)	<u>(2,163.75)</u>
	<u>84,442.50</u>
<b>Total comprehensive income attributable to:</b>	
Owners of parent (Bal. Figure)	85,106.25
Non-Controlling Interest (Wk 4)	<u>(663.75)</u>
	<u>84,442.50</u>

**Working Notes****Wk 1: Group Structure**

Olu PLC ----- 70% ----- Oba LTD

NCI ----- 30%

**Wk 2: Unrealised profit**

$$\text{URP} = 40,000,000 \times 25/125 \times 3/4 = \text{N}6,000,000$$

**Wk 3: Excess depreciation**

$$30,000,000/5 \times 9/12 = \text{N}4,500,000$$

**Wk 4: Share of subsidiary's profit**

	₦'000
For the year (19,650 x 9/12)	14,737.50
Impairment losses	(28,000.00)
Management fee	10,000.00
Interest paid	6,550.00

Unrealised profit (Wk 2)	(6,000.00)
Excess depreciation	<u>(4,500.00)</u>
Revised profit for the year	(7,212.50)
Other comprehensive income:	<u>5,000.00</u>
Total comprehensive income	<u>(2,212.50)</u>
NCI at 30%:	
Profit for the year	<u>(2,163.75)</u>
Total comprehensive income	<u>(663.75)</u>

**b i. Computation of goodwill on acquisition**

	₦'000	₦'000
Purchase consideration (70% x 40,000 x 3/5 x ₦8.10)		136,080.00
Fair value of non-controlling interest (30% x 40,000 x ₦5.05)		<u>60,600.00</u>
Total Purchase consideration		196,680.00
Net Identified asset:		
Share capital of subsidiary	40,000.00	
Retained earnings at acquisition (50,550 - (19,650 x 9/12))	35,812.50	
Fair value adjustment (Plant)	<u>30,000.00</u>	
Net asset acquired		<u>(105,812.50)</u>
Non-controlling interest (Wk 4)		90,867.50
Less Impairment		<u>28,000</u>
Goodwill		<u>62,867.50</u>

ii.

**Computation of non-controlling interest at reporting date**

	₦'000
Fair value of non-controlling interest (30% x 40,000 x ₦5.05)	60,600.00
Share of profit/loss	(2,163.75)
Share of revaluation surplus (₦5m x 30%)	<u>1,500.00</u>
NCI at reporting date	<u>59,936.25</u>



**c. Exceptions to the rule of a parent company preparing consolidated financial statements.**

IFRS 10 provides that a parent need not present consolidated financial statements if (and only if) **all** the following conditions apply:

- i. The parent itself (X) is a wholly owned subsidiary, with its own parent(Y). Alternatively, the parent (X) is a partially owned subsidiary, with its own parent (Y), and the other owners of X are prepared to allow it to avoid preparing consolidated financial statements;
- ii. The parent's debt or equity instruments are not traded in a public market;
- iii. The parent does not file its financial statements with a securities commission for the purpose of issuing financial instruments in a public market; and
- iv. The parent's own parent, or the ultimate parent company (for example, the parent of the parent's parent), **does** produce consolidated financial statements for public use that comply with IFRS.

**Examiner's report**

Parts 'a' and 'b' of the question test candidates' ability to prepare consolidated statement of profit or loss and other comprehensive income while that part 'c' is on exception rules on why a parent may be excluded from preparing consolidated financial statement.

Few candidates attempted the questions and performance was below average.

Most candidates could not correctly calculate the goodwill and non -controlling interest in part 'b' of the question.

Candidates are advised to pay more attention to preparation of group accounts and relevant IFRS on group accounts for better performance.

**Marking guide**

a	Marks	Marks
a) <b>Preparation of consolidated statement of profit and loss and other comprehensive income</b>		
- Stating title of the consolidated financial statement	1/4	
- Determination of consolidated revenue	1	
- Determination of consolidated cost of sales	1 1/2	
- Stating of consolidated gross profit	1/4	
- Determination of consolidated distribution cost	3/4	
- Determination of consolidated administrative expenses	1 1/4	
- Determination of consolidated finance costs	1	

- Stating the consolidated profit before taxation	1/4	
- Determination of consolidated income tax expenses	3/4	
- Stating the consolidated profit for the year	1/4	
- Determination of gains on revaluation	3/4	
- Stating total comprehensive income	1/4	
- Determination of profit for the year attributable to owner's of parent	1/4	
- Determination of profit for the year attributable to non-controlling interest	1 1/2	
- Determination of total comprehensive income attributable to owner of parent	1/4	
- Determination of total comprehensive income attributable to non-controlling interest	1 3/4	<u>12</u>
<b>bi) Calculation of goodwill on acquisition</b>		
- Determination of purchase consideration	3/4	
- Determination of fair value of non-controlling interest	3/4	
- Determination of pre-acquisition retained earnings	1/2	
- Stating fair value adjustment for plant	1/4	
- Stating subsidiary's net asset acquired	1/4	
- Stating impairment of goodwill	1/4	
- Stating goodwill on acquisition	1/4	
<b>ii) Computation of non-controlling Interest</b>		
- Stating fair value of non-controlling interest at acquisition date	1/4	
- Stating share of post-acquisition profit or loss	1/4	
- Stating share of revaluation reserve	1/4	
- Stating NCI at reporting date	1/4	4
<b>c) Exception to preparation of consolidated financial statements by IFRS 10</b>		
- Exceptions to preparation of consolidated financial statement		<u>4</u>
<b>Total</b>		<b><u>20</u></b>

## **SOLUTION 4**

- (a) Temporary differences are differences between the carrying amount of an asset or liability in the statement of financial position and its tax base
- Temporary differences may be either:
- i. Taxable temporary differences, which are temporary differences that will result in taxable amounts in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled; or
  - ii. Deductible temporary differences, which are temporary differences that will result in amounts that are deductible in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled.
- (b) The major components of tax expense or income to be disclosed may include:
- i. Current tax expense or income;
  - ii. Any adjustments recognised in the period for current tax of prior periods;
  - iii. The amount of deferred tax expense or income relating to the origination and reversal of temporary differences;
  - iv. The amount of deferred tax expense or income relating to changes in tax rates or the imposition of new taxes;
  - v. The amount of the benefit from a previously unrecognised tax loss, tax credit; or temporary difference of a prior period that is used to reduce deferred tax expense;
  - vi. Deferred tax expense arising from the write-down, or reversal of a previous write-down of a deferred tax asset; and
  - vii. The amount of tax expense or income relating to those changes in accounting policies and errors that are included in profit or loss in accordance with IAS 8, because they cannot be accounted for retrospectively.

c. i)

**Buga Nigeria Limited**

**Tax computation and current tax expense for the year September 30, 2022**

	₦'000	₦'000
Accounting profit before taxation		196,800
<b>Add:</b>		
Depreciation on freehold property	26,300	
Depreciation of office equipment	28,250	
Increase in provision for doubtful debts	16,750	
Accrued interest	10,850	
Fine payable	<u>32,500</u>	114,650
<b>Less:</b>		
Interest income	3,250	
Tax allowable depreciation on freehold proper	94,600	
Tax allowable depreciation on office equipment	<u>22,500</u>	<u>(120,350)</u>
Taxable Profit		<u>191,100</u>
Tax at 30%		<u>57,330</u>

**(ii) Deferred tax liability as at September 30, 2022**

	Carrying amount ₦'000	Tax base ₦'000	Temporary difference ₦'000
Freehold property	236,700	168,400	68,300
Office equipment	205,000	182,500	22,500
Trade receivables	174,250	191,000	(16,750)
Interest receivables	3,250	-	3,250
Fines payable	(32,500)	(32,500)	-
Interest payables	(10,850)	-	<u>(10,850)</u>
			<u>66,450</u>
Deferred tax at 30%			<u>19,935</u>

	Temporary difference	Deferred tax at 30%
Deferred tax liabilities	94,050	28,215
Deferred tax assets	<u>(27,600)</u>	<u>(8,280)</u>
Deferred tax	<u>66,450</u>	<u>19,935</u>

(iii) Movement on the deferred tax account for the year ended Sept. 30, 2022

	N'000
Deferred tax as at October 1, 2021	8,100
Statement of profit or loss (balancing figure)	<u>11,835</u>
Deferred tax as at September 30, 2022	<u>19,935</u>

### Examiner's report

The question is on IAS 12 Income Tax with particular emphasis on deferred taxation computation and disclosure requirements.

Most candidates did not attempt the question and the few that attempted it performed badly.

This is an indication that most candidates avoid this area of institute's syllabus, hence the poor performance.

Candidates are advised to pay more attention to this area of the syllabus for better performance in future examinations.

### Marking guide

		Marks	Marks
a.	<b>Explanation and types of "temporary difference"</b>		
	- Explanation of temporary difference	1	
	- Discussion of two types of temporary difference	<u>2</u>	<u>3</u>
b.	Stating five components of tax expenses or income		5
c. i)	<b>Preparation of tax computation and current tax expense</b>		
	- Stating of accounting profit before tax	$\frac{1}{2}$	
	- Adjustment for depreciation of freehold property	$\frac{1}{2}$	
	- Adjustment for depreciation of office equipment	$\frac{1}{2}$	
	- Adjustment for increase in allowance for doubtful debts	$\frac{1}{2}$	
	- Adjustment for accrued interest	$\frac{1}{2}$	
	- Adjustment for fine payable	$\frac{1}{2}$	
	- Adjustment of interest income	$\frac{1}{2}$	
	- Deduction of tax allowable depreciation on freehold property	$\frac{1}{2}$	

	- Deduction of tax allowable depreciation on office equipment	$\frac{1}{2}$	
	- Stating of total taxable profit	$\frac{1}{2}$	
	- Calculation of current tax expense	<u><math>\frac{1}{2}</math></u>	
	- Any 8 items at $\frac{1}{2}$ mark each		4
ii)	<b>Calculation deferred tax Liability</b>		
	- Determination of carrying amounts	$1 \frac{3}{4}$	
	- Determination of tax base	$1 \frac{1}{4}$	
	- Determination of temporary difference	2	
	- Calculation of deferred tax	<u>1</u>	6
iii)	<b>Movement on the deferred tax account</b>		
	- Title of statement	$\frac{1}{2}$	
	- Stating opening deferred tax balance	$\frac{1}{2}$	
	- Stating deferred tax changed to profit or loss	$\frac{1}{2}$	
	- Stating closing deferred tax income	<u><math>\frac{1}{2}</math></u>	<u>2</u>
	<b>Total</b>		<b><u>20</u></b>

## SOLUTION 5

a i) A financial asset is any asset that is:

- Cash;
- an equity instrument of another entity; and
- a contractual right to receive cash or another financial asset from another entity; or to exchange financial assets or financial liabilities with another entity.

A financial liability on the other hand is any liability that is a contractual obligation:

- to deliver cash or another financial asset to another entity.
- to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity.

ii) Financial assets must be classified into one of three categories on initial recognition.

The three categories are:

### i) Financial assets at amortised cost

A financial asset is measured at amortised cost if both of the following conditions are met:

- the asset is held within a business model whose objective is to hold assets in order to collect contractual cash flows; and
- the contractual terms of the financial assets give rise on specified dates to cash flows that are solely payments of principal and interest

on the principal amount outstanding.

Examples include loans, trade receivables and held-to-maturity bonds.

ii) **Financial assets at fair value through other comprehensive income (FVTOCI)**

A financial asset is measured at fair value through OCI if both of the following conditions are met:

- the asset is held within a business model whose objective is achieved by both holding and collecting contractual cash flows and selling the financial assets; and
- the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

Examples include ordinary share

iii) **Financial assets at fair value through profit or loss (FVTPL)**

Any financial assets that do not meet the criteria for measurement at amortised cost or FVTOCI are measured at FVTPL.

An entity may, at initial recognition, irrevocably designate a financial asset as measured at FVTPL if doing so eliminates or significantly reduces a measurement or recognition inconsistency.

Examples include derivatives, equity investments unless the entity has elected to present changes in fair value in other comprehensive income. Loans and receivables that fail the amortised cost or FVTOCI criteria, or other securities that are held for trading.

**Olisa Nigeria PLC**

**Computation of amortised cost of the bond at the end of each year**

Year ended	Amortised cost b/f	Interest at 5.94234%	Cashflows	Amortized cost c/f
	₦	₦	₦	₦
2018	10,000,000	594,234	500,000	10,094,234
2019	10,094,234	599,834	500,000	10,194,068
2020	10,194,068	605,766	700,000	10,099,834
2021	10,099,834	600,166	700,000	10,000,000

### Examiner's report

The question tests candidates' knowledge of the provisions of IAS 9 – Financial Instruments, part ` a' of the question is on explanation and description of various categories of financial assets while part ` b' is on calculation of amortised cost of bonds.

Few candidates attempted the question and performance was below average. Some of the candidates were able to explain different categories of financial assets but majority of them could not calculate amortised cost of bonds.

Candidates are advised to pay attention to both qualitative and quantitative aspects of financial instruments sections of the syllabus for better performance in future.

### Marking guide

	Marks	Marks
a i) <b>Explanation of financial asset and financial liability</b>		
- Explanation of financial assets	1½	
- Explanation of financial liability	<u>1½</u>	3
ii) <b>Description and categories of financial assets:</b>		
- Stating three categories of financial assets	1½	
- Description of financial assets at amortised cost	1	
- Example of financial asset at amortised cost	½	
- Description of financial asset at fairvalue through other comprehensive income (FVTOCI)	1	
- Example of financial asset at FVTOCI	½	
- Description of financial asset at fair value through profit or loss (FVTPL)	1	
- Examples of financial asset at (FVTPL)	<u>1½</u>	7
b) <b>Calculation of the amortised cost of bond</b>		
- Title of calculation	¼	5
- Determination of amortised cost b/f	1¼	
- Determination of yearly interests	1¼	
- Determination of cashflows	1	
- Determination of amortised cost c/f	1¼	
<b>Total</b>		<b><u>15</u></b>



## **SOLUTION 6**

### **a.i) Perpetual inventory system**

This is a system where inventory records are continuously updated so that inventory values are always available. A single account is used to record all inventory movements. The account is used to record purchases in the period and inventory is brought down on the account at each year-end. The account is also used to record all issues out of inventory.

All transactions involving the receipt or issue of inventory must be recorded and at any time, the balance on the inventory account should be the value of inventory currently held.

The following are the possible cause of differences between the balance on the inventory account and the physical inventory counted:

- Theft of inventory;
- Damage to inventory with failure to record that damage;
- Mis-posting of inventory receipts or issues (for example posting component A as component B);
- Failure to record a receipt; and
- Failure to record an issue.

### **ii) Disclosure requirements for inventory**

IAS 2 requires the following disclosures in the notes to the financial statements:

- The accounting policy adopted for measuring inventories, including the cost measurement method used;
- The total carrying amount of inventories, is classified appropriately. For a manufacturer, appropriate classifications will be raw materials, work-in-progress and finished goods;
- The amount of inventories carried at net realisable value (NRV);
- The amount of inventories written-down value and so recognised as an expense during the period;
- Details of any circumstances that have led to the write-down of inventories to NRV;
- The amount of any reversal of any write-down that is recognised as a reduction in the amount of inventories recognised as expense in the period; and
- The circumstances or events that led to the reversal of a write-down of inventories.

d. **Block-Chain Technology** is one of the new technologies that became popular globally through the advancements in digital currency transactions such as Bitcoin. It is used by many businesses to record their financial and non-financial transactions in an open secured and decentralised ledger. It also makes the transaction records accessible to authorised users at any time and at any location.

**The following are the disadvantages of adopting the block-chains technology:**

- **High implementation cost:** Blockchain is costlier compared to a traditional database. Additionally, businesses need proper planning and execution to integrate blockchain into their process;
- **Data modification.** Blockchain technology does not allow easy modification of data once recorded, and it requires rewriting the codes in all of the blocks, which is time-consuming and expensive. The downside of this feature is that it is hard to correct a mistake or make any necessary adjustments;
- **Scalability issues:** Blockchain networks, especially public ones, often face problems with scalability. As the number of transactions increases, the size of the blockchain grows, and more computational power is required to process new transactions, making the system slower over time;
- **Energy consumption:** Blockchain networks, particularly those that use proof-of-work consensus mechanisms like Bitcoin, consume large amounts of energy. This is because the computers or 'nodes' in the network need to solve complex mathematical problems to add a new block to the chain, which requires substantial computational power;
- **Regulatory and legal challenges:** The decentralised nature of blockchain poses regulatory and legal challenges. It can be difficult to apply traditional legal frameworks to blockchain transactions, especially when they cross jurisdictions. Moreover, issues related to privacy and data protection can emerge, given that information stored on the blockchain is transparent and immutable;
- **Adoption and interoperability:** For blockchain to reach its full potential, widespread adoption is necessary. However, different blockchains are often not compatible with each other, and existing systems and infrastructure may need significant changes to accommodate blockchain technology;
- **Potential for misuse:** Although blockchain's security features can help prevent fraud, the technology can also be used for illicit activities. For example, crypto currencies that uses blockchain technology have been used for money laundering due to the potential anonymity they can provide;
- **Thorough knowledge or expert:** It's challenging to implement and manage a Blockchain project. To complete the process, the business must have in-depth expertise. One of the disadvantages of Blockchain is that it necessitates hiring numerous experts in the sector, which creates a problem.
- **Inefficiency:** It is inefficient to have several network users validating the same operation, since only one will receive the record derived from the mining process. That is, some blockchains are sometimes inefficient due to how they operate.
- **Unemployment:** As blockchain technology is adopted and implemented, all the intermediation sectors for the validation of payments and process

will necessarily be reduced to the point of disappearing and with it the jobs required for it will disappear, and

- **Security:** Blockchains are not completely secured.

### Examiner's report

The question tests candidates' knowledge of IAS 2 - Inventories and Block -Chain Technology.

Most of the candidates attempted part `a' of the question on Inventory while only few of them attempted part `b' on Block – Chain Technology. Candidates' performance was good in part `a' but poor in part `b'.

Inability of the candidates to pay special attention to information technology part of the syllabus led to loss of marks.

Candidates are advised to pay more attention to all areas of the syllabus for better performance in future.

### Marking guide

	Marks	Marks
a) i. <b>Explanation of perpetual inventory system and cause of difference in balance</b>		
- Explanation of perpetual inventory system	2½	
- Stating five cause of differences between balance in inventory account and physical count	<u>2½</u>	5
ii. <b>Disclosure requirements for Inventory</b>		
- Five correct disclosure of inventory		5
b) <b>Block-Chain Technology</b>		
- Explanation of block-chains	2	
- Stating three disadvantages of adopting block-chain	<u>3</u>	<u>5</u>
<b>Total</b>		<b><u>15</u></b>

### SOLUTION 7

(a) Qualitative characteristics of General-Purpose Financial Statements are:

- Relevance** Information must be relevant to the decision-making needs of users. Information is relevant if it can be used for predictive and/or confirmatory purposes.
  - It has **predictive value** if it helps users to predict what might happen in the future.
  - It has **confirmatory value** if it helps users to confirm the assessments and predictions they have made in the past.

The relevance of information is affected by its materiality. Information is material if omitting it or misstating it could reasonably be expected to influence decisions of the primary users based on financial statements.

- Materiality is an entity-specific aspect of relevance based on the nature or magnitude (or both) of the items to which the information relates in the context of an individual entity's financial report.
- Therefore, it is not possible for the IASB to specify a uniform quantitative threshold for materiality or predetermine what could be material in a particular situation;

ii. **Faithful representation** Financial reports represent economic phenomena (economic resources, claims against the reporting entity, and the effects of transactions and other events and conditions that change those resources and claims) by depicting them in words and numbers.

To be useful, financial information must not only represent relevant phenomena, but it must also faithfully represent the phenomena that it purports to represent. A perfectly faithful representation would have three characteristics. It would be:

- Complete – the depiction includes all information necessary for a user to understand the phenomenon being depicted, including all necessary descriptions and explanations;
- Neutral – the depiction is without bias in the selection or presentation of financial information; and
- Free from error – where there are no errors or omissions in the description of the phenomenon, and the process used to produce the reported information has been selected and applied with no errors in the process;

iii. **Comparability** Comparability is the qualitative characteristic that enables users to identify and understand similarities in, and differences among, items. Information about a reporting entity is more useful if it can be compared with similar information about other entities and with similar information about the same entity for another period or another date. Consistency is related to comparability but is not the same. Consistency refers to the use of the same methods for the same items, either from period to period within a reporting entity or in a single period across entities. Consistency helps to achieve the goal of comparability;

iv. **Verifiability:** This quality helps assure users that information faithfully represents the economic phenomena it purports to represent.

- Verifiability means that different knowledgeable and independent observers could reach consensus that a particular depiction is a faithful representation.
- Quantified information need not be a single point estimate to be verifiable. A range of possible amounts and the related probabilities can also be verified;

- v. **Timeliness:** This means having information available to decision-makers in time to be capable of influencing their decisions; and
- vi. **Understandability** Information is made understandable by classifying, characterising and presenting it in a clear and concise manner. Financial reports are prepared for users who have a reasonable knowledge of business and economic activities and who review and analyse the information diligently.
- (b) Models of valuation recognised in IAS 16 – Property, Plant and Equipment. All items of property, plant and equipment in a class can be accounted for using one of two models:
- i. Cost model - Property, plant and equipment are carried at cost less any accumulated depreciation and any accumulated impairment losses; and
  - ii. Revaluation model - Property, plant and equipment are carried at a revalued amount. This is the fair value at the date of the revaluation less any subsequent accumulated depreciation and any accumulated impairment losses.

The same model should be applied to all assets in the same class. For example, a company's policy might be to value all its motor vehicles at cost but to apply the revaluation model to all its land and buildings.

### Examiner's report

The question tests candidates' knowledge of Conceptual Framework of Financial Reporting and methods of valuation of property plant and equipment in accordance with IAS 16.

Most of the candidates attempted the question and performance was good.

Candidates are advised to pay more attention to all relevant International Financial Reporting Standards (IFRS) at this level of the Institute's examination for better performance in future.

### Marking guide

	Marks	Marks
a) <b>Identification and explanation of qualitative characteristics of general Purpose Financial Statements</b>		
- Stating five qualitative characteristics	2½	
- Explanation of the five qualitative characteristics	<u>7½</u>	10
b) <b>Methods of valuation of PPE</b>		
- Stating two methods of valuation	2	
- Explanation of the two methods	<u>3</u>	<u>5</u>
<b>Total</b>		<b><u>15</u></b>

**THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA****SKILLS LEVEL EXAMINATION – MAY 2023****AUDIT AND ASSURANCE****EXAMINATION INSTRUCTIONS****PLEASE READ THESE INSTRUCTIONS BEFORE THE COMMENCEMENT OF THE PAPER**

1. Check your pockets, purse, mathematical set, etc. to ensure that you do not have prohibited items such as telephone handset, electronic storage device, programmable devices, wristwatches or any form of written material on you in the examination hall. You will be stopped from continuing with the examination and liable to further disciplinary actions including cancellation of examination result if caught.
2. Write your **EXAMINATION NUMBER** in the space provided above.
3. Do **NOT** write anything on your question paper **EXCEPT** your
4. examination number.
5. Do **NOT** write anything on your docket.
6. Read all instructions in each section of the question paper carefully before answering the questions.
7. Do **NOT** answer more than the number of questions required in each section, otherwise, you will be penalised.
8. All solutions should be written in **BLUE** or **BLACK INK**. Any solution written in **PENCIL** or **RED INK** will not be marked.

**WEDNESDAY, MAY 17, 2023****DO NOT TURN OVER UNTIL YOU ARE TOLD TO DO SO**

# THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

## SKILLS LEVEL EXAMINATION – MAY 2023

### AUDIT AND ASSURANCE

Time Allowed: 3<sup>1</sup>/<sub>4</sub> hours (including 15 minutes reading time)

**INSTRUCTION: YOU ARE REQUIRED TO ATTEMPT FIVE OUT OF THE SEVEN QUESTIONS IN THIS PAPER**

**SECTION A: COMPULSORY QUESTION (30 MARKS)**

#### QUESTION 1

Promise and Treasure are two good childhood friends. After their secondary education, Promise travelled abroad to further his education. He did his first degree and second degree over there.

Treasure had his own education in Nigeria, he attended a university in the Southwest. He came out with a second class lower degree. During his sojourn abroad, Promise met with some foreigners to join hands together to set up a company in Nigeria. Promise invited his childhood friend to join them in the business.

They formed a company called Promise and Treasure Company Nigeria Limited. They are into importation of steel products, with the intention of setting up a factory to produce steel products in future.

The first year accounts were made up to December 31, 2020.

Your firm has been appointed as auditors to the company. At the completion of the audit, you requested for a written representation from the management. This request was strange to the Managing Director of Promise and Treasure Company Nigeria Limited, because according to him, they have given your firm all necessary information and documents needed to carry out the audit.

#### Required:

- a. Explain to the Managing Director the objectives of the auditor in obtaining a written representation as per ISA 580. (4 Marks)
- b. State the steps the auditor should take if a representation by management is contradicted by other audit evidence. (6 Marks)
- c. State **THREE** matters that are required of management in the letter of representation in line with ISA 580 which requires the auditor to obtain specific representation from management. (3 Marks)
- d. Highlight **SEVEN** of the form and contents of a letter of representation. (14 Marks)

- e. State the steps the auditor should take if management refuses to provide the requested written representation. (3 Marks)

**(Total 30 Marks)**

**SECTION B: OPEN-ENDED QUESTIONS (40 MARKS)**

**INSTRUCTION: YOU ARE REQUIRED TO ATTEMPT ANY TWO OUT OF THE THREE QUESTIONS IN THIS SECTION**

**QUESTION 2**

Your audit firm was recently appointed as the external auditors of a fast growing fast-foods outlet, Foods Only Limited. The directors are not clear as to their responsibilities and the nature of their relationship with the external auditors. The engagement partner has instructed you to visit the client and explain to the directors some fundamental aspects of the appointment.

**Required:**

- a. Explain the matters to be stated in an audit report according to Companies and Allied Matters Act (CAMA) 2020. (5 Marks)
- b. State the auditor's rights under Companies and Allied Matters Act (CAMA). (5 Marks)
- c. State the duties of external auditors under Companies and Allied Matters Act (CAMA). (5 Marks)
- d. What are the responsibilities of management and those charged with governance in relation to the accounting function of the company? (5 Marks)

**(Total 20 Marks)**

**QUESTION 3**

The following issues emanated from the pre-audit meeting of FIFO Limited:

- i. The operating environment has been affected by the COVID-19 pandemic. Management has tried to react to it by creating a number of policy initiatives which have been embarked upon to stem the negative impact of the pandemic on the company. As a direct consequence of the slowdown in business, there was some contraction in Q2 2020 financial performance which affected the half year results and led to a revision of the previously approved 2020 budget. The effects of the pandemic on the economy includes a shrink in Gross Domestic Product, reduced yields on investment and government securities, growth in foreign exchange rates and an upward trend in inflation. This has led the company to make loss in the year.

The significant drop reflects the negative impacts of the disruption caused by COVID-19 pandemic;

- ii. There is the likelihood of increase in account receivable balance due to inability of customers to make sales and repay balances;



- iii. The company focused on ensuring that there was sufficient liquidity to meet daily operations;
- iv. With the loss position, the engagement team has to look at appropriate benchmarks for materiality. Profit before tax from continuing operations is often used for profit-oriented entities. When profit before tax from continuing operations is volatile, other benchmarks may be more appropriate, such as gross profit or total revenues;
- v. The firm's software has formula for calculating materiality, after it has been based on the selection of an appropriate benchmark, The fundamental requirement is for the auditor to exercise professional judgement in assessing materiality;
- vi. Members of the engagement team should declare their independence and client's information should be kept confidential;
- vii. To meet the agreed timelines, all preliminary engagement activities should be completed as scheduled and submitted to the Partner for prompt review; and
- viii. Preliminary analytical review is a key procedure in helping to assess risk in the planning of an audit. It helps to identify the existence of unusual transactions or events and amounts; ratios and trends that might indicate matters that have audit implications. This may assist the auditor in identifying risks of material misstatements due to fraud. Hence, it should be handled with care. At the end of the pre-audit meeting, an Audit Associate has requested for some explanations from you.

**Required:**

- a. State the preliminary activities to be undertaken before commencement of the audit. (6 Marks)
- b. State the characteristics of confidentiality in auditing. (7 Marks)
- c. Explain briefly the purposes of analytical review. (4 Marks)
- d. State at what stage of the audit an analytical review should be performed. (3 Marks)

**(Total 20 Marks)**

#### **QUESTION 4**

Cringe Professional Services has been auditing Kogberegbe Limited for about 20 years. Being a limited liability company, no regulation imposed restriction on the tenure of the auditors.

The firm also provides taxation and valuation services for the company. The company has just adopted International Financial Reporting Standards and has employed the services of Cringe Professional Services for conversion services from local GAAP. The firm experienced a high staff turnover in the year and has no choice than to include the daughter of the Managing Director of the company as part of the engagement team, although as a support staff.

Management has indicated in confidence that the audit fee for the year will not be increased, except the firm can guarantee them that no adverse management letter will be issued and no loss will be made by the company as they are planning to go to the capital market to raise capital for expansion. With poor management letter and loss position, they believe that it will be difficult to achieve this.

At the end of the audit exercise, the company made huge profit even with unfavourable economic climate, thanks to challenges associated with COVID-19. There was public outcry because it was believed that the financial statements of the company were misstated and the auditor was accused of negligence. This necessitated the Financial Reporting Council to conduct an investigation on the company. It was found that the company restructured its debt portfolio which was denominated in foreign currency with attendant foreign exchange risks to Naira.

The company restructured a huge intercompany loan to a 7-year principal payment holiday with principal repayment commencing September 30, 2025. The interest on the loan for the period was not brought into the books of account.

The company accrued for a ~~NGN~~70.60m benefit from a transaction in 2019 from operating fees. This has been treated as income in the financial statements.

There were identified defaults by the company in relation to the payment of interests and principal on its outstanding loans and borrowings.

There were adverse ratios in the company's financial performance ratios in the year due to interest on borrowings from financial institutions and related parties.

A revisit of the operating performance for the year revealed the following:

- The entity made an operating loss of ~~₦~~1.22billion;
- It generated negative operating cashflows of ~~₦~~2.15billion;
- There was positive working capital as the current assets exceeded the current liabilities by ~~₦~~1.2billion in the year; and
- The net assets position of the company was in the negative as the total liabilities exceeded the total assets by ~~₦~~9.8billion.

The Financial Reporting Council concluded that there were threats to the auditors' independence, hence the professional firm was penalised for that.

A concerned staff of the company asks you of the implications of the issues raised by the Financial Reporting Council.

**You are required to:**

- a. Identify and explain the threats to independence of the auditor in the above scenario (7Marks)
  - b. Discuss circumstances that could give rise to threat to independence (7 Marks)
  - c. Suggest appropriate safeguards which could be put in place to mitigate the identified threats (6 Marks)
- (Total 20 Marks)**

**SECTION C: OPEN-ENDED QUESTIONS (30 MARKS)**

**INSTRUCTION: YOU ARE REQUIRED TO ATTEMPT ANY TWO OUT OF THE THREE QUESTIONS IN THIS SECTION**

**QUESTION 5**

The Association of Builders is conducting a selection process for an external audit firm. Your firm has been invited to participate by submitting a proposal to render external audit services.

- i. **Terms of reference:** The terms of reference are intended to provide a scope of work and deliverables for external audit services for an initial period of three financial years, covering March 31, 2021 to March 31, 2023. Further provision for an extension of the initial period by two years, will be subject to approval by the Council of the Association.
- ii. **Background:** The Association of Builders is a statutory body, established in 2014 and registered with the Corporate Affairs Commission. It is committed to serving and protecting the public and providing guidance to registered members in the profession.  
  
The objective of the association is to regulate the building profession in the country in all aspects pertaining to registration, education and training, professional conduct and ethical behaviour, ensuring continuing professional development, and fostering compliance with building standards.
- iii. **Objectives:** The objectives of the audit are that the auditors would conduct the audit assignment as follows:
  - The auditors shall express an independent opinion as to whether the

Financial statements give a true and fair view of the financial position, financial performance and cash flows of the association in accordance with the International Financial Reporting Standards (IFRS) and relevant enabling laws;

- The audit shall be carried out in accordance with the International Standards on Auditing (ISAs), as issued by the International Federation of Accountants (IFAC); and
- The auditors in their duties, shall comply with all relevant enabling laws including the Financial Reporting Council Act.

iv. **Scope of work:** The appointed service provider will be required to:

- Perform an audit of annual financial statements in accordance with International Financial Reporting Standards (IFRS) and express an audit opinion;
- Perform audits in compliance with International Standards on Auditing (ISAs);
- Work in conjunction with Internal Auditors (where possible) in the provision of assurance to the Council on the effectiveness of the internal control systems;
- Communicate audit findings to management and ensure they are fully aware of the implications to operations of the association;
- Review the financial information in the annual report prior to publishing; and
- Attend and provide input in the Audit and Risk Committee meetings, where necessary.

v. **Mandatory requirements:** The service provider should meet the following competency requirements:

- The proposed External Auditor must be registered with a recognised Accounting body and Financial Reporting Council;
- Must have experience and a comprehensive understanding of the construction industry; and
- The audit firm must have sufficient in-house capacity to perform external audit for the association.

vi. **Contents of the proposal:** The proposal must include the following:

- Firm profile and relevant experience;
- Relevant information about the firm to assess her competence;
- Proposed methodology and approach to be used in keeping with the scope of works;

- Description of similar work, including fee per project undertaken in the past 3 years; and
- Curriculum vitae of proposed project team, stating qualification and experience.

**vii. Evaluation process:**

Submission after the deadline will attract disqualification.

Your firm has included you as a member of the team to work on the audit proposal to be submitted soonest.

**Required:**

Going by the requirements of the Companies and Allied Matters Act and best practice:

- Identify and explain briefly the rights of external auditors in relation to Companies and Allied Matters Act. (5 Marks)
- State responsibilities of management and those charged with governance in relation to the financial statements. (6 Marks)
- Explain what auditors are required to do in relation to International Standards on Auditing (ISA 200). (4 Marks)

**(Total 15 Marks)**

**QUESTION 6**

At one of the seminars you attended on legal and regulatory frameworks of financial reporting, it was stated that one of the duties of Financial Reporting Council of Nigeria (FRC) is to provide legal and regulatory frameworks for minimum practice guideline for auditors in Nigeria. To do this, they (FRC) are supposed to ensure that all activities of Registered Auditors, other Assurance Providers and Audit Committee members are regulated, with a view to sustaining best ethical practices capable of promoting quality audit services.

It is part of the obligations of the Financial Reporting Council of Nigeria to conduct practice review of registered professionals.

You learnt from the seminar that, for the Financial Reporting Council of Nigeria to do this effectively, the Audit Regulation requires external auditors to create audit file for each of the statutory audits carried out and ensure the retention of the working papers and other materials that support the auditor's conclusions in any audit report for a minimum period of seven years.

A classmate from the University, who now works in the bank and attended the seminar with you, has asked for further explanation on what is meant by "working

paper” and why it is of great importance that a regulator has to be interested in the review when there are other important duties to be carried out.

**Required:**

- a. Identify the different types of audit working paper files. (5 Marks)
- b. Outline the importance of audit working paper files. (5 Marks)
- c. Explain briefly the conditions that determine the size of audit working papers. (5 Marks)

**(Total 15 Marks)**

**QUESTION 7**

Indorise Limited has been in business for about 20 years. The company has divisional offices in three locations. The accounting records are kept mainly at the head office, with back up in an adjacent building to the office. The office is not far from a petrol station.

An unfortunate incident happened in a certain year, the petrol station got burnt and most offices in the location were engulfed in fire. The company lost most of the properties in the building, including important accounting records. The company has to make another arrangement for an office location on another street. Fortunately, the end of year audit has just been concluded, but most of the accounting records have not been backed up. The tax office, customers and suppliers are disputing balances and some are even putting up claim for litigation since they know the company may not be able to show proof of the balances against them.

A decision was made to approach the external auditors of the company if they can help to retrieve some accounting records from the schedules and other information earlier made available to them. The auditors were happy to assist and some of the problems were resolved.

The Chief Accountant expressed his appreciation to the firm.

**You are required:**

- a. Explain why sufficient and appropriate audit documentation is necessary. (5 Marks)
- b. Explain briefly why you will recommend computer-based audit packages for documentation. (6 Marks)
- c. Identify and explain who has responsibility for the ownership, custody and confidentiality of working papers. (4 Marks)

**(Total 15 Marks)**

## **SOLUTION 1**

- a. ISA 580 defines a written representation as a written statement by management provided to confirm certain matters or to support other audit evidence. ISA 580 requires appropriate written representations from management to be in the form of a letter of representation, addressed to the auditor. These written representations may be an important source of audit evidence.

The objectives of the auditor in this area, per ISA 580, are to:

- i. Obtain written representations from management that it has fulfilled its responsibilities in respect of the financial statements and the audit;
  - ii. Obtain written representations as appropriate to support other audit evidence; and
  - iii. Respond appropriately to written representations provided by management, or if management refuses to provide the written representations requested.
- b. If a written representation is contradicted by other audit evidence, the auditor should:
- i. Consider whether his risk assessment of that area is still appropriate;
  - ii. Consider whether additional audit procedures are needed; and
  - iii. If he has concerns about the integrity of management, document those concerns and consider withdrawing from the audit.
- c. Matters that are required of management in the letter of representation include:
- i. It has fulfilled its responsibility for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework;
  - ii. It has provided the auditor with all relevant information; and
  - iii. All transactions have been recorded and are reflected in the financial statements.
- d. Form and contents of Management Representation letter  
The letter of representation is:
- i. Usually drafted by the auditor as he knows the areas on which he requires written representations;
  - ii. Addressed to the auditor; and
  - iii. Dated as near as practicable to, but not after, the date of the audit report.

A written representation letter may include the following statements:

- i. The presentation letter relates to the audit of the client company;
- ii. The management of the entity has fulfilled its responsibilities for the preparation of the financial statements, and the financial statements give a true and fair view and are free from material misstatements;
- iii. The assumptions made by management to make accounting estimates and reach fair values are reasonable – ISA 540;

- iv. Related party relationships and transactions have been disclosed – ISA 550;
  - v. All events after the reporting period have been either adjusted or disclosed – ISA 560;
  - vi. The effect of any uncorrected misstatements (a list of which should be attached to the letter) is immaterial – ISA 450;
  - vii. The auditors have been provided with all relevant materials including the books of accounts and unrestricted access to individuals within the entity;
  - viii. All transactions have been recorded and are included in the financial statements;
  - ix. Management has disclosed to the auditors all information that is relevant to fraud or suspected fraud – ISA 240;
  - x. Management has disclosed all known instances of non-compliance with laws or regulations that are relevant to the preparation of the financial statements; and
  - xi. Representations may also be included that refer to specific assertions in the financial statements, if the auditors require that such assertions should be made.
- e. Where there are circumstances in which management refuses to provide written confirmation of representations that the auditors consider necessary, the auditors should:
- i. Discuss the matter with management;
  - ii. Re-evaluate the integrity of management and reconsider the impact on other representations and audit evidence;
  - iii. Take appropriate action, including considering the effect on the audit report;
  - iv. Consider the implications of this scope limitation for their report; and
  - v. Not place reliance on other representations made by management during the audit.

### **Examiner's report**

The question tests candidates' knowledge of written representation according to the requirements of ISA 580.

As a compulsory question, all the candidates attempted the question but their performance was poor.

The commonest pitfall of the candidates was their inability to explain the requirements of audit standard ISA 580.

Candidates are advised to study the requirements of the specified ISAs, read relevant texts and ICAN Pathfinders.



## Marking guide

	<b>Marks</b>
a) <b>Explanation of the objectives of the auditor in obtaining a written representation</b>	
2 marks each for any 2 objectives of written representation	4
b) <b>Steps the auditor would take if management representation is contradicted by other audit evidence</b>	
2 marks each for any 3 steps the auditor will take if representation is contradicted by other audit evidence	6
c) <b>Matters that are required of management in the letter of representation</b>	
1 mark each for any 3 matters that are required of management	3
d) <b>Highlighting the form and contents of a letter of representation</b>	
2 marks each for a maximum of seven contents of letter of representation	14
e) <b>Steps the auditor should take if management refuses to provide written representation</b>	
1 mark each for any 3 steps the auditor will take for non-provision of written representation	3
<b>Total</b>	<b><u>30</u></b>

## SOLUTION 2

- a. **Matters to be expressly stated in the auditor's report according to the Fifth Schedule – s.404 (2) of CAMA 2020**

These matters include:

- i. Whether the auditors have obtained all the information and explanations which, to the best of their knowledge and belief, were necessary for the purposes of their audit;
- ii. Whether, in the auditor's opinion, proper books of account have been kept by the company, so far as appears from their examination of those books, and proper returns adequate for the purposes of their audit have been received from branches not visited by them;
- iii. Whether the company's balance sheet and (unless it is framed as a consolidated profit and loss account) profit and loss account dealt with by the report are in agreement with the books of account and returns;

- iv. Whether, in the auditor's opinion and to the best of their information and according to the explanations given them, the said statements give the information required by this Act in the manner so required and give a true and fair view in the case of the:
  - Balance sheet, of the state of the company's affairs as at the end of its year; and
  - Profit and loss account, of the profit and loss for its year; or as the case may be, give a true and fair view thereof subject to the non-disclosure of any matters (to be indicated in the report) which, by virtue of Part I of the First Schedule of this Act, are not required to be disclosed; and
- v. In the case of a holding company submitting group financial statements, whether, in their opinion, the group financial statements have been properly prepared in accordance with the provisions of this Act so as to give a true and fair view of the state of affairs and profit or loss of the company and its subsidiaries and associates dealt with where it, so far as it concerns members of the company, or the case may show as to give a true and fair view thereof subject to the non-disclosure of any matter to be indicated in the report which by virtue by part 1 of the First Schedule to this Act, are not required to be disclosed.

**b. Auditor's rights under Companies and Allied Matters Act 2020**

External auditors have certain statutory rights, to enable them to perform their statutory duties. The main statutory rights of the auditor per CAMA 2020 (sections 407 and 410) include the following:

- i. The right of access to all accounting books and records at all times;
- ii. The right to all information and explanations (from management) necessary for the proper conduct of the audit;
- iii. The right to receive notice of all meetings of the shareholders (such as the annual general meeting) and to attend those meetings;
- iv. The right to be heard at the shareholders' meetings on matters affecting the audit and auditors; and
- v. The auditors have the right to receive copies of all resolutions if the company uses written resolutions.

- c. The primary duty of the external auditors** according to section 407 of CAMA is to investigate and form an opinion regarding the maintenance of proper accounting records and that the financial statements are in consonance with those records.

**Other duties include, to:**

- i. Examine the financial statements; and
- ii. Issue an auditor's report on the financial statements, which is then presented to the shareholders.

Sections c407 and 410 CAMA 2020 require the auditor to also form an opinion on:

- i. Whether proper accounting records have been kept by the company and proper returns adequate for the audit have been received from branches not visited by the auditors;
- ii. Whether the company's balance sheet and (if not consolidated) its profit and loss account are in agreement with the accounting records and returns; and
- iii. Whether the information in the directors' report for the year for which the accounts are prepared is consistent with the financial statements.

d. **Responsibility of management and those charged with governance**

With respect to the audit and contrary to what members of the public believe, it is the directors and those charged with governance who are primarily responsible for:

- i. Prevention and detection of fraud;
- ii. Preparation of the financial statements; and
- iii. Design and implementation of effective internal controls – for example, authorising payments above a certain amount and monthly bank reconciliations.

They are also responsible for providing the auditor with:

- i. Access to information relevant to the preparation of the financial statements;
- ii. Additional information relevant to the audit;
- iii. Unrestricted access to persons whom the auditor needs access to in order to complete the audit; and
- iv. Providing written representations to the auditor at the end of the audit.

**Examiner's report**

This question tests candidates' knowledge of the rights and duties of the external auditors according to the provisions of CAMA 2020 and, the responsibilities of management and those charged with governance.

About 85% of the candidates attempted this question. The overall performance was below average.

The candidates' pitfall was their inability to refer specifically to the auditor's rights and duties under the CAMA 2020.

Candidates should cover adequately all the sections of the syllabus and make use of the Institute's Study Text.

## Marking guide

	<b>Marks</b>
<b>a) Explaining the matters in an audit report according to CAMA 2020</b>	
1 mark each for any 5 matters to be stated in an audit report	5
<b>b) Stating auditors' rights under CAMA</b>	
1 mark each for any 5 rights of the auditor under CAMA	5
<b>c) Stating the duties of external auditors under CAMA</b>	
1 mark each for any 5 duties of auditor under CAMA	5
<b>d) Stating the responsibility of management and those charged with governance</b>	
1 mark each for a maximum of 5 responsibilities of management and those charged with governance	<u>5</u>
<b>Total</b>	<b><u>20</u></b>

## SOLUTION 3

- a. The preliminary activities before commencement of the audit involve the preparation of an audit strategy memorandum. This is a document setting out the main points involved in the planning process and the key planning decisions that have been taken. The memorandum will cover the following areas:
- i. The assignment objectives and reports to be issued;
  - ii. The audit timetable, to meet the required reporting deadlines for the audit report;
  - iii. Changes in the client's organisation or business, or external environmental changes affecting the client's business, since the previous audit, as applicable;
  - iv. A summary of key financial ratios and other ratios from previous years;
  - v. Planning decisions for the audit;
  - vi. The use that will be made of the client's staff in the audit (for example, internal auditors) and the use that will be made of external experts;
  - vii. Possible problem areas in the audit and the approach to be adopted to deal with them;
  - viii. Staffing requirements for the audit, the planned allocation of the work between members of the audit team, time budgets and records from previous audits;
  - ix. Attendance at locations (if the client has more than one location); and

- x. Proposed methods of communication with the client (for example, meeting/reports);

**Other preliminary activities include:**

- i. Obtaining professional clearance from former auditor, in the case of a new client; and
- ii. Conducting initial opening balance review when a new audit is involved.

**b. Characteristics of confidentiality in auditing include:**

- i. A professional accountant should respect the confidentiality of information acquired as a result of professional or business relationships;
- ii. The normal ethical rule requires that accountants should maintain client confidentiality, and should not disclose information without the client's consent;
- iii. An exception to the rule of confidentiality is that the duty of confidentiality is overridden by the requirement to provide evidence when requested by a court of law or by professional right or duty;
- iv. Confidential information should not be used for the personal advantage of the professional accountant or third parties;
- v. Legal requirements for disclosure override the rules of client confidentiality. There may be professional duty or right to disclosure when not prohibited by law;
- vi. The duty of confidentiality continues even after the end of the relationship between the professional accountant and the client or employer; and
- vii. The ICAN's Rules of Professional Conduct for Members on confidentiality gives guidance on how members should handle confidential information.

**c. Analytical review procedures consider both comparisons and relationships between financial information in the draft financial statements with a benchmark. The procedures include:**

- i. Ratios, trends, and relationships for the current financial year are compared with prior periods (historical data);
- ii. Ratio, trends and relationships for the current financial year are compared with budgets and forecasts;
- iii. Ratio, trends and relationships for the current financial year are compared with industry averages (ratios for business entities in the industry);
- iv. Reviewing relationship between elements of financial information, such as gross margins percentages; and
- v. Reviewing relationship between financial and non-financial information like payroll costs to staff nominal roll.

**d. Analytical review procedures can be performed at three stages in the audit process and they are:**

- i. Performed in planning the nature, timing and extent of other audit procedures;

- ii. Performed as a substantive procedure when their use is more effective or efficient than detailed substantive tests of transactions and balances; and
- iii. Used at the overall review stage, to allow the auditor to conclude whether the financial statements as a whole are consistent with his knowledge of the business or entity.

### **Examiner's report**

The question tests candidates' understanding of the preliminary activities to be undertaken before the audit, confidentiality in auditing, and analytical review procedures.

Only about 25% of this candidates attempted this question notwithstanding that these are popular areas in auditing. The performance of candidates was generally poor.

The commonest pitfall was the candidates' poor knowledge of confidentiality in auditing.

Candidates are advised to cover all topics of the syllabus when preparing for future examinations.

### **Marking guide**

	Marks
a) <b>Listing preliminary activities to be undertaken before the commencement of the audit</b>	
1 mark each for any 6 preliminary activities before audit commencement	6
b) <b>Stating the characteristics of confidentiality in auditing</b>	
1 mark each for any 7 characteristics of confidentiality in audit	7
c) <b>Explaining briefly the purpose of analytical review</b>	
1 mark each for any 4 purposes of analytical review	4
d) <b>Stating the stage of the audit analytical review is performed</b>	
1 mark each for any 3 stages of performing analytical review	<u>3</u>
<b>Total</b>	<b><u>20</u></b>

## **SOLUTION 4**

- a. **The identified threats to independence of the auditor are:**
- i. Cringe Professional Services being an auditor of Kogberegbe for about 20 years could lead to familiarity threats. The long term relationship between the firm and the company might lead to other relationships outside business relationships;
  - ii. The provision of taxation and valuation services for the company could create self review threat, as some of the output from the services could be input for the audit services;
  - iii. Including the daughter of the Managing Director of the company as part of the engagement team will create self-interest, familiarity threats and intimidation threats; and
  - iv. The management indication not to increase the audit fees, except the professional services firm can guarantee no adverse management letter will be issued and no loss will be made by the company will lead to self-interest threats and intimidation threats.
- b. **Circumstances that could lead to threats to independence of the auditor include:**
- (i) **Fees and pricing:** When the total fees generated by an assurance firm from a client represents a large portion of the assurance firm's total fees earnings, this can create self-interest or intimidation threats;
  - (ii) **Financial interests:** A financial interest in a client would constitute a self-interest threat, although the nature of the interest and the degree of control the accountant has over it will affect the level of the risk;
  - (iii) **Loans and guarantees:** A loan from a client which is a bank or similar institution, made on normal commercial terms would not constitute a threat to independence. However, loans or guarantees made to or by assurance clients in other circumstances constitute self-interest threat and should be avoided;
  - (iv) **Close business relationships:** Close business relationships with assurance clients, such as having a material joint venture, represent a self-interest threat and possibly an intimidation threat. They should be avoided;
  - (v) **Family and personal relationships:** Family and personal relationships between assurance staff and clients might cause self-interest, familiarity or intimidation threats. It is impracticable to outline every relationship that might cause such a risk and each situation should be considered individually, bearing in mind the role of the assurance staff and the closeness of the relationship;
  - (vi) **Employment with assurance clients:** The assurance team's independence may be threatened if a director or other senior employee of the client has recently been employed by the assurance firm. There may be self-interest, familiarity and intimidation threats, particularly if close connections remain between the individual and the assurance firm;

- (vii) **Long association of senior personnel with assurance clients:** Using the same staff on an assurance engagement over a long period of time may cause a familiarity threat. The firm should consider factors such as the nature of the person's role and the length of time that he has been doing it when deciding which staff members to be involved in assurance work;
- (viii) **Provision of other services (non-audit work):** The independence of an audit firm may be threatened when the firm carries out a large amount of non-audit work like valuation services and taxation services for a company that is also its audit client which may create self-review threats; and
- (ix) **Gifts and hospitality:** Assurance team members/firms should not accept goods or hospitality from an assurance client, unless the value of that gift is clearly insignificant (to all parties).

c. **Appropriate safeguards to be put in place for identified threats include:**

- i. **Familiarity threats** -Cringe Professional Services being the auditor of Kogberegbe for about 20 years could lead to familiarity threats. **The safeguard** is that Cringe Professional Services as the auditor should be disengaged or alternatively, there should be a regular rotation of both the partner and manager in charge of the job to address familiarity threats;
- ii. **Self-review threats** -The provision of taxation and valuation services for the company could create self-review threat as some of the output from the services could be input for the audit services. The safeguard is that Cringe Professional Services as an auditor should be disengaged from providing other services that could constitute self-review and also ensure that the income from one client will not constitute undue significance to influence their objectivity and independence;
- iii. **Familiarity threats** - Including the daughter of the Managing Director of the company as part of the engagement team will create self-interest, familiarity threats and intimidation threats. The safeguard is that the daughter of Managing Director should be excluded from engagement team to prevent all stated threats;
- iv. **Intimidation threats** - The management indication not to increase the audit fees, except the professional services firm can give guarantee that no adverse management letter will be issued and no loss will be made by the company will lead to self-interest threats and intimidation threats. The safeguard is that audit fees should be agreed and fixed before the commencement of the assignment and should never be contingent on further event that influences auditor's independence. Contingent fees are even not approved in professional accounting practice.



## Examiner's report

The question tests candidates' knowledge of threats to the independence of auditors.

About 85% of the candidates attempted the question and performance was above average.

Candidates' commonest pitfall was in part (c) where valuable marks were lost because of their inability to state the appropriate safeguards to identified threats.

Candidates are advised to apply their skills to identify circumstances that could give rise to threats to independence of auditors in any given scenario.

## Marking guide

	<b>Marks</b>	<b>Marks</b>
<b>a) Identifying the threats to independence of the auditor in a given scenario</b>		
1 mark each for any 4 threats to independence of the auditor identified	4	
1 mark each for any 3 threats to independence of the auditor explained	<u>3</u>	7
<b>b) Discussing circumstances that could give rise to threat to independence</b>		
1 mark each for any 7 characteristics that could give rise to threat to independence		7
<b>c) Stating appropriate safeguards to mitigate identified threats</b>		
2 marks each for any 3 appropriate safeguards to be put in place		<u>6</u>
<b>Total</b>		<b><u>20</u></b>

## SOLUTION 5

### a. Auditor's rights under Companies and Allied Matters Act 2020:

External auditors have certain statutory rights, to enable them to perform their statutory duties. The main statutory rights of the auditor per CAMA 2020 (sections 407 and 410) include the right:

- i. Of access to all accounting books and records at all times;
- ii. To all information and explanations (from management) necessary for the proper conduct of the audit;
- iii. To receive notices of all meetings of the shareholders (such as the annual general meeting) and to attend those meetings;

- iv. To be heard at the shareholders' meetings on matters affecting the audit and the auditor; and
- v. To receive a copy of all resolutions, if the company uses written resolutions.

**b. Responsibility of management and those charged with governance**

With respect to the audit and contrary to what members of the public believe, it is the directors and those charged with governance who are primarily responsible for:

- i. Prevention and detection of fraud;
- ii. Preparation of the financial statements;
- iii. Design and implementation of effective internal controls – for example, authorising payments above a certain amount and monthly bank reconciliation.

They are also responsible for providing the auditor with:

- i. Access to information relevant to the preparation of the financial statements;
- ii. Additional information relevant to the audit;
- iii. Unrestricted access to persons whom the auditor needs access to in order to complete the audit; and
- iv. Providing written representations to the auditor at the end of the audit.

**c. In relation to International Standards on Auditing (ISA) 200, auditors are expected to:**

- i. Obtain reasonable assurance about whether the financial statements as a whole are free from material misstatements, whether due to fraud or error. This allows the auditor to give an opinion on whether or not the financial statements have been prepared in accordance with the applicable financial reporting framework;
- ii. Report on the financial statements, and communicate as required by the ISAs, in accordance with the auditor's findings; and
- iii. Disclaim an opinion or resign, where the auditor is unable have reasonable assurance and a qualified opinion is insufficient.

ISA 200 also requires the auditor to:

- i. Comply with all ISAs relevant to the audit;
- ii. Comply with relevant ethical requirements;
- iii. Plan and perform an audit with professional skepticism;
- iv. Exercise professional judgement in planning and performing an audit; and
- v. Obtain sufficient and appropriate audit evidence to allow him have reasonable assurance.

### **Examiner's report**

The question tests candidates' knowledge of the rights of external auditors under the CAMA, responsibilities of management and those charged with governance in relation to the financial statements and requirements of ISA 200.

About 85% of the candidates attempted the question and they showed a fair understanding of the requirements of the question in parts (a) and (b), but poor in part (c). The general performance was fair.

The commonest pitfall was the inability of the candidates to explain what the auditors are required to do according to ISA 200.

Candidates are advised to study the ISAs, as they are essential requirements of auditing papers at relevant levels of the examinations and even the practice of auditing.

### **Marking guide**

	<b>Marks</b>
<b>a) Identifying the rights of external auditors in relation to CAMA</b>	
1 mark each for any 5 rights of the auditor under CAMA	5
<b>b) Stating the responsibilities of management and those charged with governance in relation to financial statements</b>	
1 mark for any 6 responsibilities of management and those charged with governance	6
<b>c) Explaining what the auditor should do in relation to ISA 200</b>	
1 mark each for any 4 actions the auditor can take in relation to IAS 200	<u>4</u>
<b>Total</b>	<b><u>15</u></b>

### **SOLUTION 6**

#### **a. Types of audit working paper files**

All audit works must be properly documented and held in an audit file. It has been a normal practice to maintain two types of audit files; a permanent file and a current file.

Permanent audit file records information that is likely to be of significance to every annual audit of that client and of continuing significance to more than the current audit.

**Examples of such information might include:**

- i. The legal constitution of the company or entity;
- ii. A summary of history, development and ownership of the business or entity;
- iii. A record of the accounting systems and procedures used by the client;
- iv. Other important legal documents and agreements; and
- v. Copies of previous years' financial statements.

Current audit file contains information relevant to the current year's audit.

Examples include:

- i. Final financial statements and audit report;
- ii. Audit planning material which includes audit plan, materiality threshold calculations and risk assessments;
- iii. Audit letters;
- iv. Audit programme; and
- v. Audit control materials like time budgets and review points.

**b. Importance of audit working papers files include:**

- i. Enhancing the quality of the audit;
- ii. Facilitating the effective review and evaluation of the audit evidence obtained and conclusions reached, before the audit report is finalised;
- iii. Assisting the audit team to plan and perform an audit;
- iv. Assisting supervisors in directing and supervising audit work; and
- v. Keeping a record of matters of continuing significance to future audits.

**c. Conditions that determine the size of the audit working papers include:**

- i. The nature, timing and extent of the audit procedures performed;
- ii. The results of the audit procedures and the audit evidence obtained;
- iii. Significant matters arising during the audit and the conclusions reached thereon;
- iv. The nature of the financial statements and reports; and
- v. Method of audit documentation whether paper, electronic or other media.

**Examiner's report**

The question tests candidates' knowledge of audit working papers.

About 50% of the candidates attempted the question but the performance was just average.

The commonest pitfall was the candidates' poor knowledge of audit working papers. Candidates are advised to read relevant texts and ICAN Pathfinders when preparing for future examinations.

## Marking guide

	Marks	Marks
a) <b>Identifying the different types of working paper files</b>		
1 mark each for the 2 types of working paper files identified	2	
½ mark each for any 3 examples of content of each working paper files stated	<u>3</u>	5
b) <b>Outlining the importance of audit working paper file</b>		
1 mark each for any 5 points of importance stated		5
c) <b>Explaining conditions that determine the size of working paper file</b>		
1 mark each for any 5 points on conditions that determine size of audit documentation working papers		<u>5</u>
	<b>Total</b>	<b><u>15</u></b>

## SOLUTION 7

- a. **Reasons for preparing sufficient and appropriate audit documentation include:**
- Enhancing the quality of the audit;
  - Facilitating the effective review and evaluation of the audit evidence obtained and conclusions reached, before the audit report is finalised;
  - Enabling an experienced auditor, with no previous connection with that audit, to conduct quality control reviews or other inspections, that is, by understanding the work that has been performed and the conclusions that have been reached;
  - Ensuring members of the audit team are accountable for their work; and
  - Keeping a record of matters of continuing significance to future audits.
- b. **The advantages of the computer software packages for auditors are as follows:**
- The working papers are neat, easy to read and in standard formats;
  - There is a lower risk of error by the auditor in processing adjustments;
  - The audit review process by senior managers or the audit partner can be carried out remotely, without the necessity for the manager or partner to visit the client's premises to carry out the review;
  - Auditors often use computer software (with laptop computers) to improve the efficiency of preparing audit working papers;
  - Automatic processing of adjustments saves significant time and therefore saves costs; and
  - It is easy to store and retrieve relevant information.

- c. **Ownership, custody and confidentiality of audit working papers**  
 The audit firm has ownership of the audit working papers. The working papers are not a part of the client's accounting records and do not belong to the client. The auditor needs to decide how long to keep the audit files. ISQC1 requires a minimum period of five years from the date of the audit report, or group audit report, if later (and relevant). Auditing standards require the auditor to ensure that working papers are kept safe and that their contents are kept confidential. Confidential information should only be made available to third parties in accordance with ethical guidelines and legal requirements.

### **Examiner's report**

This question tests candidates' knowledge of audit documentation.

About 70% of the candidates attempted the question and their performance was fair. The commonest pitfall was in part (b) where the candidates did not show the expected knowledge of computer-based audit packages.

Candidates should familiarise themselves with computer-based audit procedures, because of their relevance in modern-day auditing. They should also make good use of the Institute's Study Text and Pathfinders.

### **Marking guide**

	Marks	Marks
a) <b>Explaining why sufficient and appropriate audit documentation is necessary</b>		
1 mark each for 5 reasons why sufficient and appropriate audit documentation is necessary		5
b) <b>Explaining why computer-based audit packages would be recommended for documentation</b>		
2 marks each for any 3 recommendations of a computer-based audit packages		6
c) <b>Explaining the responsibility for the ownership custody and confidentiality of working papers</b>		
2 marks for identification of responsibilities for ownership, custody and confidentiality of working papers	2	
2 marks each for explanation of responsibility for ownership, custody and confidentiality of working papers	<u>2</u>	<u>4</u>
<b>Total</b>		<b><u>15</u></b>

**THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA****SKILLS LEVEL EXAMINATION – MAY 2023****PERFORMANCE MANAGEMENT****EXAMINATION INSTRUCTIONS****PLEASE READ THESE INSTRUCTIONS BEFORE THE COMMENCEMENT OF THE PAPER**

1. Check your pockets, purse, mathematical set, etc. to ensure that you do not have prohibited items such as telephone handset, electronic storage device, programmable devices, wristwatches or any form of written material on you in the examination hall. You will be stopped from continuing with the examination and liable to further disciplinary actions including cancellation of examination result if caught.
2. Write your **EXAMINATION NUMBER** in the space provided above.
3. Do **NOT** write anything on your question paper **EXCEPT** your examination number.
4. Do **NOT** write anything on your docket.
5. Read all instructions in each section of the question paper carefully before answering the questions.
6. Do **NOT** answer more than the number of questions required in each section, otherwise, you will be penalised.
7. All solutions should be written in **BLUE** or **BLACK INK**. Any solution written in **PENCIL** or **RED INK** will not be marked.
8. A formula sheet and discount tables are provided with this examination paper.

**WEDNESDAY, MAY 17, 2023****DO NOT TURN OVER UNTIL YOU ARE TOLD TO DO SO**

**THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA**  
**SKILLS LEVEL EXAMINATION – MAY 2023**  
**PERFORMANCE MANAGEMENT**

Time Allowed: 3¼ hours (including 15 minutes reading time)

**INSTRUCTION: YOU ARE REQUIRED TO ATTEMPT FIVE OUT OF THE SEVEN QUESTIONS IN THIS PAPER**

**SECTION A: COMPULSORY QUESTION (30 MARKS)**

**QUESTION 1**

Vestapricy and Company Limited is a manufacturing outfit located in Port Harcourt. It produces a tracking device that is attached to motor vehicles. The device is designed to help locate the whereabouts of stolen motor vehicles within the country. The company's capital (or cash operating cycle) is the length of time between the payment for purchased materials and the receipt of payment from selling the goods made with the materials.

The table below gives information extracted from the annual accounts of Vestapricy and Company limited for the past three years.

**Extracts from Vestapricy and Company Limited annual accounts for 31<sup>st</sup> December 2020 to December 2022:**

	<b>2020</b>	<b>2021</b>	<b>2022</b>
	<b>₦</b>	<b>₦</b>	<b>₦</b>
Inventory:			
Raw materials	108,000	145,800	180,000
Work in progress	75,600	97,200	93,360
Finished goods	86,400	129,600	142,875
Purchases	518,400	702,000	720,000
Sales	864,000	1,080,000	1,188,000
Trade receivables	172,800	259,200	297,000
Trade payables	86,400	105,300	126,000



**Other information is as follow:**

- (1) All purchases and sales are on credit.
- (2) Direct wages:
  - 2021: ₦300,000
  - 2022: ₦250,000
- (3) Production expenses:
  - 2021: ₦72,600
  - 2022: ₦171,995
- (4) The company's policy is that any data that will be used from the statement of financial position in determining the working capital cycle period will be average based.

**Required:**

- a.
  - i. Compute the cost of goods sold for 2021 and 2022. (3 Marks)
  - ii. Calculate the length of the working capital cycle (assuming 365 days in the year) for 2021 and 2022. (7 Marks)
  - iii. List the actions that the management of the company might take to reduce the length of the cycle. (5 Marks)
- b. In 2023, the company (Vestapricy) decided to open a new small apple shop in Owerri to be managed by a shopkeeper. The shopkeeper is deciding on the number of boxes of special apples it hopes to buy each day. A box of apples earns a contribution of ₦400 and costs ₦250.

Demand of apple is uncertain and could vary from 30 boxes to 10 boxes. Any apple that is purchased but not sold will be thrown away at the end of the day.

The shop keeper has decided that he will buy 10 boxes, 20 boxes or 30 boxes each day, and these are the only three options he wants to consider.

**Required:**

- i. Construct the Pay-off table for this business in Owerri. (7 Marks)
- ii. How many boxes should the storekeeper purchase if the decision is based on:

The Maximax decision rule; The Maximum decision rule and The Minimax regret decision rule? Give reasons for your decisions. (8 Marks)

**(Total 30 Marks)**

**SECTION B: OPEN-ENDED QUESTIONS****(40 MARKS)****INSTRUCTION: YOU ARE REQUIRED TO ATTEMPT ANY TWO OUT OF THE THREE QUESTIONS IN THIS SECTION****QUESTION 2**

The local football club has asked for your advice on the number of programmes that should be printed for each game. The cost of printing and production of programmes for each game, as quoted by the local printer, is ₦1,000,000 plus ₦400 per copy. Advertising revenue which has been agreed for the season represents ₦800,000 for each game.

Programmes are sold for ₦150 each. A review of sales during the previous seasons indicates that the following pattern is expected to be repeated during the coming season of 50 games:

<b>Number of programmes sold</b>	<b>Number of games</b>
10,000	5
20,000	20
30,000	15
40,000	10

Programmes not sold at the game are sold as waste paper to a paper manufacturer at ₦100 per copy.

**Assuming that the four quantities listed are the only possibilities, you are required to:**

- Prepare a payoff table; (6 Marks)
- Determine the number of programmes that would provide the highest profit if a constant number of programmes were to be printed for each game; (4 Marks)
- Explain why you should buy 30,000 or 40,000 copies, assuming one of these is the most profitable quantity, despite the fact that the most probable sales are 20,000 copies per game; (2 Marks)
- Calculate the profit which would arise from a perfect forecast of the numbers of programmes which would be sold at each game. (4 Marks)
- Discuss the major limitations at expected value criterion in decision making. (4 Marks)

**(Total 20 Marks)**

### QUESTION 3

Kenny Limited (KL) has been offered a contract that, if accepted, would significantly increase next year's activity levels. The contract requires the production of 20,000 kg of product X and specifies a contract price of ₦10,000 per kg. The resources used in the production of each kg of X include the following:

#### Resources per kg of X

Labour:

Grade 1	2 hours
Grade 2	6 hours

Materials:

A	2 units
B	1 litre

Grade 1 labour is highly skilled and although it is currently under-utilised in the firm, it is KL's policy to continue to pay grade 1 labour in full. Acceptance of the contract would reduce the idle time of grade 1 labour. Idle time payments are treated as non-production overheads.

Grade 2 is unskilled labour with a high turnover, and may be considered a variable cost.

The costs to KL of each type of labour are

Grade 1	₦400 per hour
Grade 2	₦200 per hour

The materials required to fulfil the contract would be drawn from those materials already in stock. Material A is widely used within the firm, and any usage for this contract will necessitate replacement. Material B was purchased to fulfil an expected order that was not received, if material B is not used for the contract, it will be sold. For accounting purposes, FIFO is used. The various values and costs for A and B are:

	A per unit (₦)	B per litre (₦)
Book value	800	3,000
Replacement cost	1,000	3,200
Net realisable value	900	2,500

A single recovery rate for fixed factory overheads is used throughout the firm, even though some fixed production overheads could be attributed to single products or departments. The overhead is recovered per productive labour hour, and initial estimates of next year's activity, which excludes the current contract, show fixed production overheads of ₦60,000,000 and productive labour hours of 300,000. Acceptance of the contract would increase fixed production overheads by ₦22,800,000.

Variable production overheads are accurately estimated at ₦300 per productive labour hour.

Acceptance of the contract would be expected to encroach on the sales and production of another product, Y, which is also made by KL Limited. It is estimated that sales of Y would then decrease by 5,000 units in the next year only. However, this forecast reduction in sales of Y would enable attributable fixed factory overheads of ₦5,800,000 to be avoided. Information on Y is as follows:

	<b>(per unit)</b>
Sales price	₦7,000
Labour grade 2	4 hours
Materials: relevant variable costs	₦1,200

All activity undertaken by KL is job costed using full or absorption costing in order to derive a profit figure for each contract. If the contract for X is accepted, it will be treated as a separate job for routine costing purposes. The decision to accept or reject the contract will be taken in sufficient time to enable its estimated effects to be incorporated in the next year's budget and also in the calculations carried out to derive the overhead recovery rate to be used in the forthcoming year.

**Required:**

- a. Advise KL on the desirability of the contract (8 Marks)
  - b. Show how the contract, if accepted, will be reported on the routine job costing system used by KL (6 Marks)
  - c. Briefly explain the reasons for any differences between the figures used in (a) and (b) above. (6 Marks)
- (Total 20 Marks)**

**QUESTION 4**

Tayo Limited is a civil engineering company based in Benin. Contracts are carried out under the supervision of project managers who are sent out from Head Office and remain on site for the duration of the contract. The project manager recruits local labour, and arranges for plant and materials to be provided by Head Office.

Some time ago, the company successfully tendered for two contracts which have now become mutually exclusive. It is currently considering which of these to accept. Both jobs would last for 12 months.

The following information about each contract is available:

	<b>Abuja</b> <b>₦'000</b>	<b>Lagos</b> <b>₦'000</b>
Contract price	17,000	18,000
Penalty payment (i.e. a condition of the tender if offered the job and it is not accepted)	1,600	800
Materials required:		
In store (at cost)	2,000	2,400
Contracted for	-	3,600
To be ordered (at current cost)	4,000	3,400
Labour required:		
Project manager's salary	1,000	1,000
Travel, lodgings etc.	400	400
Local recruitment	7,000	5,600
Head office:		
Plant depreciation	600	600
Interest on plant	200	200
General administration	800	800

**Notes:**

- (i) The materials which would be used on the Abuja job have increased in money value by 60% over their purchase cost. Tayo Limited has no other use for these materials on any other contract apart from the Abuja one, but they could be re-sold to other companies in the industry at 90% of their value. Transportation and other selling costs would further decrease the cash inflow from the sale by 16.67% of the sales price.
- (ii) The materials for the Lagos job have no other obvious use, but could be sold for scrap if the contract were cancelled. The scrap value would be 10% of cost, and costs of transport, etc. would be paid by the scrap merchant. It is likely, however, that the materials could be used next year on another contract in substitution for a different material normally costing 20% less than the cost of the materials to be used on the Lagos contract.
- (iii) Local labour can be hired as and when required.
- (iv) Plant is depreciated on a straight line basis, and the interest on plant charge is a nominal cost added for accounting purposes.
- (v) The two contracts would require similar plant, although more plant would be required for the Lagos than for the Abuja job. The plant not required on the Abuja job would be sub-contracted out by Head Office for ₦200,000 per annum.

- (vi) Head office administration costs are fixed at ₦2,500,000 for the coming year. This excludes project managers' salaries.

**Required:**

- Present the data to management in a form which will assist in making the decision as to which job to undertake. Provide notes to explain the principles which have been used in selecting the data and to support any calculations made. (12 Marks)
- Comment on the appropriateness of the approach used in your analysis. (4 Marks)
- List briefly any other factors which ought to be considered before finally making the decision in this case. (4 Marks)

**(Total 20 Marks)**

**SECTION C: OPEN-ENDED QUESTIONS (30 MARKS)**

**INSTRUCTION: YOU ARE REQUIRED TO ATTEMPT ANY TWO OUT OF THE THREE QUESTIONS IN THIS SECTION**

**QUESTION 5**

A company is considering whether or not to invest in any of the two projects where the initial cash investment would be ₦13,000,000 for A and ₦14,000,000 for B. The project would have a five-year life, and the estimated annual cash flows are as follows:

**Project A**

Year	Cash inflows ₦	Cash outflows ₦
1	6,000,000	3,000,000
2	8,000,000	4,000,000
3	10,000,000	4,000,000
4	9,000,000	3,000,000
5	6,000,000	3,000,000
<b>Total</b>	<b>39,000,000</b>	<b>17,000,000</b>

**Project B**

Year	Cash inflows ₦	Cash outflows ₦
1	10,000,000	5,000,000
2	9,000,000	4,000,000
3	8,000,000	3,000,000
4	8,000,000	3,000,000
5	4,000,000	2,000,000
<b>Total</b>	<b>39,000,000</b>	<b>17,000,000</b>

The company cost of capital is 10%.

The estimates of cash outflows are considered fairly reliable. However, the estimates of cash inflows are much more uncertain. Several factors could make the annual cash flows higher or lower than expected.

Factor 1: There is a 20% probability that government measures to control the Industry will reduce annual cash inflows by 25%.

Factor 2: There is a 30% probability that another competitor will also enter the market: this would reduce the estimated cash inflows by 10%.

Factor 3: There is a 40% probability that demand will be stronger than expected. The company would not be able to supply more products to the market, but it would be able to sell at higher prices and cash inflows would be 5% higher than estimated.

**Required:**

a. Calculated the expected net present value of the two projects. (10 Marks)

b. Which of the Projects will be more profitable? (5 Marks)

**(Total 15 Marks)**

**QUESTION 6**

TK is a theme park. The following information is available for the forthcoming month:

**Forecast daily ticket sales and prices**

	<b>Ticket sales</b>	<b>Price per ticket</b>
Pre-booked discounted ticket	1,500	₦580
Standard ticket	8,000	₦780
Premium family ticket (admits 4 people)	675	₦3,700

The theme park will be open for 30 days in the month.

**Costs**

Variable costs per person per day are forecast to be ₦2050

Fixed costs for the month are forecast to be ₦130,000,000

**Pricing information**

The sales of pre-booked discounted tickets and standard tickets will be restricted to 1,500 and 8,000 per day respectively for the forthcoming month. It is forecast that all of these tickets will be sold.

A premium family ticket admits four people to the theme park and allows them to go to the front of the queues in the theme park. The price of a premium family ticket has been set at ₦3,700 in order to maximise the profit from the sale of these tickets for the month.

Market information shows that for every ₦100 increase in the selling price of a premium family ticket, the demand would reduce by 25 tickets. For every ₦100 decrease in the selling price, the demand would increase by 25 tickets.

The theme park has adequate capacity to accommodate any level of demand for the premium family tickets. It is to be assumed that four people would always be admitted on every premium family ticket sold.

Sales of the different ticket types are independent of each other.

### **Equipment hire**

TK is considering hiring some automated ticket reading equipment for the forthcoming month. The hire of this equipment would increase fixed costs by ₦5,000,000 for the month. However, variable costs per person would be reduced by 8% during the period of the hire.

### **Required:**

- a) Calculate the financial benefit of hiring the equipment for the forthcoming month given its impact on variable cost and the price charged for premium family tickets. (11 Marks)
- b) It has now been realised that a competing theme park is planning to offer discounted ticket prices during the forthcoming months. It is thought that this will reduce the demand for TK's standard tickets. TK will not be able to reduce the price of the Standard Tickets for the forthcoming month.

Discuss the sensitivity of the decision to hire the equipment to a change in the number of standard tickets sold per day. (Note: your answer should include the calculation of the sensitivity). (4 Marks)

**(Total 15 Marks)**



### QUESTION 7

Kola Plc produces and sells a brand of security padlock keys. Its budget for next year is as follows:

	<b>N'000</b>	<b>N'000</b>
Sales		18,000
Materials (15,000 kg)	1,800	
Labour (42,000 hours)	7,560	
Variable production overheads (absorbed on labour hours)	2,520	
Fixed production overheads (absorbed on labour hours)	1,260	
Administration overheads (absorbed on labour hours)	<u>2,520</u>	<u>15,660</u>
Profit		<u>2,340</u>

When reviewing the budget, the company is approached by a customer asking for a quote for a special security padlock keys - superior lock. Kola Plc is a bit apprehensive about the order since they tried a similar venture at the end of last year and made heavy losses as shown below:

	<b>N</b>	<b>N</b>
Sales (200 units)		960,000
Materials (500kg)	54,000	
Labour (5,000 hours)	840,000	
Variable production overheads ( <del>N</del> 42/hour)	210,000	
Fixed production overheads ( <del>N</del> 24/hour)	120,000	
Administration overheads - ( <del>N</del> 36/hour)	<u>180,000</u>	<u>1,404,000</u>
Loss		<u>(444,000)</u>

Further research showed that the time taken for the first 50 units of these was 1,800 hours and the first 100 units took 3,000 hours.

The customer is insistent that Kola Plc at least quotes a price for his requirement of 400 units though part of Kola plc's reluctance to do so arises from the fact that the order would divert labour away from the planned production of the regular padlock keys and the company has found it impossible to recruit more staff. If the contract is taken on, the same type of material would be used as for the regular padlock keys, fixed production overheads of ~~N~~150,000 and ~~N~~30,000 of administration costs would be incurred.

#### **Required:**

Calculate the minimum price Kola plc should quote for the 400 units of the special padlock keys. **(Total 15 Marks)**

# Formulae

## Learning curve

$$Y = ax^b$$

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

a = the time taken for the first unit of output

x = the cumulative number of units produced

b = the index of learning ( $\log LR/\log 2$ )

LR = the learning rate as a decimal

## Demand curve

$$P = a - bQ$$

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

a = price when Q = 0

$$MR = a - 2bQ$$

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

$$Y = a + bX$$

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

$$a = \frac{\sum y}{n} - \frac{b \sum x}{n}$$

## Coefficient of determination ( $r^2$ )

$$r^2 = \frac{(n \sum XY - \sum x \sum Y)^2}{(n \sum X^2 - (\sum X)^2)(n \sum Y^2 - (\sum Y)^2)}$$

## The Miller-Orr Model

$$Spread = 3 \times \left( \frac{\frac{3}{4} \times \text{Transaction Cost} \times \text{Variance of Cash flows}}{\text{Interest rate (as a proportion)}} \right)^{\frac{1}{3}}$$

### Annuity Table

Present value of an annuity of 1 i.e.

$$\frac{1 - (1 + r)^{-n}}{r}$$

Where

r = discount rate

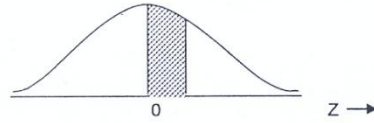
n = number of periods

### Discount rate (r)

Periods	Discount rate (r)										
(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	.1481	.1517
0.4	.1554	.1591	.1628	.1664	.1700	.1736	.1772	.1808	.1844	.1879
0.5	.1915	.1950	.1985	.2019	.2054	.2088	.2123	.2157	.2190	.2224
0.6	.2257	.2291	.2324	.2357	.2389	.2422	.2454	.2486	.2518	.2549
0.7	.2580	.2611	.2642	.2673	.2704	.2734	.2764	.2794	.2823	.2852
0.8	.2881	.2910	.2939	.2967	.2995	.3023	.3051	.3078	.3106	.3133
0.9	.3159	.3186	.3212	.3238	.3264	.3289	.3315	.3340	.3365	.3389
1.0	.3413	.3438	.3461	.3485	.3508	.3531	.3554	.3577	.3599	.3621
1.1	.3643	.3665	.3686	.3708	.3729	.3749	.3770	.3790	.3810	.3830
1.2	.3849	.3869	.3888	.3907	.3925	.3944	.3962	.3980	.3997	.4015
1.3	.4032	.4049	.4066	.4082	.4099	.4115	.4131	.4147	.4162	.4177
1.4	.4192	.4207	.4222	.4236	.4251	.4265	.4279	.4292	.4306	.4319
1.5	.4332	.4345	.4357	.4370	.4382	.4394	.4406	.4418	.4430	.4441
1.6	.4452	.4463	.4474	.4485	.4495	.4505	.4515	.4525	.4535	.4545
1.7	.4554	.4564	.4573	.4582	.4591	.4599	.4608	.4616	.4625	.4633
1.8	.4641	.4649	.4656	.4664	.4671	.4678	.4686	.4693	.4699	.4706
1.9	.4713	.4719	.4726	.4732	.4738	.4744	.4750	.4756	.4762	.4767
2.0	.4772	.4778	.4783	.4788	.4793	.4798	.4803	.4808	.4812	.4817
2.1	.4821	.4826	.4830	.4834	.4838	.4842	.4846	.4850	.4854	.4857
2.2	.4861	.4865	.4868	.4871	.4875	.4878	.4881	.4884	.4887	.4890
2.3	.4893	.4896	.4898	.4901	.4904	.4906	.4909	.4911	.4913	.4916
2.4	.4918	.4920	.4922	.4925	.4927	.4929	.4931	.4932	.4934	.4936
2.5	.4938	.4940	.4941	.4943	.4945	.4946	.4948	.4949	.4951	.4952
2.6	.4953	.4955	.4956	.4957	.4959	.4960	.4961	.4962	.4963	.4964
2.7	.4965	.4966	.4967	.4968	.4969	.4970	.4971	.4972	.4973	.4974
2.8	.4974	.4975	.4976	.4977	.4977	.4978	.4979	.4980	.4980	.4981
2.9	.4981	.4982	.4983	.4983	.4984	.4984	.4985	.4985	.4986	.4986
3.0	.49865	.4987	.4987	.4988	.4988	.4989	.4989	.4989	.4990	.4990
3.1	.49903	.4991	.4991	.4991	.4992	.4992	.4992	.4992	.4993	.4993
3.2	.49931	.4993	.4994	.4994	.4994	.4994	.4994	.4995	.4995	.4995
3.3	.49952	.4995	.4995	.4996	.4996	.4996	.4996	.4996	.4996	.4997
3.4	.49966	.4997	.4997	.4997	.4997	.4997	.4997	.4997	.4997	.4998
3.5	.49977									

## SOLUTION 1

(a) i. Computation of Cost of goods sold for 2021 and 2022

	<b>2021</b>	<b>2022</b>
	<b>₦</b>	<b>₦</b>
Opening raw Material	108,000	145,800
Materials Purchased	702,000	720,000
Cost of material available	810,000	865,800
Less Closing Material	145,800	180,000
Cost of material used	664,200	685,800
Direct Wages	300,000	250,000
Prime Cost	964,200	935,800
Production expenses	72,600	171,995
	1,036,800	1,107,795
Add Opening work in progress	75,600	97,200
Less Closing work in Progress	(97,200)	(93,360)
Production costs	1,015,200	1,111,635
Add opening Finished goods	86,400	129,600
Less Closing finished goods	(129,600)	(142,875)
Cost of goods sold	972,000	1,098,360

i. Length of working capital cycle (Assuming 365 days in a year) for 2021 and 2022

### Working capital cycle for 2021

Holding Period for raw material stock	=	$\frac{[(\text{Opening} + \text{Closing})/2] \times 365}{\text{Purchases}}$	=	
	=	$\frac{[(108,000 + 145,800)/2] \times 365}{702,000}$	=	66 days
Production period for Work in Progress	=	$\frac{[(\text{Opening} + \text{Closing})/2] \times 365}{\text{Cost of goods sold}}$	=	
	=	$\frac{[(75,600 + 97,200)/2] \times 365}{972,000}$	=	33 days
Holding period for Finished goods	=	$\frac{[(\text{Opening} + \text{Closing})/2] \times 365}{\text{Cost of goods sold}}$	=	
	=	$\frac{[(86,400 + 129,600)/2] \times 365}{972,000}$	=	41 days
Collection period for receivables	=	$\frac{[(\text{Opening} + \text{Closing})/2] \times 365}{\text{Sales}}$	=	
	=	$\frac{[(172,800 + 259,200)/2] \times 365}{1,080,000}$	=	73 days
Less Payment period for payable	=	$\frac{(\text{Opening} + \text{Closing})/2] \times 365}{\text{Purchases}}$	=	
	=	$\frac{(86,400 + 105,300)/2 \times 365}{702,000}$	=	(50 days)
Working capital cycle				163 days
Working capital cycle for 2022				

Holding Period for raw material stock	=	$\frac{[(\text{Opening} + \text{Closing})/2] \times 365}{\text{Purchases}}$	=	
	=	$\frac{[(145,800 + 180,000)/2] \times 365}{720,000}$	=	83 days
Production period for Work in Progress	=	$\frac{[(97,200 + 93,360)/2] \times 365}{1,098,360}$	=	32 days
Holding period for Finished goods	=	$\frac{[(\text{Opening} + \text{Closing})/2] \times 365}{\text{Cost of goods sold}}$	=	
	=	$\frac{[(129,600 + 142,875)/2] \times 365}{1,098,360}$	=	45 days
Collection period for receivables	=	$\frac{(\text{Opening} + \text{Closing})/2] \times 365}{\text{Sales}}$	=	
	=	$\frac{[(259,200 + 297,000)/2] \times 365}{1,188,000}$	=	85 days
Less Payment period for payable	=	$\frac{[(\text{Opening} + \text{Closing})/2] \times 365}{\text{Purchases}}$	=	
	=	$\frac{[(105,300 + 126,000)/2] \times 365}{720,000}$	=	(59 days)
Working capital cycle				186 days

(iii) **Actions that the management of the company might take to reduce the length of the cycle:**

- Reduce the period raw materials are held in inventory by adopting a JIT system
- Improve the throughput of the products by adopting efficient manufacturing equipment and process
- Reducing finished goods holding period by producing to order.
- Reducing the length of time customers take to pay by offering early settlement discount.
- Negotiate for longer credit period with suppliers
- Company need to improve on sales strategy to sell more maybe open new markets or they should plan to reduce the sales target to reduce the amount of finished goods left at the end of the year.

(b)i. Payoff Table

Constructing the Payoff table

Course of Action	Demand of 10 boxes ₦	Demand of 20 boxes ₦	Demand of 30 boxes ₦
Buy 10 boxes	(4000 - 2500)=1500	(4000 - 2500)=1500	(4000 - 2500)=1500
Buy 20 boxes	(4000 - 5000)= (1000)	(8000 - 5000)=3000	(8000 - 5000)=3000
Buy 30 boxes	(4000 - 7500)= (3500)	(8000 - 7500)= 500	(12000 - 7500)=4500

Payoff table

Course of Action	Demand of 10 boxes ₦	Demand of 20 boxes ₦	Demand of 30 boxes ₦
Buy 10 boxes	1500	1500	1500
Buy 20 boxes	(1000)	3000	3000
Buy 30 boxes	(3500)	500	4500

ii. Number of boxes based on maximum decision rule

Course of action	Maximum of maximum returns
Buy 10 boxes	1500
Buy 20 boxes	3000
Buy 30 boxes	4500

Decision: Buy 30 boxes

Number of boxes based on maximin decision rule

Course of action	Maximum of minimum returns
Buy 10 boxes	1500
Buy 20 boxes	(1000)
Buy 30 boxes	(3500)

Decision: Buy 10 boxes

Minimax regret decision rule

Constructing the regret Payoff table

Course of Action	Demand of 10 boxes ₦	Demand of 20 boxes ₦	Demand of 30 boxes ₦
Buy 10 boxes	$(1500 - 1500) = 0$	$3000 - 1500 = 1500$	$4500 - 1500 = 3000$
Buy 20 boxes	$1500 - (-1000) = 2500$	$(3000 - 3000) = 0$	$4500 - 3000 = 1500$
Buy 30 boxes	$1500 - (-3500) = 5000$	$3000 - 500 = 2500$	$4500 - 4500 = 0$

Regret Payoff table

Course of Action	Demand of 10 boxes ₦	Demand of 20 boxes ₦	Demand of 30 boxes ₦
Buy 10 boxes	0	1500	3000
Buy 20 boxes	2500	0	1500
Buy 30 boxes	5000	2500	0

Number of boxes based on Minimax regret decision rule

Course of action	Minimum of Maxi regret returns ₦
Buy 10 boxes	3000
Buy 20 boxes	2500
Buy 30 boxes	5000

Decision: Buy 20 boxes which delivers minimum of the maxi regrets.

### Examiner's report

This is a compulsory question that is in two parts. The first part tests candidates ability to determine company's cost of goods sold and working capital cycle period. The second part is on decision making under situation of uncertainty as it affects maxi-max decision rule, mini-max decision rule and maxi-min regret decision rule.

The question being a compulsory question was well attempted.

Performance of the candidates was average.

The major pitfalls are the inability of most candidates to use average stock in determining the working capital cycle and correctly set out the payoff matrix table.

It is hereby recommended that candidates should use ICAN study manual and other Performance Management text books in preparing for future Institute's examination.

### Marking guide

		<b>Mark s</b>	<b>Marks</b>	
a) i	Cost of goods sold 2021 and 2022 (30 ticks @ <sup>1</sup> /10 mark)	3		
ii	Length of working capital cycle for 2021 and 2022 (28 ticks @ <sup>1</sup> /4 mark)	7		
iii	Factors that will reduce length of working capital cycle (any 5 points @1 mark)	<u>5</u>	15	
b) i	Pay off table (21 ticks @ <sup>1</sup> /3 mark)	7		
ii	<ul style="list-style-type: none"><li>• Maximax (5 ticks @<sup>1</sup>/2 mark) 2½</li><li>• Maximax (5 ticks @<sup>1</sup>/2 mark) 2½</li><li>• Minimax Regret (6 ticks @<sup>1</sup>/2 mark) <u>3</u></li></ul>	<u>8</u>	<u>15</u>	30

### SOLUTION 2

#### PAY OFF TABLE (R600)

a.	Course of Action	Prob.	State of Nature (Demand)			
			10,000	20,000	30,000	40,000
	10,000	0.1	2,700	2,700	2,700	2,700
	20,000	0.4	5,700	5,200	5,200	5,200
	30,000	0.3	8,700	8,200	7,700	7,700
	40,000	0.2	11,700	11,200	10,700	10,200



	<b>Cost of copies</b>	<b>Cost of Unsold copies</b>	<b>=</b>	<b>₦600</b>
a.	₦200 + (250 x 10)	+ (300 x 0)	=	2,700
b.	₦200 + (250 x 10)	+ (300 x 0)	=	2,700
c.	₦200 + (250 x 10)	+ (300 x 0)	=	2,700
d.	₦200 + (250 x 10)	+ (300 x 0)	=	2,700
e.	₦200 + (250 x 10)	+ (300 x 10)	=	5,700
f.	₦200 + (250 x 20)	+ (300 x 0)	=	5,200
g.	₦200 + (250 x 20)	+ (300 x 0)	=	5,200
h.	₦200 + (250 x 20)	+ (300 x 0)	=	5,200
i.	₦200 + (250 x 10)	+ (300 x 20)	=	8,700
j.	₦200 + (250 x 20)	+ (300 x 10)	=	8,200
k.	₦200 + (250 x 30)	+ (300 x 0)	=	7,700
l.	₦200 + (250 x 30)	+ (300 x 0)	=	7,700
m.	₦200 + (250 x 10)	+ (300 x 30)	=	11,700
n.	₦200 + (250 x 20)	+ (300 x 20)	=	11,200
o.	₦200 + (250 x 30)	+ (300 x 10)	=	10,700
p.	₦200 + (250 x 40)	+ (300 x 0)	=	10,200

Course of Action	State of Nature (N'000)				
	Prob.	10,000	20,000	20,000	40,000
10,000	0.1	₦270	₦270	₦270	₦270
20,000	0.4	₦2,280	₦2,080	₦2,080	₦2,080
30,000	0.3	₦2,610	₦2,460	₦2,310	₦2,310
40,000	0.2	₦2,340	₦2,240	₦2,140	₦2,040

b.

#### Maximax Decision Rule

course of Action	Maximum Profit
10,000	270
20,000	2,080
30,000	2,310
40,000	2,040

\*Least Cost yields highest profit  
Decision: 10,000 copies

- c. The production or printing of the programmes involves incurring fixed cost. The larger the volume printed, the lower will be the cost of printing per copy. Therefore, printing 30,000 or 40,000 copies will be an optimistic decision informed by the need to maximise the benefit that is derivable from the fixed cost of printing.

d.	Profit from perfect forecast:		<b>₦'000</b>
	Result without perfect information	(270 + 2080 + 2310 + 2040)	(6,700)
	Result with perfect information	(270 + 270 + 270 + 270)	<u>(1,080)</u>
			<u><u>5,620</u></u>
e.	Limited of expected value criteria		
	i.	It depends on subjective probability	
	ii.	Only useful for repetitive outcome and not for one-off	
	iii.	The expected value might not be one of the possible outcome	
	iv.	It does not give a view of the risk involved	
	v.	it is a weighted average of all possible outcomes.	

### Examiner's report

The question is on decision making under uncertainty and tests candidates' ability to answer questions on maxi-max decision rule and decision on perfect information.

The question was well attempted.

The Performance of the candidate was average.

The major pitfall observed was the inability of candidates to set out the Payoff matrix table and decipher the process of computing values when there is perfect information.

It is hereby recommended that candidates should use ICAN study manual on Performance Management when preparing for future Institute's examination.

### Marking guide

a.	Pay off table		
	• 15 ticks @ <sup>1</sup> / <sub>5</sub> mark)	3	
	• 15 ticks @ <sup>1</sup> / <sub>5</sub> mark)	<u>3</u>	6
b.	Number of programmes (8 ticks @ <sup>1</sup> / <sub>2</sub> mark)		4
c.	Most profitable quantity (4 points @ <sup>1</sup> / <sub>2</sub> mark)		2
d.	Profit from perfect forecast (4 ticks @ <sup>1</sup> / <sub>2</sub> mark)		4
e.	Major Limitations (4 points @1 mark)		<u>4</u>
			<b>20</b>

### SOLUTION 3

(a) Relevant costs and relevant revenues from acceptance of contract

	(₦'000)	(₦'000)
Sales revenue (20,000 kg at ₦10,000)		200,000
Relevant costs:		
Labour (20,000 × 6hrs × ₦200)	24,000	
Materials		
A (20,000 × 2 units × ₦1,000 replacement cost)	40,000	
B (20,000 × 1 litre × 2,500 NRV)	50,000	
Variable overheads <sup>b</sup> (20,000 × 8hrs × ₦300)	<u>48,000</u>	
	162,000	
Add increase in fixed costs	<u>22,800</u>	
Net incremental costs	184,800	
Add		
Loss on product Y		
Lost contribution <sup>c</sup> (5,000 × ₦3,800)	19,000	
Fixed costs avoided <sup>d</sup> (5,800)	<u>13,200</u>	<u>198,000</u>
Excess of relevant revenues over relevant costs		<u>2,000</u>

Advice: In view of the fact that the Contract achieved excess of relevant revenue over relevant cost, the Contract is therefore desirable.

#### Notes

- i. Grade 1 labour is not an incremental cost.
- ii. Variable overheads vary with production labour – 8 labour hours per unit are used, causing variable overheads to increase by ₦300 per hour. Grade 1 labour is not an incremental cost, but it does cause variable overheads to increase.
- iii. Lost contribution

Selling price	7,000	
Less		
Grade 2 labour (4 hrs × ₦200)	800	
Materials	1,200	
Variable overheads (4 hrs × ₦300)	<u>1,200</u>	<u>3,200</u>
Contribution	<u>3,800</u>	
- iv. Assumed fixed costs represent incremental costs or incremental savings.

- (b) To calculate the product cost for job costing purposes it is necessary to calculate the fixed overhead rate. The calculation is as follows:

	<b>Fixed overheads</b>	<b>Director labour hours</b>
Initial budget	₦60,000,000	300,000
Plus contract	₦22,800,000	160,000 <sup>a</sup>
Less product Y	<u>(₦5,800,000)</u>	<u>(20,000) = (4hrs × 5,000)</u>
	<u>₦77,000,000</u>	<u>440,000</u>

Fixed overhead absorption rate = ₦175/hour (₦77,000,000/440,000hrs).

**Note**

<sup>a</sup> The fixed overhead rate is per productive labour hour. Grade 1 labour hours represent additional productive labour hours. If the contract is not accepted then grade 1 labour hours will be non-productive. Total productive hours relating to the contract = 2,000 × (2 hours + 6 hours) = 160,000 hours

The job costing contract will be reported as follows:

	<b>(₦000)</b>	<b>(₦000)</b>
Direct labour:		
Grade 1 (20,000 × 2hrs × ₦400)	16,000	
Grade 2 (20,000 × 6hrs × ₦200)	<u>24,000</u>	40,000
Direct materials:		
A (20,000 × 2units × ₦800)	32,000	
B (20,000 × 1litre × ₦3,000)	<u>60,000</u>	92,000
Variable overheads		
20,000 × 8hrs × ₦300	48,000	
Fixed overheads		
20,000 × 8hrs × ₦175	<u>28,000</u>	<u>76,000</u>
Total cost		<u>(208,000)</u>
Sales revenue		<u>200,000</u>
Reported loss		<u><u>(8,000)</u></u>

- c. The difference between the relevant cost profit of ₦2,000,000 and the routine cost loss of ₦8,000,000 arises because of the different ways in which costs are determined in each statement. A reconciliation and summary of the difference is as follows:

	<b>Difference</b>	<b>Explanation</b>
	<b>₦000</b>	
Grade 1 labour	16,000	Not charged as a relevant cost because it is 'sunk' and will be incurred anyway.
Material A	(8,000)	Replacement cost is relevant but book value is the routing charge.
Material B	10,000	Book value overstate the charge – realisable value is the relevant cost.

Fixed overheads	5,200	Routine costing passes on overheads that would be incurred anyway. The relevant cost is simply the incremental cost.
Effect on product Y	(13,200)	Routine costing ignores the loss of contribution from Y – relevant costing takes it into account
	10,000	

### Examiner's report

The question tests candidate's ability to answer questions on relevant costing.

The question was well attempted.

The Performance was above average.

The major pitfall observed was candidate inability to decipher relevant costs of material, labour and overhead cost elements in situations involving replacement costs, realisable value of materials and replacement costs.

It is hereby recommended that candidates should use ICAN Study Text on Performance Management when preparing for future Institute's examination.

### Marking guide

a	Desirability of the contract (16 ticks @½ mark)	8	
b	Routine job casting (12 ticks @½ mark)	6	
c	Differences between (a) and (b) (Any 4 points @1½ marks)	6	20

### SOLUTION 4

#### TAYO LIMITED

a) Consequences of undertaking the:

	Abuja Contract		Lagos contract	
	₦'000	₦'000	₦'000	₦'000
Contract revenue		17,000		18,000
Sale of materials held for the Abuja contract (Note 1)				2,400
Saving in material purchases by alternative use of materials for Lagos contract (note 2)		4,800		
Hire of plant		200		
		₦22,000		₦20,400

Incremental costs:			
Materials to be ordered (note 3)	4,000		3,400
Project manager's travel, lodging, etc.	400		400
Local labour	7,000		5,600
Penalty for cancelling the other contract	<u>800</u>		<u>1,600</u>
		12,200	11,000
Excess of revenue/savings over incremental costs		<u>₦9,800</u>	<u>₦9,400</u>

**Notes:**

- i. If the Lagos job is undertaken, sales of materials no longer required for the Abuja job would be:

	<b>₦'000</b>
Current market price = ₦2,000 × 1.60 =	<u>3,200</u>
Sales value = ₦3,200 × 90%	2,880
Less transport cost (16.67%)	<u>480</u>
Net sales revenue	<u>2,400</u>

- ii. If the Abuja job is undertaken, the materials for the Lagos job might be re-used on a different contract, thereby saving the purchase of additional materials:

	<b>₦'000</b>
Materials held	2,400
Contracted for	<u>3,600</u>
Cost of unwanted materials	<u>6,000</u>
Saving in purchases on different contract (80%)	<u>₦4,800</u>

- iii. The materials contracted for to carry out the Lagos job must be paid for whatever happens. Although not yet received, they must be paid for whichever (if either) contract is undertaken. It is therefore not an incremental cost chargeable to the Lagos contract.

For similar reasons, materials already held are not an incremental cost to their respective contracts. The alternative use of materials not required, is however, significant - and this has been taken into account on the revenue side of the analysis.

- iv. It is assumed that the project manager's salary is a fixed cost, whichever contract (if either) is undertaken. Incremental labour costs are therefore travel, lodgings etc. and local labour.
- v. The penalty cost of failing to undertake one contract should be treated as a consequential cost of undertaking the other contract.
- vi. The excess of revenue/savings over incremental costs calculated for each contract shows the comparative effect on profits of undertaking each job in preference to the other. The difference between the two figures (₦9,800,000

and ₦9,400,000) shows that there is a difference between the two projects of ₦400,000 in favour of the Abuja job.

- b. The approach used has assumed that one project or the other will be undertaken. Some costs have already been incurred (some materials, plant); other costs have been committed (project manager's salary, head office administration) and others are notional (interest on plant).

These are not relevant to any decision about the future action. The only relevant considerations should be:

- i. future revenues or cash savings as a consequence of the decision;
- ii. future costs, incurred as an additional expense as a consequence of the decision.

In the situation in part (a), incremental revenues are the revenues from the contract undertaken, alternative uses of materials held but not required and hire of plant. Incremental costs are only those additional costs which would be incurred as a result of the decision to undertake one of the contracts.

The cost accounting profit or loss recorded for each contract might be:

**Abuja:** ₦17,000,000 – ₦16,000,000 = ₦1,000,000

**Lagos:** ₦18,000,000 – ₦18,200,000 = (₦200,000)

These figures are irrelevant to a decision because the costs include past, committed or notional costs, and other revenues and penalty costs to the company are ignored.

- c) Other factors to consider are:
- i. the constraints on working which make the contract mutually exclusive. If there is a shortage of labour, funds etc. it might be possible to overcome and carry out both projects;
  - ii. the likelihood of another contract being offered for the same period of time, which is more profitable than either the Abuja or Lagos jobs;
  - iii. loss of goodwill and future contracts by not undertaking either project;
  - iv. reliability of the prospective customer in each contract
  - v. reliability of costs forecasts, labour availability etc. on both contracts. The net difference between the two jobs, ₦400,000, is relatively small and sensitivity/risk analysis will be very important;
  - vi. the preference for the Lagos contract (by ₦400,000) has assumed that the alternative use for the Lagos contract materials will exist. It is only a likelihood, however. Failure to obtain this saving would shift the preference strongly in favour of accepting the Lagos job.

### Examiner's report

The question test's candidates ability to answer questions on relevant costing and decision making.

The question was well attempted.

The Performance was above average.

The major pitfall observed was candidates' inability to decipher relevant costs of material, labour and overhead in situations involving replacement and historical costs.

It is hereby advised that candidates should use ICAN study manual on Performance Management when preparing for future institute's examination.

### Marking guide

a	Date to assist Decision Making (24 ticks @ ½ mark)	12	
b	Comment on Appropriations (Any 4 points @ 1mark)	4	
c	List of factors (Any 4 points @ 1mark)	<u>4</u>	<b>20</b>

### SOLUTION 5

- a. Calculate the expected net Present value of the two Projects  
Computation of joint Probability distribution

S/N	Factor 1	Factor 2	Factor 3	Workings	Joint Probability
1	YES	YES	YES	$0.2 \times 0.3 \times 0.4$	0.024
2	YES	YES	NO	$0.2 \times 0.3 \times 0.6$	0.036
3	YES	NO	NO	$0.2 \times 0.7 \times 0.6$	0.084
4	NO	NO	NO	$0.8 \times 0.7 \times 0.6$	0.336
5	NO	NO	YES	$0.8 \times 0.7 \times 0.4$	0.224
6	NO	YES	YES	$0.8 \times 0.3 \times 0.4$	0.096
7	YES	NO	YES	$0.2 \times 0.7 \times 0.4$	0.056
8	NO	YES	NO	$0.8 \times 0.3 \times 0.6$	0.144
				<b>Total</b>	<b>1.000</b>



Impact on inflow

S/N	Joint Probability	Inflow impact	Result	Final expected value
1	0.024	1 - 0.25 - 0.10 + 0.05	0.70	0.0168
2	0.036	1 - 0.25 - 0.10	0.65	0.0234
3	0.084	1 - 0.25	0.75	0.0630
4	0.336	1 - 0.0	1.00	0.3360
5	0.224	1 + 0.05	1.05	0.2352
6	0.096	1 - 0.10 + 0.05	0.95	0.0912
7	0.056	1 - 0.25 + 0.05	0.80	0.0448
8	0.144	1 - 0.10	0.90	0.1296
	1.000			0.9400

Thus the EV of considering the 3 factors is 0.94. Therefore the NPV of Project A and B are:

#### Project A

Year	Cash inflow N'000	EV of Cash flow N'000	Cash outflow N'000	Net Cash flow N'000	Discount rate 10%	PV of cash flow N'000
0	-		(13000)	(13,000)	1.000	(13000)
1	6000 x 0.94	5640	(3000)	2640	0.909	2399.76
2	8000 x 0.94	7520	(4000)	3520	0.826	2907.52
3	10000 x 0.94	9400	(4000)	5400	0.756	4002.40
4	9000 x 0.94	8460	(3000)	5460	0.683	3729.18
5	6000 x 0.94	5640	(3000)	2640	0.621	1639.44
	NPV					+1678.30

#### Project B

Year	Cash inflow N'000	EV of Cash flow N'000	Cash outflow N'000	Net Cash flow N'000	Discount rate 10%	PV of cash flow N'000
0	-		(14000)	(14,000)	1.000	(14000)
1	10000 x 0.94	9400	(5000)	4400	0.909	3999.60
	9000 x 0.94	8460	(4000)	4460	0.826	3683.96
	8000 x 0.94	7520	(3000)	4520	0.756	3417.12
	8000 x 0.94	7520	(3000)	4520	0.683	3087.16
	4000 x 0.94	3760	(2000)	1760	0.621	1092.96
	NPV					+1280.80

b. Project A will be more profitable with a higher NPV of ₦1,678,300

## Examiner's report

The question test's candidates' ability to provide solutions on investment appraisal decision with sensitivity components.

The question was well attempted.

The Performance was above average.

The major pitfall observed was the candidates' inability to decipher the sensitivity issues that bother on factors that affect the cash inflows for both Projects A and B.

It is hereby advised that candidates should use ICAN study manual on Performance Management when preparing for future Institute's examination.

## Marking guide

- |    |   |          |          |    |
|----|---|----------|----------|----|
| a. | Expected Net Present Value  |          |          |    |
|    | • Joint Probability<br>(9 ticks @ <sup>1</sup> / <sub>6</sub> marks)  | 1½       |          |    |
|    | • Impact on cashflow<br>(9 ticks @ <sup>1</sup> / <sub>6</sub> marks) | 1½       |          |    |
|    | • (7 ticks @1 mark)   | <u>7</u> | 10       |    |
| b. | The more profitable project<br>(10 ticks @½ mark)                     |          | <u>5</u> | 15 |

## SOLUTION 6

### a) Current Position

Particulars	Pre-booked	Standard	Premium Family
Sales Price per ticket	₦580	₦780	₦3,700
No of ticket	1,500	8,000	675
Monthly sales in quantity	30 x 1500 = 45,000	240,000	20,250

Monthly Fixed Costs ₦130,000,000

Determination of Optimal price of Premium family:

$$P = a + bx$$

Where a = Maximum Price at which no Premium Ticket will be sold:

$$b = \frac{\text{Changes in P}}{\text{Changes in X}} = \text{Price Elasticity}$$

$$\text{Marginal cost} = \text{Variable Cost} = ₦2050 \times 0.92 = ₦1886$$

$$b = \frac{100}{-25} = -4$$

Therefore:

$$p = a + bx$$

$$P = a - 4x$$

$$3,700 = a - 4(675)$$

$$= a - 2700$$

$$a = 3700 + 2700$$

$$a = 6,400. \text{ Therefore } P = 6,400 - 4x$$

### Converting to Total Revenue

$$TR = P \times Q$$

$$(6,400 - 4x)x$$

$$= 6,400x - 4x^2$$

$$MR = \frac{\partial TR}{\partial x} = 6,400 - 8x$$

$$MC = VC = 1886$$

Profit is maximized where

$$MR = MC$$

$$6,400 - 8x = 1,886$$

$$-8x = 1,886 - 6,400$$

$$-8x = -4,514$$

$$x = -4,514 / -8$$

$$x = 564 \text{ units}$$

<b>Contribution:</b>	<b>Pre-booked Ticket</b>	<b>Standard Ticket</b>	<b>Premium</b>
Price	580	780	6,400
Variable Cost	<u>(1,886)</u>	<u>(1,886)</u>	<u>(1,886)</u>
	<u>(1,306)</u>	<u>(1,106)</u>	<u>4,514</u>
Tickets sold per month	<u>45,000</u>	<u>240,000</u>	<u>16,920</u>
	<u><b>(58,770,000)</b></u>	<u><b>(265,440,000)</b></u>	<u><b>(76,376,880)</b></u>

Total Quantity for the month 1500 x 30 = 45,000; 8,000 x 30 = 240,000; 564 x 30 = 16,920

### Total Contribution

Prebooked Ticket	(58,770,000)
Standard Ticket	(265,440,000)
Premium Ticket	76,376,880
	<b>(247,833,120)</b>

Decision: No financial benefit unless it is undertaken for corporate social responsibility

b. Sensitivity Analysis

Variable Cost Savings from Standard Ticket [(2,050 – 1,886) x 8,000 x 30]	= 39,360,000	
Hiring Cost of equipment	= (5,000,000)	
	<u>34,360,000</u>	

**Examiner’s report**

The question tests candidates’ ability to provide solutions on optimal pricing, marginal cost and sensitivity implication on hire of ticketing equipment.

The question was well attempted.

The Performance was above average.

The major pitfall observed was the candidates’ inability to decipher the method to be used to compute the marginal revenue as well as determine the sensitivity components of hire of the ticketing equipment.

It is hereby advised that candidates should use ICAN study manual on Performance Management when preparing for future Institute’s examination.

**Marking guide**

a	Financial benefit and Premium Price Charged (22 ticks @½ mark)	11	
b	Sensitivity Analysis (4 ticks @1 mark)	<u>4</u>	15

**SOLUTION 7**

**Working Notes**

- The contract time for the 400 units is calculated using the learning curve technique. The company has already produced 200 units and now needs to produce another 400, i.e. 600 in total.

- The learning rate is computed as follows:

<b>Cumulative Quantity</b>	<b>Cumulative Hours</b>	<b>Cumulative Average Hours per unit</b>
50	1,800	36
100	3,000	30

The learning rate is therefore  $30/36 = 83\frac{1}{3}\%$

- The contract time can now be determined using the learning curve formula:

$$Y = ax^b$$

Where:

Y = Cumulative average time for the cumulative output of 600 units

A = the average time for the first batch i.e. 36 hours

$$x = \frac{\text{Output level desired}}{\text{Number of units in the 1st batch}} = \frac{600}{50} = 12$$

$$b = \frac{\text{Log of .83333}}{\text{Log of 2}} = -0.263$$

$$\therefore Y = 36(12)^{-0.263} = 18.73 \text{ hours}$$

Total hours for the 600 units = 600 x 18.73 = 11,238 hours

Less: Total hours for the first 200 units

already produced

5,000 hours

Hours now required

6,238 hours

- Contribution per labour hour. This is necessary because labour is in short supply. Any labour hour used on the special order entails opportunity cost. From the budget statement.

	<b>₦'000</b>	<b>₦'000</b>
Sales		18,000
Materials	1,800	
Labour	7,560	
VOH	<u>2,520</u>	<u>11,880</u>
Contribution		<u>6,120</u>
Budgeted labour hours		42,000
Contribution/hour	= 6,120,000 ÷ 42,000 = ₦145.71	

### Calculation of minimum price

Materials 1,000kg	x	<u>₦1,800,000</u>	=	₦ 120,000
		15,000		
Labour 6,238	x	<u>7,560,000</u>	=	1,122,840
		42,000		
VOH 6,238	x	<u>2,520,000</u>	=	374,280
		42,000		
Direct fixed costs			=	180,000
Opportunity cost of labour 6,238 x ₦145.71				<u>908,939</u>
Minimum price				<u><b>₦2,706,059</b></u>

**Examiner's report**

This question tests candidates' ability to use relevant costing approach to determine the minimum price to quote for special security padlock considering the learning effect on labour hours.

The question was fairly attempted.

However, the performance was average.

The major pitfall observed was candidate inability to take note of the implication of learning effect on labour and variable overhead cost.

It is hereby recommended that candidates should use ICAN study manual on Performance Management when preparing for future Institutes' examination.

**Marking guide**

The Minimum Price  
(15 ticks @1 mark)

15

**THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA****SKILLS LEVEL EXAMINATION – MAY 2023****PUBLIC SECTOR ACCOUNTING & FINANCE****EXAMINATION INSTRUCTIONS****PLEASE READ THESE INSTRUCTIONS BEFORE THE COMMENCEMENT OF THE PAPER**

1. Check your pockets, purse, mathematical set, etc. to ensure that you do not have prohibited items such as telephone handset, electronic storage device, programmable devices, wristwatches or any form of written material on you in the examination hall. You will be stopped from continuing with the examination and liable to further disciplinary actions including cancellation of examination result if caught.
2. Write your **EXAMINATION NUMBER** in the space provided above.
3. Do **NOT** write anything on your question paper **EXCEPT** your examination number.
4. Do **NOT** write anything on your docket.
5. Read all instructions in each section of the question paper carefully before answering the questions.
6. Do **NOT** answer more than the number of questions required in each section, otherwise, you will be penalised.
7. All solutions should be written in **BLUE** or **BLACK INK**. Any solution written in **PENCIL** or **RED INK** will not be marked.

**THURSDAY, MAY 18, 2023****DO NOT TURN OVER UNTIL YOU ARE TOLD TO DO SO**

# THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

## SKILLS LEVEL EXAMINATION – MAY 2023

### PUBLIC SECTOR ACCOUNTING & FINANCE

Time Allowed: 3<sup>1</sup>/<sub>4</sub> hours (including 15 minutes reading time)

**INSTRUCTION: YOU ARE REQUIRED TO ATTEMPT FIVE OUT OF SEVEN QUESTIONS IN THIS PAPER**

**SECTION A: COMPULSORY QUESTION (30 MARKS)**

#### QUESTION 1

a. The following information relates to the accounts of Dovet State Government for the year ended December 31, 2022:

	DR ₦'M	CR ₦'M
Land and buildings (cost)	387,500	
Long-term investments	187,500	
Equipment and furniture	67,500	
Accumulated depreciation:		
- Land and building		40,000
- Motor vehicles		30,000
- Equipment and furniture		21,250
Motor vehicles (cost)	145,000	
Federation account allocation		287,500
VAT allocation		87,500
Grants from Federal Government		33,750
Internally generated fund		97,500
Grant from donor agency		25,000
Personnel emolument	125,000	
Maintenance of premises	5,000	
Consolidated Revenue Fund charges	32,500	
Overhead expenses	25,000	
Miscellaneous expenditure/income	37,500	61,250
Loan notes		250,000
Current assets/liabilities	38,750	36,250
Consolidated Revenue Fund (CRF)		<u>81,250</u>
Total	<u>1,051,250</u>	<u>1,051,250</u>



**The following additional information is also relevant:**

- (i) Loan interest outstanding at the end of the year was ₦12.5 billion.
- (ii) Depreciation on tangible assets is charged at the following rates on cost:
  - Building is 5% (cost of land is ₦250 billion)
  - Motor vehicles is 20%
  - Equipment and furniture is 15%
- (iii) A building costing ₦12.5 billion with accumulated depreciation of ₦5 billion was sold for ₦11.25 billion. This transaction has not been adjusted in the accounts.
- (iv) Interest on receivable amounted to ₦10 billion.

**You are required to prepare:**

- i. Statement of financial performance of the State for the year ended December 31, 2022. (10 Marks)
  - ii. Statement of financial position as at December 31, 2022. (12 Marks)
- b. Financial statements provide information that meets a number of qualitative characteristics in financial reporting.

**Required:**

Discuss **FOUR** characteristics of financial reporting. (8 Marks)  
**(Total 30 Marks)**

**SECTION B: OPEN-ENDED QUESTIONS (40 MARKS)**

**INSTRUCTION: YOU ARE REQUIRED TO ATTEMPT ANY TWO OUT OF THE THREE QUESTIONS IN THIS SECTION**

**QUESTION 2**

- a. The revised Local Government Financial Memoranda (1991), spells out the administrative guidelines, the existing checks and balances and roles of officers of local governments.

**Required:**

Identify **THREE** objectives and **FIVE** contents of Local Government Financial Memoranda. (8 Marks)

- b. Bureau of establishments and training of Waso State awarded a contract to one of its Government Business Entities (GBE), Unity Enterprises for the supply of stationery for use in the various MDAs in the State. It had the following transactions for the year ended December 31, 2020:
- (i) The Bureau issued purchase order to Unity Enterprises for the supply of 1,250,000 reams of duplicating papers at the cost of ₦1,200 per unit. The item was supplied as specified five months after the award on May 31, 2020;
  - (ii) Another award for the supply of 5,000 training bags to Unity Enterprises at the cost of ₦2,500 per bag. The invoiced amount was fully paid and the training bags delivered on June 30, 2020;
  - (iii) During the year, 1,100,000 reams of duplicating papers were issued from store to user departments and 4,500 training bags were also issued from store for training activities during the year;
  - (iv) At physical verification of inventory carried out, 25,000 reams of the duplicating papers were damaged by floodwater; and
  - (v) The bureau transferred 25,000 reams of the duplicating papers to its outstation office during the year.

**Required:**

Record the above transactions as journal entries in the books of Bureau of Establishments and Training of Waso State. (12 Marks)

**(Total 20 Marks)**

**QUESTION 3**

- a. Sections 42 and 44 of Pension Reform Act (PRA) 2014 established Pension Transitional Arrangements Directorate (PTAD) for public service of the Federation and Pension Transitional Arrangements Directorate (PTAD) for the Federal Capital Territory (FCT) respectively.

**Required:**

- i. Identify **SEVEN** functions of the PTAD as contained in PRA, (2014). (7 Marks)
- ii. Identify **THREE** powers, which National Pension Commission has over Pension Transitional Arrangements Directorate for public service of the Federation and Federal Capital Territory. (3 Marks)

- b. Two accountants in the Ministry of Finance of Welfare State were in a debate as to which basis of accounting for revenue and expenditure should be adopted in the state. Five bases of accounting for the finance of the state were put forward i.e. accrual basis, cash basis, modified cash basis, modified accrual basis and commitment basis.

As a student of public sector accounting, explain any **FOUR** bases under the following headings:

- i. Concepts of the **FOUR** bases.
- ii. **THREE** merits of cash basis.
- iii. **THREE** merits of accrual basis.

(10 Marks)

**(Total 20 Marks)**

#### **QUESTION 4**

- a. In the course of writing Medium-Term-Expenditure Framework (MTEF) report, a lot of issues relating to states in the Federation were integrated into the report, in line with Fiscal Responsibility Act (2010).

##### **Required:**

- i. Explain the **TWO** requirements of the Fiscal Responsibility Act, as it affects time lag for the preparation of MTEF and submission to the National Assembly. (3 Marks)
- ii. Identify **FIVE** documents that should accompany the estimates of revenue and expenditure of the Nigeria's annual budget to the National Assembly (NASS). (5 Marks)

- b. On assumption of office, the head of Bureau of Establishments and Training of Takuro State organised a training for government officials across all the Ministries, Departments and Agencies (MDAs), in the state, to acquaint them with the importance of public sector accounting as a tool for efficient and effective performance of their job.

##### **Required:**

As one of the facilitators of the training workshop:

- i. Identify and explain **FOUR** objectives of public sector accounting that you will discuss at the workshop. (6 Marks)
- ii. Identify **SIX** external users of public sector accounting reports, highlighting their information needs. (6 Marks)

**(Total 20 Marks)**

**SECTION C: OPEN-ENDED QUESTIONS****(30 MARKS)****INSTRUCTION: YOU ARE REQUIRED TO ATTEMPT ANY TWO OUT OF THE THREE QUESTIONS IN THIS SECTION****QUESTION 5**

- a. A national economy requires the involvement of government to thrive and also her presence will lubricate the livelihood of the citizens.

**Required:**

- i. Identify and explain **FIVE** reasons why government intervenes in the economy. (7½ Marks)
- ii. Identify and explain **FIVE** macroeconomic objectives in Nigeria.

(7½ Marks)

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

Sometimes, countries contracting loan obligations are able to choose between different sources of credits. They could therefore make a decision based on the most favourable conditions.

**Required:**

- a. Identify and explain **FOUR** of such criteria for decision-making. (6 Marks)
- b. Explain **TWO** main principles that guide the Paris Club debt rescheduling process. (4 Marks)
- c. Discuss **FIVE** problems facing state governments in financing projects from capital markets. (5 Marks)

**(Total 15 Marks)****QUESTION 7**

Government like any other economic units needs funds, which can be raised from various sources for the purpose of financing its activities.

**Required:**

- a. Differentiate between:
- i. Public revenue and public receipts and state their sources. (3 Marks)
- ii. Oil and non-oil revenue. (2 Marks)
- b. Discuss **FIVE** problems associated with revenue allocation in Nigeria. (10 Marks)

**(Total 15 Marks)**

## SOLUTION 1

a.i)

**Dovet State Government**  
**Statement of financial performance for the year ended**  
**December 31, 2022**

	N'm	N'm
<b>Revenue:</b>		
Federation account allocation		287,500
VAT allocation		87,500
Grants from Federal Government		33,750
Internally generated revenue		97,500
Grant from donor agency		25,000
Miscellaneous income		61,250
Interest on investment		10,000
Profit on sale of building (W 1)		<u>3,750</u>
<b>Total revenue</b>		<b>606,250</b>
<b>Expenditure:</b>		
Personal emolument	125,000	
Maintenance of premises	5,000	
Consolidated revenue charges	32,500	
Overhead expenses	25,000	
Interest on loans	12,500	
Depreciation (W 2) - Buildings	6,250	
- Motor vehicles	29,000	
- Equipment and furniture	10,125	
Miscellaneous expenses	<u>37,500</u>	
<b>Total expenditure</b>		<b><u>282,875</u></b>
Surplus for the year		<b>323,375</b>
Consolidated Revenue Fund b/f		<u>81,250</u>
<b>Consolidated Revenue Fund c/f</b>		<b><u>404,625</u></b>

ii.

**Dovet State Government**  
**Statement of financial position as at December 31, 2022**

	N'm	N'm
Non-current assets (W 5)		455,875
Long term investments		187,500
<b>Current assets</b>		
Current assets (W 3)		<u>60,000</u>
<b>Total assets</b>		<b>703,375</b>
<b>Liabilities:</b>		
<b>Non current liabilities</b>		
Loan notes	250,000	
<b>Current liabilities:</b>		

Current liabilities (W 4)	<u>48,750</u>	
<b>Total liabilities</b>		<b><u>(298,750)</u></b>
<b>Net assets</b>		<b><u>404,625</u></b>
<b>Equity</b>		
Consolidated Revenue fund		<u>404,625</u>
<b>Total</b>		<b><u>404,625</u></b>

### Workings

	N'm
<b>1 Profit on sale of building</b>	
N 11,250 – (N 12,500 – N 5,000)	3,750
<b>2 Depreciation:</b>	
Building N(387,500- (250,000+12,500) @ 5%)	6,250
Motor vehicles (N145,000 @ 20%)	29,000
Equipment and furniture (N 67,500 @ 15%)	10,125
<b>3 Current assets</b>	
Current assets b/f	38,750
<b>Add:</b> - Proceeds from sale of building	11,250
- Interest receivable	<u>10,000</u>
<b>Current assets c/f</b>	<b><u>60,000</u></b>
<b>4 Calculation of total current liabilities</b>	
Current liabilities b/f	36,250
Loan interest	<u>12,500</u>
<b>Current liabilities c/f</b>	<b><u>48,750</u></b>
<b>5 Non-current assets schedule</b>	

	Land and buildings	Equipment and furniture	Motor vehicles	Total
	N'm	N'm	N'm	N'm
<b>Cost:</b>				
Bal. /b/f	375,500	67,500	145,000	600,000
Disposal	<u>(12,500)</u>	-	-	<u>(12,500)</u>
<b>Bal. c/f</b>	<b><u>375,000</u></b>	<b><u>67,500</u></b>	<b><u>145,000</u></b>	<b><u>587,500</u></b>
<b>Depreciation:</b>				
Bal. b/f	40,000	21,250	30,000	91,250
Disposal	(5,000)	-	-	(5,000)
Charged for the year	6,250	<u>10,125</u>	29,000	45,375
<b>Bal. c/f</b>	<b><u>41,250</u></b>	<b><u>31,375</u></b>	<b><u>59,000</u></b>	<b><u>131,625</u></b>
<b>Carrying amount</b>	<b><u>333,750</u></b>	<b><u>36,125</u></b>	<b><u>86,000</u></b>	<b><u>455,875</u></b>

(b) **Qualitative characteristics of financial reporting**

Qualitative characteristics of financial reporting are as follows:

- i. **Understandability**  
Information is understandable when users might reasonably be expected to comprehend its meaning. For this purpose, users are assumed to have a reasonable knowledge of the entity's activities and the environment in which it operates, and to be willing to study the information. Information about complex matters should not be excluded from the financial statements merely on the grounds that it may be too difficult for certain users to understand.
- ii. **Relevance**  
Information is relevant to users if it can be used to assist in evaluating past, present or future events or in confirming, or correcting, past evaluations. In order to be relevant, information must also be timely.
- iii. **Materiality**  
The relevance of information is affected by its nature and materiality. Information is material if its omission or misstatement could influence the decisions of users or assessments made on the basis of the financial statements. Materiality depends on the nature or size of the item or error judged in the particular circumstances of its omission or misstatement. Thus, materiality provides a threshold or cut-off point rather than being a primary qualitative characteristic which information must have if it is to be useful.
- iv. **Reliability**  
Reliable information is free from material errors and bias, and can be depended on, by users, to represent faithfully that, which it purports to represent.
- v. **Faithful representation**  
Financial reports represent economic phenomena (economic resources, claims against the reporting entity and effects of transactions and other events and conditions that change those resources and claims) by depicting them in words and numbers.

To be useful, financial information must not represent relevant phenomena, but it must also faithfully represent the phenomena that it purports to represent. A perfect faithful representation would have three characteristics. It would be:

- Complete – the depiction includes all information necessary for a user to understand the phenomenon being depicted, including all necessary descriptions and explanation;

- Neutral –the depiction is without bias in the selection or presentation of financial information; and
- Free from error – where there are no errors or omissions in the description of the phenomenon, and the process used to produce the reported information has been selected and applied with no errors in the process.

vi. **Prudence**

Prudence is the inclusion of a degree of caution in the exercise of the judgments needed in making the estimates required under conditions of uncertainty, such that assets or revenue are not overstated and liabilities or expenses are not understated. However, the exercise of prudence does not allow, for example, the creation of hidden reserves or excessive provisions, the deliberate understatement of assets or revenue, or the deliberate overstatement of liabilities or expenses, because the financial statements would not be neutral and, therefore, not have the quality of reliability.

vii. **Comparability**

Information in financial statements is comparable when users are able to identify similarities and differences between that information and information in other reports.

Comparability applies to the:

- Comparison of financial statements of different entities; and
- Comparison of the financial statements of the same entity over periods of time.

An important implication of the characteristic of comparability is that users need to be informed of the policies employed in the preparation of financial statements, changes to those policies and the effects of those changes. It is important that financial statements show corresponding information for preceding periods, because users wish to compare the performance of an entity over time.

**Timeliness**

If

There is an undue delay in the reporting of information it may lose its relevance. To provide information on a timely basis, it may often be necessary to report before all aspects of a transaction are known. If there is an undue delay in the reporting of information it may lose its relevance. To provide information on a timely basis, it may often be necessary to report before all aspects of a transaction are known, thus impairing reliability. Conversely, if reporting is delayed until all aspects are known, the information may be highly reliable but of little use to users who have had to make decisions in the interim. In achieving a balance between relevance and reliability, the overriding consideration is how best to satisfy the decision-making needs of users.



ix. **Balance between benefit and cost**

The balance between benefit and cost is a pervasive constraint. The benefits derived from information should exceed the cost of providing it. The evaluation of benefits and costs is, however, substantially a matter of judgment. Furthermore, the costs do not always fall on those users who enjoy the benefits. Users other than those for whom the information was prepared may also enjoy benefits. For these reasons, it is difficult to apply a benefit-cost test in any particular case. Nevertheless, standard-setters, as well as those responsible for the preparation of financial statements and users of financial statements, should be aware of this constraint.

**Examiner's report**

Part ai. and ii. of the question test candidates' knowledge on the preparation of financial performance and financial position of the state government, while part (b) requires the candidates to discuss characteristics of financial reporting in accordance with IPSAS 3 – Accounting Policies, Changes in Accounting Estimates and Errors.

As a compulsory question, all the candidates attempted the question and their performance was above average.

The common pitfalls were the inability of the candidates to calculate the depreciation to be charged to the statement of financial performance. Also, candidates were unable to properly discuss characteristics of financial reporting in accordance with IPSAS 3.

Candidates are advised to have adequate knowledge of the relevant provisions of International Public Sector Accounting Standards (IPSAS) and to make use of Pathfinder and Study Text of the Institute for better performance in the Institute's future examinations.

**Marking guide**

	Marks	Marks
a.i. <b>Statement of financial performance:</b>		
Title	½	
Calculation of total revenue	3	
Determination of total expenditure	3¼	
Stating of surplus for the year	1	
Determination of Consolidated Revenue Fund c/f	1¼	
Workings	<u>1</u>	10
ii <b>Statement of financial position:</b>		
Title	¼	
Stating of total non-current assets	6	
Determination of total assets	1½	
Calculation of total liabilities	1½	
Determination of net assets	½	

Recognition of net equity	$\frac{1}{2}$	
<b>Workings</b>	<u><math>1\frac{3}{4}</math></u>	12
b. <b>Qualitative characteristics of financial reporting</b>		
Identification of four qualitative characteristics of financial reporting	2	
Explanation of the qualitative characteristics identified	<u>6</u>	<u>8</u>
<b>Total</b>		<u><b>30</b></u>

## **SOLUTION 2**

### **a. The objectives of the Financial Memoranda:**

- i. To serve as administrative guidelines, which facilitate day-to-day running of local governments;
- ii. To expressly highlight the implications of disbursing government fund and property unjustly without proper authority and approval;
- iii. To facilitate recording of local government financial transactions in the appropriate accounting method; and
- iv. To serve as a learning tool for officers on first appointment or on transfer to a new section.

### **The contents of Local Government Financial Memoranda:**

- i. The format of budget and budgetary control;
- ii. The financial responsibilities of the Chairman and other accounting officers of a local government;
- iii. The responsibilities of the Local Government Secretary, Treasurer and Heads of Departments;
- iv. The responsibilities of the Internal Auditor as they relate to audit alarm;
- v. The powers and functions of the Auditor-General for Local Government;
- vi. The various financial offences and their respective sanctions;
- vii. The means of revenue collection and control;
- viii. Main books of accounts kept in the Local Government; and
- ix. The custody, accounting and control of stores.

b. **Bureau of Establishment and Training of Waso State**  
**Preparation of journal entries**

S/N	Particulars	Dr ₦'000	Cr ₦'000
i.	Inventory- Stationary account (1,250,000 @ ₦1,200 each) Payable- Unity Enterprises account Being purchase of 1,250,000 reams of duplicating papers at ₦1,200 per ream on May 31, 2020	1,500,000	1,500,000
ii.	Inventory- Training bags account (5,000 @ ₦2,500 each) Bank account Being purchase of 5,000 training bags at ₦2,500 per bag paid for on June 30, 2020	12,500	12,500
iii.	User departments: - Duplicating papers account (1,100,000 @ ₦1,200 each) - Training bags account (4,500 @ ₦2,500 each) Inventory - Duplicating papers account - Training bags account Being issuance of 1,100,000 reams of duplicating papers and 4,500 training bags to user departments during the year	1,320,000 11,250	1,320,000 11,250
iv.	Non-personal advance account (25,000 @ ₦1,200 each) Inventory – Duplicating papers account Being 25,000 reams of duplicating papers damaged by flood water during the physical verification of inventory	30,000	30,000
v.	Outstation account (25,000 @ ₦1,200 each) Inventory – Duplicating papers account Being transferred of 25,000 reams of duplicating papers transferred to its outstation.	30,000	30,000

**Examiner's report**

Part (a) of the question requires the candidates to identify objectives and contents of revised Local Government Financial Memoranda (1991) while part (b) tests the candidates' knowledge of the preparation of journal entries to record financial transactions.

Few of the candidates attempted the question and their performance was below average.

The common pitfalls were the inability of the candidates to identify objectives and contents of revised Local Government Financial Memoranda (1991). Also some candidates were unable to prepare journal entries and state the narration correctly.

Candidates are advised to make use of the Pathfinder and Study Text of the Institute for better performance in the Institute's future examinations.

### Marking guide

	Marks	Marks
a. Identification of three objectives of Local Government Financial Memoranda	3	
Identification of five contents of Local Government Financial Memoranda	<u>5</u>	8
b. <b>Preparation of journal entries</b>		
Title	1	
Correct journal entries of the transactions	6	
Narration of the journal entries	<u>5</u>	<u>12</u>
<b>Total</b>		<b><u>20</u></b>

### SOLUTION 3

#### a. i. Functions of the Pension Transitional Arrangements Directorate (PTAD)

The functions are as follows:

- Implementation of policies, rules and regulations relating to pension matters under the Defined Benefit Scheme (DBS);
- Ensure accurate payments are made to authentic pensioners under the civil service jurisdiction;
- Facilitate the maintenance of an accurate and comprehensive database of pensioners under its jurisdiction;
- Management and maintenance of pensioners' records and files;
- Prepare budgetary estimates for existing pensioners as well as outstanding liabilities and benefits of pensioners with genuine complaints;
- Prepare and submit the monthly payroll of civil service pensioners and issue payment instructions to the Office of the Accountant-General of the Federation(OAGF), through the Government Integrated Financial Management Information System (GIFMIS) platform for direct payment to pensioners;
- Respond to pensioners' complaints, relating but not limited to, non-/under-/over-payment of pensions, gratuities, death benefits, etc.;
- Carry out monthly payment analysis and payroll review and ascertain deficits in pension payments;
- Carry out prepayment audit of all payment vouchers;
- Carry out compliance audit to ensure government financial rules and regulations are complied with in all financial transactions;

- Review of financial statements– transcripts, bank reconciliations, pensioners' statement of claims etc.;
- Safeguarding the assets of the department;
- Periodic examination of systems and processes, certification of payment vouchers and other accounting books and records by use of internal audit stamp;
- Production of monthly audit reports; and
- Collaborate with Pension Support team and ensure periodic verification of civil service pensioners.

(ii) **Powers of the Commission over Pension Transitional Arrangements Directorate**

The Commission shall have power to:

- Regulate and supervise the activities of the Federal Government Pension Transitional Arrangements Directorate (PTAD) and the Federal Capital Territory Pension Transitional Arrangements Directorate to ensure compliance with the provisions of the Pension Reform Act;
- Intervene to administer and render technical support and advice on the management of the various Pension Transition Administration Directorates as per the directive of the President of the Federal Republic; and
- Ensure that the Federal Government Pension Transitional Arrangements Directorate and the Federal Capital Territory Pension Transitional Arrangements Directorate operate under the rules, regulations and directives issued by the Commission from time to time.

(b) i. **Concepts**

- **Cash basis** the basis of accounting under which revenue is recorded only when cash is received and expenditure recognised only when cash is paid, irrespective of the fact that the transactions might have occurred in the previous accounting period. This is a simple method of recording financial transactions in the public sector. The cash basis measures cash flows at the time those flows actually take place.
- **Accrual basis** - The basis records expenditures and revenues when they become due (that is in many cases before the associated cash flows take place). It records assets and liabilities and is therefore associated with the production of statements of financial position. It is also associated with providing depreciation on assets with finite lives.

- **Modified accrual** is similar to the full accruals basis, but it is simpler because it does not involve the capitalisation of non-current assets or the provision of depreciation of non-current assets.
- **Modified cash basis**-Under this basis, the books of accounts are left open for a maximum of three months after the end of the year, so as to capture substantial amount of income or expenses relating to the year just ended. It allows a short period of time after the year-end for settling liabilities of the year just ended (and treats this expenditure as occurring in the year just ended).
- **Commitment basis**- It is a basis that records anticipated expenditure evidenced by a contract or a purchase order. In public sector financing, budgetary and accounting systems are closely related to the commitment basis.

ii. **Merits of cash basis of government accounting**

- It is simple to understand;
- It eliminates the existence of receivables and payables;
- It permits easy identification of those who authorised payments and collect revenue;
- It allows for comparison between the amount provided in the budget and that actually spent;
- It saves time and is easy to operate;
- It permits the delegation of work in certain circumstances; and
- The cost of tangible assets is written off in the year of purchase, resulting in fewer accounting entries.

iii. **Merits of accrual basis of government accounting**

- It takes a realistic view of financial transactions;
- It reveals an accurate picture of the state of financial affairs at the end of the period;
- It could be used for both economic and investment decision-making as all parameters for performance appraisal are available;
- It aligns with the 'matching concept; and
- It makes allowances for the diminution in the value of assets used to generate the revenue of the enterprise.

## Examiner's report

Part (ai.) of the question requires candidates to identify the functions Pension Transitional Arrangements Directorate (PTAD) as contained in Pension Reform Act (PRA) 2014 while part (aii) requires the candidates to identify the powers, which National Pension Commission has over the Pension Transitional Arrangements Directorate of the Federation and Federal Capital Territory.

Part (b) of the question requires the candidates to explain the concepts and bases of public sector accounting including the merits of cash basis and accrual basis.

Few candidates attempted the question and their performance was below average. The common pitfalls were the inability of the candidates to identify the functions Pension Transitional Arrangements Directorate (PTAD) and the powers, which National Pension Commission has over the Pension Transitional Arrangements Directorate of the Federation and Federal Capital Territory.

Candidates are advised to read widely and ensure they have adequate knowledge of relevant provisions of Pension Reform Act (PRA) 2014 and other extant regulations. Pathfinder and Study Text of the Institute are relevant learning materials on this aspect of the syllabus for better performance in future examinations

## Marking guide

	Marks	Marks
a. i. Identification of seven functions of the Pension Transitional Arrangements Directorate	7	
ii. Identification of three powers of the Pension Transitional Arrangements Directorate	<u>5</u>	12
b. i. Explanation of four bases of accounting	4	
ii. Identification of three merits of cash basis	3	
iii. Identification of three merits of accrual basis	<u>3</u>	<u>10</u>
<b>Total</b>		<b><u>20</u></b>

## **SOLUTION 4**

- a. i. Requirements of the Fiscal Responsibility Act as it affect time lag for preparation of Medium-Term Expenditure Framework (MTEF) and notifying the National Assembly.

Section 11 of the Fiscal Responsibility Act, 2007:

- Requires preparation and submission to the National Assembly, a medium-term expenditure framework for the next three financial years on which the National Assembly will deliberate. This would have to be done not later than six months from the commencement of the Act; and
- Subsequently, not later than four months before the next financial year, commences a medium-term expenditure framework for the next three financial years will be prepared for the National Assembly's consideration.

- ii. Documents that should accompany the estimates of revenue and expenditure of the Nigeria's annual budget:

- A macro-economic framework setting out the three financial years, the underlying assumptions and an evaluation and analysis of the macro-economic projection for the preceding three financial years;
- Fiscal strategy document setting out:
  - Federal Government's medium-term financial objectives;
  - The policies of the Federal Government for the medium term relating to taxation, recurrent expenditure borrowings, lending and investment and other liabilities;
  - The strategies, economic, social and developmental priorities of government for the next three financial years; and
  - An explanation of the financial objectives, strategic, economic, social and developmental priorities and fiscal measures;
- An expenditure and revenue frameworks which set out:
  - Estimates of aggregate revenue for the federation for each financial year, based on the pre-determined commodity reference price adopted and tax revenue projections;
  - Aggregate expenditure for each of the next three financial years;
  - Minimum capital expenditure projection for the federation for each of the next three financial years; and
  - Aggregate tax expenditure projection for the federation for each of the next three financial years.



- A consolidated debt statement indicating and describing the fiscal significance of the debt liability and measures to reduce the liability;
- A statement on the nature and fiscal significance of contingent liabilities and quasi-fiscal activities and measures to offset the crystallisation of such liabilities. The estimates and expenditure stated above should be:
  - Based on reliable and consistent data;
  - Targeted at achieving the macro-economic projection; and
  - Consistent with and derive from the underlying assumptions contained in the fiscal strategy document.

b. i. **Objectives of public sector accounting**

The main objectives of public sector accounting are as follows:

- **Determining the legitimacy of transactions and their compliance with the statutes and accepted norms.**  
Public sector disbursements should accord with the provisions of the Appropriation Act and Financial Regulations. There should be due authorisation for all payments so as to avoid misappropriation;
- **Providing evidence of stewardship.**  
The act of rendering stewardship is being able to account transparently and diligently for resources entrusted. Government and public sector officers are obliged to display due diligence and sense of probity in the collection and disposal of public funds;
- **Assisting planning and control.**  
The future is full of risks and uncertainties. Therefore, mapping out strategic plans prevents an organisation from drowning in the tides. Plans of actions provide the focus of activities, which are being pursued. The unforeseen circumstance is built into plans so as to prevent or at least reduce corporate failure. Public sector establishments should act in accordance with the 'mandate theory' of governance. Control measures are adjuncts to skillful planning. They assist in avoiding unnecessary deviations from the pursuit of the original objectives set;
- **Ensuring objective and timely reporting**  
Users of public sector accounting information are anxious to bridge their knowledge gaps on government activities. Therefore, they value prompt and accurate statistics to evaluate government performance;

- **Examining the costs incurred and the benefits derivable**  
In public sector organisations, it is difficult to measure costs and benefits in financial terms. The analysis of cost-benefit assesses the economic and social advantages (benefits) and disadvantages or inconveniences (costs) of alternative courses of actions, to ensure that the welfare of the citizens are well provided for;
- **The various sources of finance**  
Identifying and highlighting various sources of revenue receivable to execute both recurrent expenditure and capital projects is part of the responsibilities of the management. This objective is very important and statutory for governments of all tiers in order to meet their respective statutory responsibilities to the citizens in form of dividends of democracy; and
- **Proffering solutions to challenges affecting quality decision-making process**  
By all extant laws and policies, public sector is charged with the underlined responsibilities to put in place all mechanism to identify any form of challenges that may hinder smooth administration of the sector by proffering solutions to any form of problems. Based on the above skill process, decision-making process can be enhanced and made more efficient.

ii. **External users and their information needs:**

- **National Assembly:** Used for budget process and for carrying out their oversight functions;
- **Members of the public:** To have knowledge of budget and expenditure in order to evaluate the performance of the government;
- **Foreign countries:** To have idea of the finances of government towards foreign direct investments;
- **Foreign financial institutions such as International Monetary Fund (IMF), World Bank, Department for International Development (DFID), United Nations Children's Fund (UNICEF), etc.):** To determine the extent of indebtedness of the country with a view to granting it loans, aids and loan forgiveness;
- **Creditors:** To ascertain the extent of loan capability of the country; and
- **Researchers:** Academic researchers who intend to investigate certain areas of public sector may need to make use of public sector financial reports to advice the governments for future planning and better governance.

### Examiner's report

Part (ai) of the question requires the candidates to explain requirements of Fiscal Responsibility Act as it affects time lag for the preparation of the Medium-Term Expenditure Framework (MTEF) and submission to the National Assembly while, part (a ii) of the question requires the candidates to identify the documents that should accompany the estimates of revenue and expenditure of the Nigeria's annual budget to the National Assembly. Part (b) requires the candidates to identify the external users of public sector accounting reports and highlighting their information needs.

Few of the candidates attempted the question and performance was average. The common pitfalls were the inability of the candidates to explain the two requirements of the Fiscal Responsibility Act and the documents that should accompany the estimates of revenue and expenditure of the Nigeria's annual budget to the National Assembly (NASS).

Candidates are advised to read widely and ensure they have adequate knowledge of relevant provisions of MTEF and other regulations relating to public sector account for better performance in the Institute's future examinations. The Pathfinder and Study Text of the Institute are relevant learning materials on this aspect of the syllabus.

### Marking guide

	Marks	Marks
a. i. Explanation of two requirements of the Fiscal Responsibility Act as it affects time lag for preparation of MTEF and notifying the National Assembly	3	
ii. Identification of any five documents that should accompany the estimates of revenue and expenditure of the Nigeria's annual budget	<u>5</u>	8
b.i. Identification of any four objectives of public sector accounting	2	
Explanation of objectives identified	<u>4</u>	<u>6</u>
ii. Identification of external users of public sector accounting information	3	
Highlighting one information need of each of the external users identified	<u>3</u>	<u>6</u>
<b>Total</b>		<b><u>20</u></b>

## **SOLUTION 5**

### **i. Reasons why government intervene in the economy**

- **Political and social ideologies (market failure argument)**

The operation of market mechanism presupposes that the economic activities are guided by rational expectations, that is, profitability. The need for government can be explained by the existence of political and social ideologies, which is different from the principle of consumer's behaviour guided by utility satisfaction. More importantly, market forces left alone cannot perform all economic functions. Therefore, there is need to guide, regulate and supplement market forces under certain circumstances.

- **Allocation of resources**

The claim that market mechanism leads to efficient allocation of resources is based on the conditions of perfect competition, which presupposes the existence of free entry and exit, perfect knowledge of the market, mobility of factors and lack of preferential treatment among other factors. Government regulations and other measures are required to ensure the presence of these conditions, as market on its own will not guarantee their existence.

- **Healthy competition**

It is the role of government to ensure that competition exists in the production of goods and services. It is therefore expected to improve quality and increase quantity of output. However, in the absence of regulation, competition may become inefficient or at best reduced to decreasing cost.

- **Legal structure**

An important factor for effective and efficient market system is the legal structure that guarantees punishment for violators of rules and regulations. It is the responsibility of government to ensure strict adherence to rules and regulations otherwise abuse becomes an albatross to economic growth and development.

- **Externalities (natural resources)**

The case of externalities may be a potent factor to explain the rationale for government intervention. Even if the legal structure is provided and all barriers removed, certain goods and services cannot be provided through the market system due to the presence of externalities that cause distortion between private and public appraisal of projects. Externalities can only be tackled through public policy. The commercial interest of private investors may be in conflict with those of the state. A private investor, for example, authorised to mine a particular resource may likely want to make more money by extracting more than it is expected.

- **Economic objectives**

The economic objectives of full employment, general price stability, optimum growth rate, equitable distribution of income as well as soundness of foreign account cannot be brought about automatically, even in the most highly developed financial economy. Therefore government policies and other measures are to achieve these objectives.

- **Strategic or security**

Governments, set up public enterprises because of the very nature of the projects, for example currency and mint cannot be expected to be left in the hands of private investors. Similarly, some defence industries, certain research and development organisations would be better handled by the public enterprises.

- **Monopoly**

Another reason for the establishment of public undertakings is where the effective control of the economy is sought to be in the hands of the state rather than individuals. This is the argument of not permitting the emergence of monopoly in the hands of private investors. The authorities might plan to have a strategic control over the workings of the whole economy through controlling of key sectors. This is generally referred to as controlling the commanding heights of the economy from which, the movement of the economy can be guided.

### iii. **Macroeconomic objectives in Nigeria**

- **Full employment**

Full employment occurs when resources especially human capital are fully engaged in productive activities that will contribute to increase in the volume of output. It describes a situation where able-bodied people who are willing to work at the prevailing wage rate are able to find job. It does not imply 100 per cent employment but rather something around 95 per cent.

- **General price stability**

This implies moderate fluctuations (upward and downward movement) in the general price level of goods and services over a given period. A rise in the price level of goods and services that is less than 3 percent is considered good as such will stimulate investment for growth and development. Higher rise in price level say over 7 percent means a fall in the purchasing power of a unit of currency and hence unacceptable.

- **Equitable distribution of income**

A fair or equitable distribution of income means that the gap between the poor and the rich is not too wide but sufficient enough to create incentive for hard work. There should be no concentration of wealth in the hands of few individuals but rather fair spread among the people.

- **Increased economic growth rate**

This means a steady and non-inflationary increase in the volume of output of goods and services of the nation. It is the primary objective of the government to pursue policies that will enhance steady rise in national output that will not be inflationary.

- **Soundness of foreign account or balance of payment equilibrium**

The country's trade position with the rest of the world should be such that will not permit or allow persistence deficit or surplus. Any deficit or surplus should be promptly addressed to avoid being regarded as unfair dealings with other countries.

### **Examiner's report**

Part (ai) of the question requires the candidates to explain reasons why government intervenes in the economy, while part (a ii) requires the candidates to explain the macroeconomic objectives in Nigeria.

Most of the candidates attempted the question and their performance was below average.

The common pitfalls were the inability of the candidates to explain reasons why government intervenes in the economy. Also, the candidates were unable to identify macroeconomic objectives of the government.

Candidates are advised to make use of Pathfinder and Study Text of the Institute for better performance in the Institute's future examinations.

### **Marking guide**

	<b>Marks</b>	<b>Marks</b>
i. Identification of any five reasons why government intervene in the economy	$2\frac{1}{2}$	
Explanation of reasons identified	<u>5</u>	$7\frac{1}{2}$
ii. Identification of any five macroeconomic objectives in Nigeria	$2\frac{1}{2}$	
Explanation of macroeconomic objectives identified	<u>5</u>	$7\frac{1}{2}$
<b>Total</b>		<b><u>15</u></b>

## **SOLUTION 6**

a. **Criteria for decision making while choosing from different sources of international loans.**

i. **The comparative rates of interest**

In using comparative interest rates to decide between loan offers, the nominal rate of interest is rarely used. Instead comparison of loans from different countries or market sources is based on the real rate of interest, which takes into consideration the rate of inflation in the creditor countries.

Furthermore, the way the interest on the loan is charged as well as the manner of its calculation is important, as these would determine the amount to be charged. Some creditor sources might charge interest at a fixed rate, that is, a flat rate percentage of the full loan or at a variable rate, which fluctuates over the life of the loan and in accordance with financial market conditions.

ii. **The possibility of the loan being project-tied**

Where loans are applied for the execution of specific projects, a further consideration of interest rate charges may focus on the returns or benefits from the project to be financed by the loans. In such instances, the project is subjected to appropriate comparative minimum unit-cost tests using national or international yardsticks. If the project is supposed to be profit yielding, it must be ensured that there is a positive internal rate of return, which is at least equal to the cost of borrowing, while projects in the area of social services, or infrastructures are considered on the basis of their cost-benefit ratios.

iii. **Degree of concessionality**

Another criterion for loan selection where several sources of external loans are being considered is the degree of concessionality of such a loan, that is, the extent of "softness" or otherwise of the loan. The degree of concessionality is measured by the percentage of grant element present in the loan. Loans have various degrees of concessionality depending on their source and nature. Where a loan has a grant element of 100 percent, it is regarded as being totally concessional.

iv. **Repayment ability**

One of the underlying principles on which loan terms and conditions are considered before selection is the repayment ability of the borrowing country. This is of mutual benefit to the donor as well as the recipient of the loan. Before taking a loan it must be ensured that the projects and programmes for which the loan is being sourced will eventually provide sufficient income from which the debt can be serviced as and when due. A further consideration of the repayment

ability is the socio-political condition of the country. Where the government in power does not command popular credibility, it may be difficult for such to access foreign loans.

b. **Principles of debt rescheduling process**

There are three main principles that guide the Paris Club rescheduling process. These principles are discussed briefly below.

i. **Imminent default**

This principle applies to the debtor country and requires the debtor nation to prove that it will not be able to meet its external debt service obligations unless it is granted a relief. This proof can be shown through accumulation of debt service arrears. The IMF balance of payments projections of the country also serve the purpose, as these projections always provide an indication of the country's economic position. This requirement is very important, as a debtor country will be denied access to the rescheduling process without the Club being satisfied that this condition has been fulfilled.

ii. **Burden sharing**

The principle of burden sharing applies to the creditor countries. It requires the creditors to be prepared to share fairly and equitably the burden of the rescheduling in the proportion of their individual exposure to the debtor countries. In effect, the creditor must agree to provide the debtor country with relief that is commensurate with their exposure. The counterpart, from the point of view of debtors, is the principle of comparability of treatment, which extols the need for debtors to treat creditors equitably in meeting the debt service obligations.

iii. **Conditionality**

This principle, which is generally regarded as the "golden rule" of the Paris Club of Creditors also, applies to the debtor countries. It requires the debtor nation to put in place an IMF structural adjustment programmes before approaching the Club for rescheduling process. Sometimes such programmes determine the type of agreement, which the official creditors would be prepared to reach with the debtor country.

c. **Problems facing state government in financing projects through capital market**

The problems include:

- i. Poor situation of accounting on the part of a state government;
- ii. Lack of qualified personnel to effectively evaluate, appraise and monitor projects;
- iii. Poor performance of existing state government projects which act as disincentive to potential investors;



- iv. Inability of government to package and market viable projects to the investing public;
- v. Lack of awareness of the potential of the investing public;
- vi. Preference for short-term investments by the public; and
- vii. Increased debt accumulation by state governments can reduce the capacity for further borrowing from the capital market.

### Examiner's report

Part (a) of the question requires candidates to explain the criteria for decision making when contracting loan obligations from different sources of credits, while part (b) asks the candidates to explain main principles that guide the Paris Club debt-rescheduling process. Part (c) requires the candidates to discuss problems facing state governments in financing projects from capital markets.

Most of the candidates attempted the question and their performance was average. The commonest pitfalls were the inability of the candidates to explain the criteria for decision-making and main principles that guide the Paris Club debt-rescheduling process. Also, candidates could not correctly discuss problems facing state governments in financing projects from capital markets.

Candidates are advised to make use of the Pathfinder and Study Text of the Institute for better performance in the future examinations.

### Marking guide

	Marks	Marks
a Identification of any four criteria for decision making	2	
Explanation of four criteria identified	<u>4</u>	6
b. Identification of any two principles that guide the Paris Club rescheduling process	1	
Explanation of the principles identified	<u>3</u>	4
c. Discussing five problems facing state government in financing projects through capital market		<u>5</u>
<b>Total</b>		<b><u>15</u></b>

### SOLUTION 7

- a i. **Public revenue** refers to income generated by government from its activities or operations. In other words it is a segment of total funds needed to finance government activities. It may be difficult to provide a complete list of all the sources of public receipts. However, the common and important ones include taxes, fees, fines, borrowings, disposal of assets, income from public undertakings, gifts, donations, licenses, royalties, rents, rates, levies, printing of currency, and so on.

**Public receipts** cover receipts from all sources; public revenue is a narrower concept and does not include borrowings, printing of currency, grants, gifts and donations, sale of public assets and reimbursement.

- ii. There are two broad sources of revenue to the federal government of Nigeria as usually specified in the country's annual budget. These are the oil revenue and non-oil revenue. The oil revenue sources include proceeds of crude oil sales, NNPC earnings, royalties, signature fees and so on. The non-oil revenue comprises personal income tax, company income tax, excise duty, import and export taxes, value added tax, stamp duties, etc. There are also the independent revenue sources like fees, fines, levies, investment income, licences, rent, rates, etc.

The oil revenue has remained the principal source of government funding as it generates most of the foreign exchange earnings for the country. Though there are other non-oil activities contributing to gross domestic product, their contributions in terms of revenue generation have been minimal due to low revenue diversification.

b. **The problems of revenue allocation in Nigeria**

i. **Over-dependence on oil revenue**

The discovery and subsequent exploration of oil in Nigeria and its high yielding revenue has continued to undermine the development of the hitherto buoyant agriculture and other viable sectors such as industry, mining and human capital development. Consequently, oil revenue has become the major source on which the country critically depends. This has with time led to the evolving of "a leech syndrome" among the component units of the federation thereby making the states dependent on the handouts from the Federation Account. The leech nature of most of the states makes them an economic appendage of the central government and has eroded the autonomy of the federating units. This, in a way, established a master-servant relationship between the federal government and the component units. The current revenue sharing formula encourages laziness and idleness as states rely heavily on the federal allocation- a situation that makes most states, perhaps, excluding Lagos, parasitic in nature feeding voraciously on the Federation Account.

ii. **Conflicts over revenue sharing formula**

Revenue sharing among the component units of the Nigerian federation has been, from inception, replete with agitations, controversies and outright rejections due to elevation of political rather than economic considerations in making decisions. The process of revenue sharing is inundated with conflicting criteria that were, often times, rejected by majority of the states. Consequently, several attempts at revenue sharing (both vertically and horizontally) have been made, yet no

revenue sharing formula and principles have been considered acceptable among and within the tiers of government at any point in time. Due to the foregoing, the determining factor in revenue allocation strongly revolved around political rather than economic criteria, thereby making revenue allocation issue in Nigeria contentious and thorny.

iii. **Agitation for resource control**

The historical facts of the use of the principle of derivation have been a source of inter-regional or states conflict, rivalry and antagonism. The major fall out of the down play of the principle of derivation, which stipulates that the component units of a system should be able to control some of their own resources as they desire, is the agitation for resource control that has taken criminal dimensions in most of the oil producing communities and states of the Niger Delta. There have been multifarious cases of kidnapping, vandalism of oil pipelines and installations, desperations and high scale violence.

iv. **Increasing fiscal units**

The rapid changes in the number of fiscal units that is not guided by economic and political philosophy led to creation of states that are fiscally and financially unviable and consequently increased demand for increased share of the "national cake". Many states in Nigeria will blame their inactivity and ineffectiveness on low or lack of allocation from the federation account rather than become inventive and innovative in ideas that will cause increase in their mobilisation of resources. The increase in the number of fiscal units in Nigeria from 3 to 4, 12, 19, 21, 30 and 36 within a period of three and a half decades is contrary to what obtains in older and other federations thereby contributing to the unending resource control controversy.

v. **Unstable constitutional framework**

The absence of a permanent and generally acceptable legal structure in the form constitution may result in chaotic tendencies. For instance, the last constitutional conference in the United States of America was in 1787 and only 27 amendments have been made as at 1999 as opposed to Nigeria in which several constitutional conferences had taken place since independence without general acceptability. In addition, states in Nigeria do not really have the statutory power to raise taxes and collect the proceeds and as such the problem had centered not on who should raise but how the proceeds should be shared. Therefore, expenditure and tax or revenue assignment is inundated with ambiguity and inefficiency. A good example is the case of issuance of road worthiness certificate by Lagos State Ministry of Transport, which became a legal tussle between the government and some activists.

viii. **Lack of political will**

The absence of sincere desire on the part of public office holders to address the challenges of revenue sharing is aptly reflected in the refusal to convoke a conference of leaders of various groups and ethnic nationalities that may lead to design of acceptable resource allocation scheme. Even where such conferences have been convoked in the past, the will to implement suddenly disappears from the initiators.

**Examiner's report**

Part (ai) of the question asks the candidates to differentiate between public revenue and receipts and to state their sources, while part (a ii) requires the candidates to differentiate between oil and non-oil revenue. Part (b) requires the candidates to discuss problems associated with revenue allocation in Nigeria.

Most of the candidates attempted the question and their performance was above average.

The common pitfalls were the inability of the candidates to differentiate between public revenue and public receipts and state their sources. Also, few candidates were unable to discuss problems associated with revenue allocation in Nigeria.

Candidates are advised to make use of the Pathfinder and Study Text of the Institute for better performance in the Institute's future examinations.

**Marking guide**

	Marks	Marks
a. i. Definition of revenue and public receipts stating two sources each	3	
ii. Definition of oil and non-oil revenue with one example each	<u>2</u>	5
b. Identification any five problems associated with revenue allocation	2½	
Explanation of five problems identified	<u>7½</u>	<u>10</u>
<b>Total</b>		<b><u>15</u></b>

**THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA****SKILLS LEVEL EXAMINATION – MAY 2023****CORPORATE STRATEGIC MANAGEMENT & ETHICS****EXAMINATION INSTRUCTIONS****PLEASE READ THESE INSTRUCTIONS BEFORE THE COMMENCEMENT OF THE PAPER**

1. Check your pockets, purse, mathematical set, etc. to ensure that you do not have prohibited items such as telephone handset, electronic storage device, programmable devices, wristwatches or any form of written material on you in the examination hall. You will be stopped from continuing with the examination and liable to further disciplinary actions including cancellation of examination result if caught.
2. Write your **EXAMINATION NUMBER** in the space provided above.
3. Do **NOT** write anything on your question paper **EXCEPT** your examination number.
4. Do **NOT** write anything on your docket.
5. Read all instructions in each section of the question paper carefully before answering the questions.
6. Do **NOT** answer more than the number of questions required in each section, otherwise, you will be penalised.
7. All solutions should be written in **BLUE** or **BLACK INK**. Any solution written in **PENCIL** or **RED INK** will not be marked.

**THURSDAY, MAY 18, 2023****DO NOT TURN OVER UNTIL YOU ARE TOLD TO DO SO**

# THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

## SKILLS LEVEL EXAMINATION – MAY 2023

### CORPORATE STRATEGIC MANAGEMENT & ETHICS

Time Allowed: 3¼ hours (including 15 minutes reading time)

**INSTRUCTION: YOU ARE REQUIRED TO ATTEMPT FIVE OUT OF THE SEVEN QUESTIONS IN THIS PAPER**

**SECTION A: COMPULSORY QUESTION (30 MARKS)**

#### QUESTION 1

Oyinbo Industries Limited is a medium-scale enterprise involved in the processing and packaging of local (traditional) food items for the Nigerian market. Its product portfolio includes Instant Elubo Powder, Instant Pounded Yam Powder, and Instant Beans Powder, all of which have been successful in the Nigerian market. The company hopes to expand its market coverage to the United States, United Kingdom, France, Canada, and United Arab Emirates, which are believed to be viable new markets for the products.

To achieve these goals, the company hopes to start by strengthening its position in the Nigerian market. To this end, the management hopes to improve the market share, sales growth, and profitability of each business unit. In pursuit of these objectives, the company expanded its portfolio by introducing the following products into the market: Instant Plantain Powder, Instant Soya Beans Powder, and Garri Ijebu.

The table below shows current market and sales growth for each product:

	Instant Elubo Powder		Instant Pounded Yam Powder		Instant Beans Powder		*Instant Plantain Powder		*Instant Soya Beans Powder	
	Market Growth Rate	Sales Growth Rate	Market Growth Rate	Sales Growth Rate	Market Growth Rate	Sales Growth Rate	Market Growth Rate	Sales Growth Rate	Market Growth Rate	Sales Growth Rate
2020	High	Low	High	High	High	High	High	-	High	-
2021	High	Low	High	High	High	Low	High	-	High	-
2022	High	High	High	High	High	Low	High	Low	High	Low

#### \*Products introduced into the market in 2021

The company's current market growth rate for each of the products is over 10%. The fast-growing nature of the market is attributable to population growth and the growing concern about the hygienic conditions of food items sold in the open market. The company hopes to take advantage of this opportunity to become the biggest producer and exporter of processed and packaged food items in the country.

Competitors of Oyinbo Industries Limited are largely cottage industries and small-scale producers, but command substantial share of the market. Entry into the industry is not regulated. Most of the firms in the industry rely on small farmers in the rural areas of the country, and they are many. As part of its growth plan going forward, Oyinbo Industries Limited plans to acquire a large expanse of land in Kwara State for farming. The firm hopes to use this farm to secure supply of the needed raw materials.

The Company also hopes to strengthen its relationship with a local fabricator of processing equipment, which supplies the plants and machinery that the firm needs. The technology that is used in the industry has remained largely unchanged in the last 20 years.

In pursuance of its growth strategy, the firm plans to leverage on its extensive distribution network and internal production capabilities to increase its market share of existing products and push the sales of the new commodities. However, the incessant power failure and frequent breakdown of the company's equipment constitute a major concern for the management of the company.

**Required:**

Advise the management of Oyinbo Industries Limited on:

- a. Potential strategies to adopt for each product that support the company's strategic direction, using the Ansoff Growth Vector Analysis. (13 Marks)
- b. How to achieve sustainable competitive advantage, using Michael Porter's Six Principles (6 Marks)
- c. Key elements of the business environment, using the PESTEL framework. (6 Marks)
- d. The type of integration strategy being pursued and its possible drawbacks. (5 Marks)

**(Total 30 Marks)**

**SECTION B: OPEN-ENDED QUESTIONS (40 MARKS)**

**INSTRUCTION: YOU ARE REQUIRED TO ATTEMPT ANY TWO OUT OF THE THREE QUESTIONS IN THIS SECTION**

**QUESTION 2**

Every business venture has some measure of risk exposure that must be identified, measured, and adequately prepared for. Indeed, each business entity should have in place a good risk management strategy.

As a risk manager, clarify the following in ways that will be comprehensible to a greenhorn in business.

- a. Risk identification. (5 Marks)
- b. Importance of ranking risks. (3 Marks)
- c. Examine the impact of risks on categories of stakeholders. (12 Marks)

**(Total 20 Marks)**

**QUESTION 3**

The code of corporate governance prescribes corporate governance disclosures for listed companies.

- a. Explain the contents of a corporate governance statement. (12 Marks)
- b. Not all information that corporate entities can provide are mandatory. Explain the justifications and drawbacks of voluntary disclosure in corporate governance reports. (8 Marks)

**(Total 20 Marks)**

**QUESTION 4**

Richard and his wife, Rachael, have just retired as top level managers from one of the biggest oil companies in the country. They have earned vast personal wealth and have ample investments in several blue-chip companies. Rachael, being a food technologist with passion for healthy living, convinced Richard to start a company that would produce organic drinks and foods from only natural ingredients. She also suggested that the company adopt environmentally friendly manufacturing processes and consider the wellbeing of all employees and other stakeholders.

The primary reason for establishing the company is to fulfill a passion, build a sustainable and socially impactful business and not to aggressively pursue profit. Hence, both Richard and Rachael are happy to just break even at the initial stage of the business and later record minimal profits.

As an expert in business ethics, you are required to:

- a. Identify the alternative ethical stances that are available to Richard and Rachael and the ones implied in the scenario given. (4 Marks)



- b. Discuss the Gray, Owen and Adams's classification of groups of people and their views of the relationship between business organisations and society. (14 Marks)
- c. Which of the classifications in (b) above is relevant to Richard and Rachael? (2 Marks)
- (Total 20 Marks)**

**SECTION C: OPEN-ENDED QUESTIONS (30 MARKS)**

**INSTRUCTION: YOU ARE REQUIRED TO ATTEMPT ANY TWO OUT OF THE THREE QUESTIONS IN THIS SECTION**

**QUESTION 5**

Creative and critical thinking are essential skills that chartered accountants should possess for optimal performance.

- a. Differentiate between creative and critical thinking. (4 Marks)
- b. Explain the modes through which creative thinking are expressed. (8 Marks)
- c. Explain how creative thinking of employees benefit their employers. (3 Marks)
- (Total 15 Marks)**

**QUESTION 6**

- a. Using the Kohlberg's stages of moral development, identify and explain the reasons why individuals make their decisions when faced with moral dilemma. (12 Marks)
- b. Explain the criticisms of Kohlberg's stages of moral development. (3 Marks)
- (Total 15 Marks)**

**QUESTION 7**

Gbam Telecoms Plc, a leading mobile phone and internet communications company, is planning to roll out its 5<sup>th</sup> Generation (5G) spectrum. As a new product, the 5G spectrum promises customers high speed internet with immense possibilities in computing, big data management, robotics and other numerous benefits. While a section of the populace believes that the roll-out is a welcome development, others express reservations about the 5G technology. Within Gbam Telecoms Plc, some employees believe that the erratic nature of the country's power supply could damage the 5G transponders. Also, the high cost of diesel would increase the company's operating costs, thus making the product largely unaffordable to prospective consumers. There are also security threats to the company's facilities due to heightened insecurity in the country. The umbrella trade union for the company's employees is also agitating for pay rise and hazard allowance should the company go ahead with the 5G roll-out. Some experts believe that the market for 5G spectrum in the country today is negligible because most telecommunication and internet devices used by consumers in the market are not 5G-compliant. There are also reports that the competitors of Gbam Telecoms Plc are studying how the market will respond

to Gbam Telecoms' 5G spectrum before deciding to enter the market. In addition, a study carried out in Europe concluded that 5G spectrum may be hazardous to the health of people living close to 5G transponders. There is also news about the development of new and better technologies called 6G and 7G, which may make 5G become obsolete within a short period of time.

Consequently, the management of Gbam Telecoms Plc is concerned about the attendant risks that are associated with the 5G spectrum roll-out.

- a. Advise the management of Gbam Telecoms Plc on the enterprise and operational risks that could be associated with the roll-out of 5G spectrum using information contained in the given scenario. (11 Marks)
- b. Suggest to Gbam Telecoms Plc the key elements that should be contained in the company's Risk Management System. (4 Marks)

**(Total 15 Marks)**

## SOLUTION 1

- i. The Ansoff growth vector analysis believes in the existence of a link between current and future products and markets of firms. The Ansoff growth vector analysis is summarised with a 2X2 matrix

		Product	
		Existing products	New products
Market	Existing market	Market penetration strategy	Product development strategy
	New market	Market development strategy	Diversification strategy

The table shows potential strategy to pursue for existing and new products in existing and new market,

From the given scenario, all of Oyinbo Foods Limited's products are in a high growth market. Also, all of them have varying degrees of sales growth. The table below shows the potential strategies to adopt for each product in the existing market.

Product	Sales Growth	Market Growth	New or Existing Product	Potential strategies
Instant Elubo Powder	High	High	Existing	Market penetration strategy
Instant Pounded Yam Powder	High	High	Existing	Market penetration strategy
Instant Beans Powder	High	High	Existing	Market penetration strategy
Instant Plantain Powder	Low	High	New	Product development strategy
Instant Soya Beans Powder	Low	High	New	Product development strategy

The table above shows the potential strategies to adopt for all products in the local market based on the information contained in the scenario and using the Ansoff growth vector matrix. However, the firm is hoping to export these products into the international market which are new markets. Strategies for these new (international) market are:

<b>Product</b>	<b>Product</b>	<b>Potential strategies</b>
Instant Elubo Powder	Existing	Market development strategy
Instant Pounded Yam Powder	Existing	Market development strategy
Instant Beans Powder	Existing	Market development strategy
Instant Plantain Powder	New	Diversification
Instant Soya Beans Powder	New	Diversification

**Market penetration:** selling more of the existing products in its existing market. The high growth rate of the market will make this strategy easier and more successful. Aggressive marketing will help the firm to increase sales.

**Product development:** Producing new products or altering existing products to give more value to the customer in existing market.

**Market development:** Opening up new markets for existing products.

**Diversification:** Introducing new products into new markets.

ii. Michael Porter proposed six principles that can help a firm achieve sustainable competitive advantage. These are:

- Principle 1: The strategic goal of the firm should be to achieve superior long-term return on investment.
- Principle 2: The strategy must offer unique value proposition to the customer. The value proposition is a combination of price and benefits that competitors do not offer;
- Principle 3: There should be a distinctive value chain. In other words, a firm should perform similar activities to competitors, but in a different way that offers more value to customers;
- Principle 4: Selected strategy will always involve trade-off. That is by selecting one set of strategic option, a company inevitably chooses not to select alternative options;
- Principle 5: All different elements in the strategy and in the value- chain should link together and reinforce each other; and
- Principle 6: There should be continuity of strategic direction. There should be consistency in the application of the chosen strategy.

iii. Application of the PESTEL model into the scenario is as follows:

- **P:Political Environment**  
Political factors that could have strong influence on business entities and other organisations.

The scenario suggests a stable political environment that will have neutral impact on the business because no mention was made about any political factor;

- **E: Economic environment**

Economic influences on an entity's wellbeing. Examples include: market growth, population changes, Gross Domestic Product variations etc.

From the given scenario, the company operates in a high growth market which provides opportunity for the company to grow its sales;

- **S: Social environment**

This is the socio-cultural factors inherent in the operating environment of the firm that influences its wellbeing. Examples include the attitude, beliefs and customs of the people.

The demand for the firm's product is indigenous to most of the consumers. As such the success of the firm in the market is in part, tied to the people's tradition;

- **T: Technology environment**

Changes in science and technology that may positively or negatively affect the firm's output, process or sales.

From the given scenario, the technology environment has been stable for over 20 years;

- **E: Ecological environment**

Factors inherent in the physical environment that can influence the firm's performance. Such factor includes flood, hurricane and other forms of natural disaster. It also includes availability of vegetation which supports living; and

The case study suggests a stable ecology environment because no such factors was mentioned.

- **L: Legal environment**

Laws and regulations affecting an entity.

iv. The firm is planning to pursue a backward integration.

This is when an entity enters the product market of its suppliers.

Drawbacks of backward integration are:

- **Inefficiencies:** Backward integration could distract the company from its core activity in which it had developed competencies since inception. This

distraction could affect the level of efficiency in its core activity;

- Substantial investment: funds that could have been used for other activities would be used in setting up the new business; and
- The company will have to start climbing the learning curve of the new business in the area of management and operations.

### Examiner's report

This compulsory question on strategic management tests in Part:

- a. The use of Ansoff Growth Vector Analysis to determine the appropriate strategies for products in line with a company's strategic direction;
- b. The use of Michael Porter's Six Principles to achieve sustainable competitive advantage;
- c. The use of PESTEL framework to discuss key elements of a business environment; and
- d. Identification of integration strategy adopted in a scenario and highlighting the drawbacks of the strategy.

Virtually all the candidates attempted this question as it was compulsory.

Most of the candidates performed poorly in this question, especially in parts which required application of the principles to the scenario.

The common pitfalls were inability of many candidates to apply the concepts and frameworks to the scenario. Also, a good number of the candidates were not familiar with Ansoff Growth Vector Analysis and Michael Porter's Six Principles to achieve competitive advantage.

In preparation for future examinations, candidates should endeavour to cover the syllabus fully and master the art of applying principles to situations, as this is the distinguishing feature between examination at the foundation and skills levels.

### Marking guide

	Marks per Point	Number of point/s	Sub-total	Total
a. Ansoff Matrix	$\frac{1}{4}$	10	$2\frac{1}{2}$	
Drawing the matrix	$\frac{1}{2}$	1	$\frac{1}{2}$	
Potential strategies (Local Market)	$\frac{1}{2}$	5	$2\frac{1}{2}$	
Potential strategies (international market)	$\frac{1}{4}$	10	$2\frac{1}{2}$	
Explanation of potential strategies	1	4	4	

	Identification of products for international market	1	1	<u>1</u>	13
b.	Porter's six principles	1	6	<u>6</u>	6
c.	<b>PESTEL</b>				
	Mentioning	$\frac{1}{4}$	6	$1\frac{1}{2}$	
	Definitions	$\frac{1}{4}$	6	$1\frac{1}{2}$	
	Relating each environmental factor with the scenario	$\frac{1}{2}$	6	<u>3</u>	6
d.	Identification of type of integration	1	1	1	
	Definition of backward integration	1	1	1	
	Drawbacks	1	3	<u>3</u>	
				<b>Total</b>	<u>5</u> <b><u>30</u></b>

## SOLUTION 2

- a. Risk identification is the first stage in a system of risk management.
- i. A company needs to understand what risks it faces, both in its environment and markets (strategic risks) and internally (operational risks).
  - ii. There are no standard rules about how risks should be identified. In a large company, it might be appropriate to identify risks at different levels in the organisation – on a group-wide basis, and for each business division and for each department or function.
  - iii. Management might be responsible for identifying strategic risks/business risks for the company, but the internal auditors or external auditors might be more efficient at identifying operational risks (and suggesting suitable internal controls to mitigate the risks).
  - iv. Many large companies set up **risk committees** to identify risks. These are committees of managers from several departments or functions. Each member of the committee is responsible for reporting on a particular category of risk or risks in a particular geographical area of the company's operations. The committee meets regularly to discuss risks and their potential significance, and changes in these risks.
- b. Risks identified by a company will vary in importance. Some risks might be unimportant, or easily controlled. Some other risks will be very significant. Having identified risks, it is necessary to assess the importance of each risk, in order to:

- i. Be able to rank the risks in order of significance (order of priority);
  - ii. Identify the risks that are the most significant; and
  - iii. Identify the significant risks where control measures are urgently needed.
- c. Risks for a company also create risks for its stakeholders. Management should be aware of the impact of the company's risks on stakeholders, because the risks for stakeholders could affect the attitude and the behaviour of stakeholders towards the company.

The impact of a company's risks on risks for stakeholders varies and depends on circumstances. The impact of company's risk on stakeholders is disclosed as follows:

**i. Employees**

Employees are exposed to several risks in their job. These include the risk of a loss of job, and the threat to health or safety in the work that they do. Employment benefits might be threatened. These risks to employees can be affected by risks that face their company.

Jobs may be threatened by the strategic choices taken by a company. If a company makes the wrong strategic decisions, and the company loses money, many employees could lose their jobs.

Safety risks for a company might be measured in terms of the risk of serious injuries and minor injuries to employees over a given period of time. (For example, a company might assess its current safety measures in terms of the expected number of serious injuries per 1,000 employees per year.)

The risk appetite of some employees might differ from the risk appetite of the company and the board's policy on risk. For example, a 'rogue trader' working in the financial markets for a bank might be willing to take high risks for the company because the potential benefits for him personally (a large cash bonus for making large trading profits) exceeds the risk (the possible loss of his job).

**ii. Investors**

When investors buy the shares of a company, they have some expectation of the sort of company it is and the returns they might expect from their investment. For example, an investor might buy shares in a company expecting it to be a high-risk company which could achieve a very high rate of growth in the share price. Or an investor might buy shares in a company because the company is stable and can be expected to pay a regular annual dividend.



The board of directors should try to ensure that the risk appetite of the company is consistent with the risk appetite of its shareholders (and other stock market investors). A company should not expose itself to strategic risks that expose the investors to a risk to their investment that the shareholders would consider excessive. When a company increases its exposures to strategic risk, many existing shareholders might decide to sell their shares and switch to investing in a lower-risk company. Investors with a larger risk appetite might buy the shares.

The board of directors should keep shareholders informed about the significant risks that the company faces, so that investors can assess their own investment risk. (In Nigeria and the UK, for example, stock market companies are now required by law to include disclosures about risks in their annual narrative report to shareholders, the business review).

### **iii. Lenders**

The main risks to a company's lenders from the company's own risks are that the company will not pay what it owes.

A high-risk company is a high credit risk. The liquidity risk and insolvency risk facing a company has an impact on the credit risk for a supplier or lender. When a company asks a bank for a loan, the bank will assess the credit status of the company, and it will make its decision to lend on the basis of whether it thinks that the company will be able to pay back the loan with interest and on schedule.

### **iv. Communities and the public**

Communities and the public are exposed to risks from the actions of companies, and the failure by companies to control their risks.

Risks to the public include:

- The consequences for the country of a decline in the business activities and profits of a company due to recession, especially when the company is a major employer;
- Health and safety risks from failures by a company to supply goods that meet with health and safety standards;
- Risks to the quality of life from environmental pollution, due to a failure by the company to control its environmental/pollution risks;
- Risks to a local community also arise from economic risks faced by the company. If a company is forced to close down a production plant in an area where it is a major employer, the economy of the entire community would be affected;
- Pressure groups and popular action groups come into existence because 'activist' members of the general public believe that their

well-being is threatened. The cause of the perceived threat is often the activities of companies; and

- Some companies take risk-based decisions that expose them to considerable strategic risk without necessarily considering fully the risk impact on the general public or local communities. For example, an energy company planning to construct a new nuclear power station should consider the long-term risks to the community – and the general public – not just their own business risks in relation to costs.

v. **Governments**

For governments, companies are a source of economic wealth for the country. They create additional economic activity which creates extra wealth, and they provide employment and tax revenues for the government. They also act as the vehicle through which the government provide infrastructures and public services such as road, potable water, electricity, etc. Therefore, when such companies that were given contracts to provide such goods and services fail, the ability of the government to deliver public goods could be hampered.

vi. **Customers**

Some risks facing companies also have an impact on their customers. A company might face operational risks from human error or system breakdown in its operations. Errors and delays in providing goods and services have an impact on business customers. For example, if a company is late in supplying a key component to a business customer, the customer will be late in supplying its own customers. Errors and delays work their way through the entire supply chain.

Product safety risks for a company are also a risk for customers who use them. For example, manufacturers of food products, drink products and medicines and drugs need to consider the potential risk to customers from weaknesses in their own safety controls.

vii. **Business partners**

There are risks in joint ventures for all the joint venture partners. A company in a joint venture might try to dominate decision-making to reduce the risk that the joint venture will not operate in the way that they want it to.

However, by reducing its exposures to risk in a joint venture, a company will affect the risks for the other joint venture partners.

Risks in partnerships can be controlled for all the partners – to some extent – by clear terms in the contract agreement between the partners, and by monitoring performance of the partnership.

viii. **Suppliers**

Loss of business: if the business is not growing, there will be no supply.  
Loss of revenue to suppliers due to the failure of customers' businesses.

Negative impact on supplier's cash flow caused by customers' inability to pay.

**Examiner's report**

This question on risk management, tests risk identification, importance of ranking risks and the impact of a company's risks on its stakeholders.

About 80% of the candidates attempted this question, with good performance. The few candidates who performed poorly could not state the importance of ranking risks.

Candidates are advised to endeavour to grasp the essence of principles to the practice of the profession.

**Marking guide**

	Description	Marks per point	No. of Points	Sub-total	Total
a	Stage of risk identification in the risk management process	$\frac{1}{2}$	1	$\frac{1}{2}$	
	Relevance of risk identification	$1\frac{1}{2}$	3	<u><math>4\frac{1}{2}</math></u>	5
b	Ranking of risk	1	3		3
c	Impact of risk on stakeholders				
	• Mentioning	$\frac{1}{2}$	6	3	
	• Explanation	$1\frac{1}{2}$	6	<u>9</u>	
				<b>Total</b>	<u><u>12</u></u> <b>20</b>

**SOLUTION 3**

a. Specific contents of corporate governance statement vary across different countries. However, best practice requires corporate governance statement to contain the following:

i. Statement about the modus operandi of the board, including high level statements about which matters are reserved for the board and which

decisions are delegated to the management;

- ii. Names of the chairman, CEO, senior independent directors and chairmen of the nominations, audit, and remunerations committee;
- iii. The names of non-executive directors that the board considers to be independent. Reasons should be given where this is appropriate;
- iv. The other significant commitments of the chairman, and changes in these commitments during the year;
- v. A statement about the performance evaluation of the board, and how this has been conducted;
- vi. A statement about the steps the board has taken to ensure that the directors are informed about the opinion of the company's major shareholders;
- vii. A section of the company's annual report describing the work of the remunerations committee;
- viii. A description of the remunerations committee;
- ix. An explanation of the directors' responsibility for preparing financial statements;
- x. A statement by the directors that the company is a going concern;
- xi. A report that the board has carried out a review of the company's system of internal control;
- xii. If the company does not have an internal audit department, the reason why it does not;
- xiii. If the company's auditors provide non-audit services to the company, an explanation of how the auditors' objectivity and independence are safeguarded;
- xiv. The terms of reference for the nominations, remunerations and audit committee;
- xv. The terms and conditions of appointment of Non-Executive Directors (NED); and
- xvi. When papers are sent to shareholders for a general meeting where there will be a proposal to elect or re-elect a NED, a statement by the board on why the individual should be elected must be made.

**b. Justifications for voluntary disclosure are:**

- i. Voluntary disclosures could be used for public relations and marketing through the provision of positive information about the company to the public. This could be a means to attracting investors and impressing other users of the company's published reports;

- ii. Providing information on voluntary basis might persuade the government or financial services regulator that compulsory disclosure and regulation are not necessary;
- iii. Companies might publish social and environmental reports out of a genuine ethical and cultural beliefs in the responsibilities of the company to society and the environment; and
- iv. A company might use voluntary disclosure as a way of improving communication with its shareholders.

**Drawbacks of voluntary disclosure are:**

- i. It is the prerogative of companies to include or exclude some information which might be useful to some of the company's stakeholders.
- ii. Due to the fact that such information is presented in a very positive form, its reliability could be in doubt.

**Examiner's report**

This question tests knowledge of the contents of a corporate governance statement in an annual report, justification and drawbacks of voluntary disclosures in corporate governance reports.

About 70% of the candidates attempted this question, but performance was poor.

The poor performance was attributable to the confusion of the contents of a corporate governance statement with elements of corporate governance by many candidates.

Candidates are admonished to study the contents of the syllabus well and carefully respond to questions in the examination.

**Marking guide**

	Description	Mark per point	Number of points	Sub-total	Total
a	Content of corporate governance statement	1	12	12	12
b	Justification	2	3	6	
	Drawbacks	2	1	<u>2</u>	
				<b>Total</b>	<u>8</u> <b>20</b>

## **SOLUTION 4**

### **a. Ethical stances**

- i. **Stance 1:** Maximising short-term shareholder interests (the 'least ethical' of the four stances), which usually is to make profit.
- ii. **Stance 2:** Maximising long-term shareholder interests.
- iii. **Stance 3:** Multiple stakeholder obligations: recognising obligations to different stakeholder groups.
- iv. **Stance 4:** Being a shaper of society.

### **Inferences from the scenario**

The stance may be inferred as stance 3 or stance 4. These are:

- i. **Stance 3:** There is a commitment to wellbeing of employees and other stakeholders.
- ii. **Stance 4:** The Company is interested in shaping society.

### **b. Gray, Owen, and Adams' classification**

#### **i. Pristine capitalists**

This position is dominant in the world of accounting and finance. The only responsibility of a company is to make money for its shareholders and to maximise shareholder wealth.

Shareholders have invested the risk capital and are the legal owners of their company. It therefore follows that only the shareholders should have any right to decide the strategies and policies of the company.

This pristine capitalist view is based on rational self-interest and putting individual self-interest before the collective benefits of society as a whole. The market economy is a good thing. There are no environmental problems because human beings are inventive and adaptable: the market economy will find solutions to the world's environmental problems.

#### **ii. Expedients**

Individuals who have an 'expedient' view also believe that the main aim of a company is to maximise the wealth of its shareholders. However, some concessions have to be made at times to other stakeholders in order to put the company in a stronger position strategically. By doing so, it is more likely to maximise shareholder's wealth.

A simple example may be that a company may pursue a policy to protect the environment, or may support a charity, to improve its reputation and customer loyalty.

This 'expedient' position is taken by people with a longer-term view than pristine capitalists, who recognise that economic success can only be achieved by companies by accepting certain social responsibilities.

iii. **Proponents of the social contract**

These individuals believe that companies and other organisations exist at the will of society, and there is a 'social contract' between the company and the society in which it operates. Companies therefore have a responsibility and an obligation to respond to the needs of society.

A company must therefore act in accordance with standards of behaviour that society finds acceptable. If it does not, society will not allow the company to continue. This is a right-based perspective in which the rights of all human beings are considered significant. Holders of this view would argue that government regulation might be necessary for the market economy because free market prices do not properly reflect all the effects that companies have on society and its environment (for example, pollution and other environmental damage).

iv. **Social Ecologists**

Individuals taking this position are concerned for the social environment. They believe that companies and other large organisations have been responsible for creating social and environmental problems. They should therefore be held responsible for dealing with those problems and finding solutions to them.

v. **Socialists**

These individuals believe that there should be a significant re-adjustment in the ownership of assets and in the structure of society. They criticise all forms of domination, including the governments of a nation state, concentrated economic power (large companies) and authoritarianism.

vi. **Radical Feminists**

These individuals believe that society and social systems are dominated by an aggressive masculine view of the world. This is harmful and wrong. There is an urgent need for more feminine values to guide attitudes, such as care, compassion, and co-operation.

vii. **Deep Ecologists/Deep Greens**

These individuals are at the opposite extreme to pristine capitalists. They believe that human beings have no greater right to existence than any other form of life. Ethical decisions should be based on concerns for all forms of life.

- c. The classifications relevant to Richard and Rachael is that of the Social Ecologists because they showed concern for the environment by the insistence that all their products and processes must be environmentally friendly.

## Examiner's report

This business ethics question requires candidates to:

- a. Identify alternative ethical stances;
- b. Discuss Gray, Owen and Adams' classification of people's views on relationship between organisations and society; and
- c. Apply Gray, Owen and Adams' classification to a scenario.

About 70% of the candidates attempted this question, with average performance.

The average performance was due to poor discussion of the Gray, Owen and Adams' classification by some candidates and inability of some to apply the classification to the scenario.

Candidates are advised to pay particular attention to application of principles and concepts to scenarios.

### Marking guide

	Description	Mark per point	Number of points	Sub-total	Total
a	Alternative ethical stance	$\frac{1}{2}$	4	<u>2</u>	
	Inferences from the scenario	1	2	2	4
b	Grey, Owen, and Adam classification:				
	Identification	1	7	7	
	Explanation	1	7	<u>7</u>	14
c	Relevance of classification:				
	Identification of social ecologist	1	1	1	
	Justification	1	1	<u>1</u>	
				<b>Total</b>	<u><u>2</u></u> <b>20</b>

### SOLUTION 5

- a. The differences between creative thinking and critical thinking are:  
Creative thinking is described as:
  - i. Making and communicating connections to think of many possibilities;
  - ii. Thinking and experiencing in various ways and use different points of view;



- iii. Thinking of new and unusual possibilities; and
- iv. Giving guidance in generating and selecting alternatives.

Critical thinking is described as:

- i. Analysing and developing possibilities to compare and contrast many ideas;
- ii. Improve and refine ideas;
- iii. Make effective decisions and judgments; and
- iv. Provide a sound foundation for effective action.

b. Creative thinking are expressed in the following modes:

- i. **Analysis**  
Creative thinking usually starts with a clear understanding of the matter at hand. Many problems are usually complex, hence, requires a process of analysis to break them down to simpler units which can be easily managed. This requires critical examination of materials, including texts, data, plans, designs, budgets, etc.
- ii. **Open-mindedness**  
To think creatively, one must remove any preconceived ideas, assumptions or biases to provide opportunities for fresh ideas and perspectives. This requires open mindedness.
- iii. **Problem-solving**  
One of the main benefits of creative thinking is in problem-solving, most especially, when the problem is not following a usual trend or pattern. New models or thoughts may be required to address them.
- iv. **Organisation**  
Organisation is an essential part of creativity. To be creative one must be able to thread patterns which may not be easily discernible by all to form a logical or physical whole. A creative mind will be able to put together the pieces of a jig saw puzzle to form a whole picture. This is organisation. Though at the analytical stage it seems the pieces are disorganised as they are dissembled, thus creating a similitude or disorganisation usually associated with creative people.
- v. **Communication**  
People will only appreciate your creative idea or solution if you communicate it effectively. You need to have strong written and oral communication skills. Creative thinking requires effective listening to fully understand the issues involved.

- c. **Benefits of creative thinking are:**
- i. Generates new sources of income or enhances existing source, through innovation.
  - ii. Creates new products.
  - iii. Finds new uses for existing products.
  - iv. Creates new markets.
  - v. Leads to improved bottom lines.

### **Examiner's report**

This question on soft skills requires candidates to distinguish between creative and critical thinking, explain modes of expression of creative thinking and discuss benefits employees' creativity to organisations.

About 50% of the candidates attempted this question.

Despite the fact that the requirements of the question are direct, performance was poor.

It is obvious that many candidates are not conversant with this aspect of the syllabus, as many could neither distinguish between creative and critical thinking, nor explain modes of expression of creative thinking.

Candidates and their trainers are enjoined to pay particular attention to the study of soft skills in the syllabus, as these skills are crucial to becoming future-ready chartered accountants.

### **Marking guide**

	Description	Marks per point	Number of points	Sub-total	Total
a.	Features of creative thinking	1	2	2	
	Features of critical thinking	1	<u>2</u>	2	4
b.	Modes of expressing creative thinking:				
	Mentioning	1	4	4	
	Explanation	1	4	<u>4</u>	8
c.	Benefits of creative thinking	1	3	3	
				<b>Total</b>	<u>3</u> <u>15</u>

## **SOLUTION 6**

a. Kohlberg's stages of moral development are

i. **Stage 1: Obedience and punishment orientation:**

At Stage 1, individuals judge right and wrong on the basis of the direct consequences for them of the actions they take. An action is bad if the individual knows that he (or she) will be punished for it. The worse the punishment, the greater the moral wrong. An action is good if the individual knows that he will receive some benefits.

ii. **Stage 2: Individualism and exchange**

At Stage 2, the individual (often a child) recognises that there is no single view of what is right and what is wrong. Different individuals have different points of view. 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. When faced with a moral dilemma, the individual's decision is based on: 'What's in it for me?'

iii. **Stage 3: Good interpersonal relationships**

The Individual now enter society and see morality as more than making deals for personal benefit. The individual believes that they should live up to the expectations of family, friends and the community. The individual is aware of the approval or disapproval that they receive from other people, and try to live up to their expectations. The individual enjoys respect and gratitude, and their moral outlook is based on how this will be obtained.

iv. **Stage 4: Maintaining social order**

At Stage 4, 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.

v. **Stage 5: Social contract orientation**

Individuals think about society differently from the conventional way. They take 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 recognise that people are different and have the right to their own views and opinions.

vi. **Stage 6: Universal ethical principles**

At this stage, 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. An individual makes moral decisions

because they are right, not because they are a means to an end, or because the action is legal or expected.

**b. Criticisms of the Kohlberg’s stages of moral development are:**

- i. At Stages 5 and 6, individuals put their own principles above society and the law, which is a dangerous moral stance to take.
- ii. Some critics believe that Kohlberg’s views have a cultural bias, because his ideas are based on Western philosophical traditions. His views might not apply to non-Western cultures;
- iii. Some expert argue that Kohlberg’s views had a gender bias. 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; and
- iv. It is also believed that Kohlberg’s stages of moral development lack empirical evidence.

**Examiner’s report**

This question requires candidates to use Kohlberg’s stages of moral development to explain individuals’ decision-making in situations of moral dilemma and highlight criticisms of the stages.

About 60% of the candidates attempted this question. General performance was above average.

The candidates who performed poorly could not critique the stages as required by the question.

Candidates must develop the skill for critical appraisal of issues, concepts, and principles, as it is essential for the practice of the profession of accountancy.

**Marking guide**

	Description	Mark per point	Number of points	Sub-total	Total
a.	Kohlberg’s stage of moral development:				
	Mentioning	1	6	6	
	Explanation	1	6	<u>6</u>	12
b.	Criticism	1	3	3	
				<b>Total</b>	<u>3</u> <b>15</b>

## **SOLUTION 7**

- a. Enterprise risks, also called strategic risks, speculative risks, or two-way risks, are said to exist when future outcome of a decision can be good or bad for the firm. They are risks that must be borne as the firm strives to make profit. Enterprise risks are mostly unavoidable.

Based on information contained in the scenario, the enterprise risks that Gbam Telecoms Plc may face in the new 5G spectrum business are as follows:

- i. Risk of loss as a result of lack of adequate patronage of 5G spectrum service by customers;
- ii. Competitors may offer the same service at a cheaper cost leading to reduced patronage;
- iii. A new but better technology might make 5G obsolete;
- iv. The risk that 5G might have some adverse effects on the health of people; and
- v. Risk that consumers might not change their devices to those with 5G capabilities.

Operational Risks or Pure Risks are:

- Those risks that an adverse event might occur; and
- This kind of risks are mostly controllable.

The operational risks that Gbam Telecoms might incur, include:

- i. The risk that the 5G technology might not actually work in Nigeria;
- ii. Heightened insecurity in the country could put the company's equipment at risk;
- iii. Rising energy costs might drive up operational costs, prices, and consequently reduce demand;
- iv. The rise in operational costs occasioned by the demand for a pay rise and hazard allowance by employees through the trade union; and
- v. Risk of disruption in the roll-out plan due to work stoppages caused by industrial disputes arising from employees' demand for pay rise and hazard allowance.

b. **Elements of a Risk Management System are:**

- i. A culture of risk awareness must be entrenched in the entity. Employees within the organisation must be aware of the risk appetite of the firm and work within this tolerance level to optimise organisational outcomes;
- ii. A system of identifying, assessing and measuring risks must be established. This will facilitate effective risk management;

- iii. An efficient and effective risks information communication system must be in place to provide the decision maker with adequate and timely information to facilitate effective risk management; and
- iv. Effective monitoring and feedback mechanism should be in place to ensure that risk management strategies are modified, changed or updated as necessary.

### **Examiner's report**

This question requires candidates to advise on enterprise and operational risk management and discuss key elements of a company's risk management system.

About 70% of the candidates attempted this question, but performance was just average.

Some candidates could not differentiate between enterprise and operational risks. A substantial number of them could not discuss elements of a risk management system. The poor attempts could only be attributed to inadequate preparation by the affected candidates, as this topic is often tested.

Candidates are admonished to prepare well before registering for the examination.

### **Marking guide**

DESCRIPTION	Mark per point	Number of points	Sub-total	Total
a. Definition of enterprise risk	1	1	1	
Enterprise risks from the given scenario	1	5	5	
Definition of operational risk	1	1	1	
Operational risks from the given scenario	1	4	<u>4</u>	11
b. Elements of risk management system	1	4	4	
			<b>Total</b>	<u>4</u> <b>15</b>

**THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA****SKILLS LEVEL EXAMINATION – MAY 2023****TAXATION****EXAMINATION INSTRUCTIONS****PLEASE READ THESE INSTRUCTIONS BEFORE THE COMMENCEMENT OF THE PAPER**

1. Check your pockets, purse, mathematical set, etc. to ensure that you do not have prohibited items such as telephone handset, electronic storage device, programmable devices, wristwatches or any form of written material on you in the examination hall. You will be stopped from continuing with the examination and liable to further disciplinary actions including cancellation of examination result if caught.
2. Write your **EXAMINATION NUMBER** in the space provided above.
3. Do **NOT** write anything on your question paper **EXCEPT** your examination number.
4. Do **NOT** write anything on your docket.
5. Read all instructions in each section of the question paper carefully before answering the questions.
6. Do **NOT** answer more than the number of questions required in each section, otherwise, you will be penalised.
7. All solutions should be written in **BLUE** or **BLACK INK**. Any solution written in **PENCIL** or **RED INK** will not be marked.
8. Tax and Capital Allowances rates are provided with this examination paper.

**TUESDAY, MAY 16, 2023****DO NOT TURN OVER UNTIL YOU ARE TOLD TO DO**

# THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

## SKILLS LEVEL EXAMINATION – MAY 2023

### TAXATION

Time Allowed: 3¼ hours (including 15 minutes reading time)

**INSTRUCTION: YOU ARE REQUIRED TO ATTEMPT FIVE OUT OF SEVEN QUESTIONS IN THIS PAPER**

**SECTION A: COMPULSORY QUESTION (30 MARKS)**

#### QUESTION 1

Fadeke, Femi, Kola and Gbenga have been in partnership as medical practitioners for eight years. The statement of profit or loss for the year ended December 31, 2021 is as follows:

	₦	₦
Gross income		224,500,000
Direct expenses		<u>(48,700,000)</u>
Gross profit		175,800,000
Deduct:		
Salaries and wages	72,000,000	
Rent and rates	1,500,000	
Transport and travelling	825,000	
Telephone and telex	210,000	
Motor running expenses	680,000	
Allowance for doubtful debts	310,000	
Miscellaneous expenses	1,450,000	
Other professional charges	360,000	
Audit fees	500,000	
Bank charges and commission	1,122,500	
Depreciation	1,240,600	
Interest on loan:		
Fadeke	300,000	
Femi	240,000	
Kola	180,000	
Gbenga	150,000	
Interest on capital:		
Fadeke	1,250,000	
Femi	1,250,000	
Kola	1,250,000	
Gbenga	1,250,000	
Passage and leave allowance:		
Fadeke	660,000	
Femi	660,000	



Kola	660,000	
Gbenga	<u>660,000</u>	<u>88,708,100</u>
Net profit for the year		<u>87,091,900</u>

**Additional information:**

- (i) Included in salaries and wages is ₦1,200,000 paid for each of the partners.
- (ii) Rent and rates comprise:

	₦
Rent paid to partner – Fadeke	1,440,000
Rates	<u>60,000</u>
	<u>1,500,000</u>

- (iii) Miscellaneous expenses:

These include:

Donation to a church in the hometown of Fadeke	50,000
Allowance paid to the domestic staff of Femi	240,000
Cost of repairs and maintenance of the residence of each partner totaling	840,000
Office repairs	<u>320,000</u>
	<u>1,450,000</u>

- (iv) Capital allowances agreed with the revenue was ₦980,000
- (v) Profits are to be shared equally amongst the partners
- (vi) Fadeke and Femi are married with three and two children, respectively
- (vii) Fadeke has a life assurance policy of ₦960,000 on which she pays ₦96,000 annually as premium
- (viii) Fadeke maintains her aged father who is over 68 years

**Required:**

For the relevant assessment year:

- a. Compute the income of the partnership (5 Marks)
- b. Compute the income tax liability of each of the partners (25 Marks)

**(Total 30 Marks)**

**SECTION B: OPEN-ENDED QUESTIONS (40 MARKS)**

**INSTRUCTION: YOU ARE REQUIRED TO ATTEMPT ANY TWO OUT OF THE THREE QUESTIONS IN THIS SECTION**

**QUESTION 2**

The Personal Income Tax Act Cap.P8 LFN, 2004 (as amended) defines “employment”, whilst the Labour Act Cap.L1 LFN, 2004 (as amended), defines “contract of employment.”

An individual’s liability to income tax is often determined according to whether or not a person receiving the income is resident in a State for a particular year of assessment. A taxpayer is, therefore, liable to the tax authority of the territory in which he is deemed to be resident for a year of assessment.

**Required:**

- a. Differentiate between “contract of employment” and “contract for employment”.  
(8 Marks)
  - b. Explain the rules guiding the determination of residence for **SIX** categories of individuals for tax purposes.  
(12 Marks)
- (Total 20 Marks)**

**QUESTION 3**

Taxation has been defined as the imposition of compulsory levies on individuals and entities by governments in most countries in the world. The primary objective of taxation is essentially to generate revenue or raise money for government expenditure on social welfare.

You were appointed as the accountant of Specks Nigeria Limited on August 31, 2022. Based on self assessment, the company filed the audited financial statements for year ended December 31, 2021, together with its tax computations on June 7, 2022, and the relevant tax liabilities were fully paid on same date.

On August 31, 2022, the Federal Inland Revenue Service raised an assessment that was not in line with the tax returns. At the meeting of the directors held in September 2022, this issue was discussed and you were mandated to quickly address same so that the assessment would not become final and conclusive.

**Required:**

- a. When will an assessment become final and conclusive? (5 Marks)
  - b. Discuss the following in relation to objection and appeal procedures:
    - (i) Time limit for objection and appeal (4 Marks)
    - (ii) Contents of a notice of objection (4 Marks)
    - (iii) Amendment of assessment and notice of refusal to amend (NORA) (7 Marks)
- (Total 20 Marks)**

#### QUESTION 4

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 income tax computation for beginners during the firm's training session.

You are provided with the following information relating to Wizzy-Baddo Limited, which commenced business on September 1, 2020:

	<b>Adjusted Profit (₦)</b>
Period to December 31, 2020	6,937,500
Year ended December 31, 2021	9,300,500

The following assets were acquired as follows:	<b>₦</b>
June 5, 2020 – Land and building	5,467,500
July 1, 2020 – Motor vehicle	10,000,000
October 15, 2020 – Machinery	4,375,000
February 28, 2021 – Furniture	3,458,000
May 1, 2021 – Delivery van	4,750,000

**Required:**

**For the relevant assessment years;**

- a. State the basis periods for assessable profits and qualifying capital expenditure (5 Marks)
  - b. Compute the capital allowances (15 Marks)
- (Total 20 Marks)**

**SECTION C:**

**OPEN-ENDED QUESTIONS**

**(30 MARKS)**

**INSTRUCTION:**

**YOU ARE REQUIRED TO ATTEMPT ANY TWO OUT OF THE THREE QUESTIONS IN THIS SECTION**

#### QUESTION 5

Multiple taxation is a tax regime under which various and similar taxes are imposed on taxpayers by different tiers of government. This has become a national problem discouraging taxpayers from performing their civic responsibilities.

The 1999 Constitution of the Federal Republic of Nigeria seeks to eliminate multiple taxation at all levels of government as provided for in Part II, paragraph 7 to 10.

**Required:**

- a. Explain **FOUR** Constitutional and other possible solutions provided on how to eliminate multiple taxes. (10 Marks)
  - b. State **FIVE** possible causes of multiple taxation. (5 Marks)
- (Total 15 Marks)**

**QUESTION 6**

Fountain Hotels Limited is a group of hotels located in many parts of North Central Nigeria providing accommodation and other hospitality services. It renders its returns at the end of each month in accordance with the Value Added Tax Act 2004 (as amended).

The following are the details of the transactions for the month of July 2022:

	₦
VAT on outdoor catering services	600,000
VAT on food	360,000
VAT on drinks	240,000
VAT on other vatable hotel services	270,000
VAT on drinks purchased	150,000
VAT on foodstuff purchased	210,000
VAT on kitchen equipment	480,000
VAT on professional services	240,000

**You are also provided with the following additional information:**

- (i) 30% of outdoor catering services were on credit
- (ii) 20% of food and drinks were on credit
- (iii) Other vatable hotel services were paid for in full.
- (iv) 25% VAT on drinks and foodstuff purchased were on credit.
- (v) VAT on kitchen equipment and professional services were paid for in full.

**Required:**

- a. Compute the VAT remittable to the Federal Inland Revenue Service in respect of July 2022 transactions. (9 Marks)
- b. Write short notes on the following:
  - (i) Revenue VAT (2 Marks)
  - (ii) Zero rated supplies and services (2 Marks)
  - (iii) VAT on export (2 Marks)

**(Total 15 Marks)**

## QUESTION 7

The Federal Government in a bid to further boost the growth in foreign exchange earnings, create new jobs, facilitate economic diversification, industrialisation and provide access to foreign technology, came up with its export processing zones (EPZs) policy.

EPZ is regarded as a customs area where an enterprise is allowed to import plant, machinery, equipment and raw materials, process them, and then export them to the world market, under security and without paying duty.

To facilitate better understanding of the above assertions, the Managing Director of a would-be client approached you for the explanations of the relevant provisions of the Nigerian Export Processing Zones Act Cap. N107 LFN 2004 (as amended) and Companies Income Tax Act Cap. C21 LFN 2004 (as amended).

### Required:

- a. Discuss **SIX** special tax incentives for enterprises operating in an export processing zone. (12 Marks)
- b. Explain the penalties for non-compliance with section 55(1) of CITA (as amended). (3 Marks)

**(Total 15 Marks)**

## NIGERIAN TAX RATES

### 1. CAPITAL ALLOWANCES

	<b>Initial %</b>	<b>Annual %</b>
Building Expenditure	15	10
Industrial Building Expenditure	15	10
Mining Expenditure	95	Nil
Plant Expenditure (excluding Furniture & Fittings)	50	25
Manufacturing Industrial Plant Expenditure	50	25
Construction Plant expenditure (excluding Furniture & Fittings)	50	Nil
Public Transportation Motor Vehicle	95	Nil
Ranching and Plantation Expenditure	30	50
Plantation Equipment Expenditure	95	Nil
Research and Development Expenditure	95	Nil
Housing Estate Expenditure	50	25
Motor Vehicle Expenditure	50	25
Agricultural Plant Expenditure	95	Nil
Furniture and Fittings Expenditure	25	20

### 2. INVESTMENT ALLOWANCE

10%

### 3. RATES OF PERSONAL INCOME TAX

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

	<b>Taxable Income</b>	<b>Rate of Tax</b>
	<b>(₦)</b>	<b>(%)</b>
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: FINANCE ACT 2019 SPECIFIES:

30% (Large Company)

20% (Medium-Sized Company)

0% (Small Company)

### 5. TERTIARY EDUCATION TAX: 2% OF ASSESSABLE PROFIT (UP TO DECEMBER 31, 2021)

2.5% OF ASSESSABLE PROFIT (With Effect from January 1, 2022)

### 6. COMPANIES INCOME TAX RATE

30%

### 7. TERTIARY EDUCATION TAX

(2% of Assessable Profit)

### 8. CAPITAL GAINS TAX

10%

### 9. VALUE ADDED TAX

7.5%

### 10. HYDROCARBON TAX

15% (Petroleum prospecting License and Marginal Fields Companies)

30% (Petroleum Mining Lease Companies)

## SOLUTION 1

a) **Fadeke, Femi, Kola and Gbenga**  
**Computation of computed income of the partnership**  
**For the year ended December 31, 2021 (Assessment year 2022)**

Net profit for the year	₦	87,091,900
Add:		
Allowance for doubtful debts	310,000	
Donation to a church in the home town of Fadeke	50,000	
Allowance paid to the domestic staff of Femi	240,000	
Repairs and maintenance of the residence of each partner	840,000	
Depreciation	<u>1,240,600</u>	<u>2,680,600</u>
Adjusted profit		89,772,500
Capital allowances		<u>(980,000)</u>
Computed income		<u>88,792,500</u>

b) **Computation of partners' income tax liabilities**

	Fadeke ₦	Femi ₦	Kola ₦	Gbenga ₦	Total ₦
Share of profit	22,198,125	22,198,125	22,198,125	22,198,125	88,792,500
Interest on loan	300,000	240,000	180,000	150,000	870,000
Interest on capital	1,250,000	1,250,000	1,250,000	1,250,000	5,000,000
Passage and leave allowance	660,000	660,000	660,000	660,000	2,640,000
Partner's salary	1,200,000	1,200,000	1,200,000	1,200,000	4,800,000
Rent	<u>1,440,000</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>1,440,000</u>
Tax exempt items	27,048,125	25,548,125	25,488,125	25,458,125	103,542,500
Life insurance premium	<u>(96,000)</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>(96,000)</u>
<b>Gross income</b>	26,952,125	25,548,125	25,488,125	25,458,125	103,446,500
<b>Consolidated relief allowance</b> ₦200,000 or 1% of gross income, whichever is higher plus 20% of gross income	<u>(5,659,946)</u>	<u>(5,365,106)</u>	<u>(5,352,506)</u>	<u>(5,346,206)</u>	<u>(21,723,764)</u>
<b>Chargeable income</b>	<u>21,292,179</u>	<u>20,183,019</u>	<u>20,135,619</u>	<u>20,111,919</u>	<u>81,722,736</u>
Income tax liability					
First ₦300,000 @ 7%	21,000	21,000	21,000	21,000	84,000
Next ₦300,000 @ 11%	33,000	33,000	33,000	33,000	132,000
Next ₦500,000 @ 15%	75,000	75,000	75,000	75,000	300,000
Next ₦500,000 @ 19%	95,000	95,000	95,000	95,000	380,000
Next ₦1,600,000 @ 21%	336,000	336,000	336,000	336,000	1,344,000
Next ₦18,092,179 @ 24%	4,342,123				4,342,123
Next ₦16,983,019 @ 24%		4,075,925			4,075,925
Next ₦16,935,619 @ 24%			4,064,549		4,064,549
Next ₦16,911,919 @ 24%				<u>4,058,861</u>	<u>4,058,861</u>
<b>Income tax payable</b>	4,902,123	4,635,925	4,624,549	4,618,861	18,781,458

**Withholding tax:**

Rent	(144,000)				(144,000)
Interest on loan	<u>(30,000)</u>	<u>(24,000)</u>	<u>(18,000)</u>	<u>(15,000)</u>	<u>(87,000)</u>
<b>Net income tax payable</b>	<u>4,728,123</u>	<u>4,611,925</u>	<u>4,606,549</u>	<u>4,603,861</u>	<u>18,550,458</u>

**Examiner's report**

The question tests candidates' knowledge of the computation of income of a partnership and the income tax liabilities of partners.

This being a compulsory question, about 100% of the candidates attempted the question. The performance of the candidates was average.

The commonest pitfalls of the candidates were their inability to identify allowable expenses in the determination of computed income of the partnership and compute the consolidated relief allowance.

Candidates are advised to read widely and be conversant with the provisions of the Personal Income Tax Act Cap. P8 LFN 2004 (as amended) before sitting for subsequent examinations to enhance better performance.

**Marking guide**

a)	<b>Computation of the income of the partnership</b>	<b>Marks</b>	<b>Marks</b>
Heading	- Name	1/2	
	- Computation of computed income	1/2	
	- Assessment years	1/2	
	Net profit	1/2	
	Allowance for doubtful debts	1/2	
	Donation to church	1/2	
	Domestic allowance	1/2	
	Repairs and maintenance	1/2	
	Depreciation	1/2	
	Capital allowances	1/2	
			<u>5</u>



<b>b) Computation of partners' income tax liabilities</b>		
Share of profit – ( $\frac{1}{2}$ mark each for any correct amount)		2
Interest on loan – ( $\frac{1}{2}$ mark each for any correct amount)		2
Interest on capital - ( $\frac{1}{2}$ mark each for any correct amount)		2
Postage and leave allowance - ( $\frac{1}{2}$ mark each for any correct amount)		2
Partners' salary - ( $\frac{1}{2}$ mark each for any correct amount)		2
Rent		$\frac{1}{4}$
Life insurance premium		$\frac{1}{4}$
Consolidated relief allowance – ( $\frac{1}{4}$ mark each for any correct amount)		1
Income tax liability:		
( $\frac{1}{2}$ mark each for any correct amount)		12
Withholding tax - Rent		$\frac{1}{2}$
- Interest on loan ( $\frac{1}{4}$ mark for each correct amount)		<u>1</u>
<b>Total</b>		<u><u>25</u></u>
		<u><u>30</u></u>

## SOLUTION 2

### (a) Contract of employment and contract for employment

The Personal Income Tax Act Cap. P8 LFN 2004 (as amended) defines employment to include any appointment or office, whether public or otherwise, for which remuneration is payable, and “employee” and “employer” shall be construed accordingly.

However, the Labour Act 1994, defines a contract of employment as “any agreement whether written or verbal, expressed or implied, whereby one person agrees to serve the employer as a worker.”

A contract for employment is an agreement whereby a person is engaged as an independent contractor, such as a self-employed person or vendor engaged for a fee to carry out an assignment or a project for the company. In a contract for employment, there is no employer-employee relationship in the contract and the self- employed person is not covered by the Labour Act.

An individual under a contract of employment is commonly referred to as an employee, while an individual under a contract for employment is referred to as an independent contractor or self-employed person. The following distinctions can be drawn between a contract of employment and a contract for employment:

- i. An individual under a contract of employment earns remuneration (that is, salary), while an individual under a contract for employment earns profit;
- ii. An individual under a contract of employment is assessed to tax on

actual year basis, while an individual under a contract for employment is assessed to tax on preceding year basis;

- iii. A self-employed person is required to register for value added tax, while an employee is not required to do so; and

An employee has the right not to be unlawfully dismissed and to receive redundancy payment and other employment rights, while a self-employed person does not have such rights.

(b) **Residence of different categories of individuals**

Liability to income tax is often determined according to whether a person receiving income is resident in a State for a particular year of assessment. A taxpayer is therefore liable to the tax authority of the territory in which he is deemed to be resident for a year of assessment. The following rules guide the determination of residence:

- (i) An individual whether in employment or whose only sources of income are unearned income is deemed to be resident for a year of assessment in the territory in which he has a place available for his domestic use in Nigeria on the first day of January of the assessment year, and does not include any hotel, rest house or other place at which he is temporarily lodging;
- (ii) An executor is deemed to be resident in the territory in which the deceased individual was last deemed to be resident or would have been deemed to be resident if the law had been in force prior to the date of his death;
- (iii) A trustee of any trust or settlement is deemed to be resident where all the income of the settlement or trust for a year of assessment arises. Where the income arises in more than one territory or where the tax authority cannot be determined, the Federal Inland Revenue Service is the tax authority;
- (iv) Partners in partnership are deemed to be resident where the principal office or the place of the partnership is situated on the first day of that year or is first established during the year;
- (v) A village or an indigenous community is deemed to be resident in the territory in which the community is found;
- (vi) An itinerant worker is deemed to be resident where he is found in a year of assessment;
- (vii) An individual not being a person assessable by FIRS (S. 2, 1 (b) ) who holds a foreign employment on the 1st day of January in a year of assessment or who first becomes liable to income tax in Nigeria for that year by reason of his entering that employment during that year, shall be deemed to be resident for that year in the territory in which the

principal office of his employer is situated on that day or on the day his foreign employment commences as the case may be; and

- (viii) An individual whose only source of earned income arising in Nigeria on the 1<sup>st</sup> day of January in a year of assessment was a pension, or who had a place or principal place on that day shall be deemed to be resident for that year in the territory in which that place or principal place of residence was situated on that day.

### **Examiner's report**

The question tests candidates' knowledge of the differences between "contract of employment" and "contract for employment", and rules guiding the determination of residence of individuals for tax purposes.

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

The commonest pitfalls of the candidates were their inability to differentiate between "contract of employment" and "contract for employment". Some of the candidates could not explain the rules guiding the determination of residence of individuals for tax purposes.

Candidates are advised to read widely by making use of relevant texts on taxation of individuals, ICAN Pathfinder and Study Text.

### **Marking guide**

	<b>Marks</b>
a) <b>Differentiation between "contract of employment" and "contract for employment"</b> (2 marks each for any correct point subject to a maximum of 4 points)	8
b) <b>Explanation of the rules guiding the determination of residence for six different categories of individuals for tax purposes</b> (2 marks each for any correct point subject to a maximum of 6 points)	<u>12</u>
<b>Total</b>	<u>20</u>

## **SOLUTION 3**

### **a) Final and conclusive assessment**

An assessment raised on a company is said to be final and conclusive where:

- i. No valid objection or appeal has been lodged against the amount of total profit assessed on a company within the time statutorily allowed for that purpose; or
- ii. The amount of total profit has been agreed by the taxpayer after his objection; or
- iii. The amount of total profit has been determined on appeal.

### **b) i. Time limit for objection and appeal**

If any company disputes a tax assessment raised on it by the tax authority, it may give a notice of objection, to the Federal Inland Revenue Service, seeking a review or revision of the assessment. However, the time limit for objection is within thirty days from the date of service of the notice of assessment.

Also, a company aggrieved by an assessment or demand notice made upon it by the FIRS or aggrieved by any action or decision of the FIRS, such as refusal to amend an assessment; may appeal against such decision or assessment or demand notice within thirty days from the date on which a copy of the order or decision which is being appealed against is made, or deemed to have been made by the FIRS.

### **ii. Contents of a notice of objection**

In line with the provision of Section 69 of Companies Income Tax Act Cap C21 LFN 2004 (as amended), for a notice of objection to be valid, it must:

- Be in writing, delivered in persons, by courier service or via electronic mail and addressed to the Chairman, Federal Inland Revenue Service;
- State the grounds of objection, namely:
  - Amount of assessable and total profits of the company for the relevant assessment year; and
  - Amount of tax which the taxpayer claims is payable for the year of assessment.
- Be raised within thirty days of the date of service of the notice of assessment.

- iii. Amendment of assessment and refusal to amend If any company disputes an assessment raised on it by the FIRS, it may apply to the FIRS, by notice of objection in writing, delivered in person, by courier service, email or any other electronic means, as directed by the Service, to review and revise the assessment made upon it. Therefore, the company must ensure that its objection:
- Is made within thirty days from the date of service of the notice of assessment; and
  - Contains the ground of objection to the assessment, that is:
    - The amount of assessable and total profits of the company for the relevant year of assessment; and
    - The amount of tax payable for the year, which the company claims should be stated on the notice of assessment.

On receipt of the notice of objection referred to above, the FIRS may require the company giving the notice of objection to furnish such particulars as the FIRS may deem necessary and to produce all books or other documents relating to the profits of the company, and may summon any person who may be able to give evidence relating to the assessment to attend for examination by an officer of the FIRS on oath or otherwise.

In the event of any company assessed, which has objected to an assessment made upon it, agreeing with the FIRS as to the amount at which it is liable to be assessed, the assessment shall be amended accordingly, and notice of the tax payable shall be served upon such company.

However, if the company fails to agree the amount at which the company is liable to be assessed with the FIRS, the FIRS shall give notice of refusal to amend the assessment as desired by such company and may revise the assessment to such amount as the FIRS may, according to the best of its judgement, determine and give notice of its revised assessment and of the tax payable together with the notice of refusal to amend the revised assessment.

### **Examiner's report**

The question tests candidates' knowledge of when an assessment can be final and conclusive. Additionally, candidates are expected to explain objection and appeal procedures.

About 50% of the candidates attempted the question but the performance was average.

The commonest pitfall of the candidates was their inability to explain the amendment of assessment and notice of refusal to amend (NORA).

Candidates are advised to read widely and make use of the Institute's Pathfinder and Study Text in their preparations for subsequent examinations.

### Marking guide

	Marks	Marks
a) <b>When an assessment is final and conclusive</b>		
i. No valid objection	1	
ii. No valid appeal	1	
iii. Time statutorily allowed (30 days)	1	
iv. Total profit agreed by the taxpayer after objection	1	
v. Total profit has been determined on appeal	<u>1</u>	5
b) i. <b>Time limit for objection and appeal</b>		
Notice of objection	1	
Time limit for objection (30 days after the date of receipt of assessment)	1	
Appeal against such decision or assessment	1	
Time limit for appeal against such decision or assessment (30 days after the date of receipt of refusal to amend)	<u>1</u>	4
ii. <b>Contents of a notice of objection</b>		
➤ Be in writing	½	
➤ Addressed to the Chairman (FIRS)	½	
➤ State grounds of objection		
- Amount of assessable and total profits	1	
- Amount of tax payable	1	
➤ Notice of objection to be raised within 30 days of the date of service of notice of assessment	<u>1</u>	4
iii. <b>Amendment of assessment and notice of refusal of amend (NORA)</b>		
➤ Notice of objection must be in writing and delivered in person, courier servicer or any electronic device	1	
➤ Objection to be filed within 30days from the date of service of the notice of assessment	1	
➤ Grounds of objection:		
- Amount of assessable and total profits	1	
- Amount of tax payable	1	
➤ Furnishing of such particulars as the FIRS may deem necessary	1	
➤ Agreeing with the FIRS as to the amount at which it is liable to be assessed	1	
➤ FIRS shall give notice of refusal to amend the assessment	<u>1</u>	<u>7</u>
<b>Total</b>		<u><u>20</u></u>

## **SOLUTION 4**

a) **Wizzy – Baddo Limited**

### **Determination of basis periods for assessable profit**

<b>Year of assessment</b>	<b>Basis period</b>
2021	1/9/2020 - 31/12/2020
2022	1/1/2021 – 31/12/2021

### **Determination of basis periods for qualifying capital expenditure (QCE)**

<b>Year of assessment</b>	<b>Basis period</b>
2021	1/9/2020 - 31/12/2020
2022	1/1/2021 – 31/12/2021

b) **Computation of capital allowances  
for 2021 and 2022 assessment years**

Assessment year	I.A AA Inv. A	Land and building 15% 10%	Motor vehicle 50% 25%	Machinery 50% 25% 10%	Furniture 25% 20%	Delivery van 50% 25%	Capital allowances
<b>2021</b> (1/9/20 - 31/12/20)	Cost	₦	₦	₦	₦	₦	₦
	I.A	5,467,500	10,000,000	4,375,000	-	-	-
	AA	(820,125)	(5,000,000)	(2,187,500)	-	-	8,00,625
	Inv A	(154,913)	(416,667)	(182,292)	-	-	753,872
		(154,913)		-			<u>437,500</u>
		<u>4,492,462</u>	<u>4,583,333</u>	<u>2,005,205</u>			<u>9,198,997</u>
W.D.V c/f to A.Y. 2022 2022 (1/1/21 – 31/12/21)	Cost	-	-	-	3,458,000	4,750,000	-
	I.A	-	-	-	(864,500)	(2,375,000)	3,239,500
	AA	<u>(464,738)</u>	<u>(1,250,000)</u>	<u>(546,875)</u>	<u>(518,700)</u>	<u>(593,750)</u>	<u>3,374,063</u>
W.D.V c/f to A.Y. 2023		4,027,724	3,333,333	1,458,333	2,074,800	1,781,250	<u>6,613,563</u>

**Examiner's report**

The question tests the candidates' knowledge of the determination of basis periods and computations of capital allowances on commencement of business.

About 70% of the candidates attempted the question but performance was fair. The commonest pitfalls of the candidates were their inability to ascertain the basis periods and prorate annual allowance on commencement of business.

Candidates are advised to read ICAN Study Text and Pathfinders when preparing for subsequent examinations to ensure better performance in future.



## Marking guide

(a) Basis periods for assessable profits and QCE	Marks	Marks
Name of company	1/2	
Heading - assessable profit	1/4	
2021 assessment year	1/2	
2022 assessment year	1/2	
Basis period - 1/9/2020 – 31/12/2022	1/2	
- 1/1/2021 – 31/12/2021	1/2	
 Heading - qualifying capital expenditure (QCE)	 1/4	
 2021 assessment year	 1/2	
2022 assessment year	1/2	
Basis period - 1/9/2022 – 31/12/2022	1/2	
- 1/1/2021 – 31/12/2021	<u>1/2</u>	5
<b>(b) Computation of capital allowances</b>		
Heading - Computation of capital allowances	1/2	
- 2021 and 2022 assessment years	1/2	
2021 assessment year	1/2	
Cost (1/2 mark each for any correct amount)	1 1/2	
Initial allowance (1/2 mark for any correct amount)	1 1/2	
Total of initial allowance	1	
Annual allowance (1/2 mark for each correct amount)	1 1/2	
Total of annual allowance	1/2	
2022 assessment year	1/2	
Cost (1/2 mark each for any correct amount)	1	
Initial allowance (1/2 mark for any correct amount)	1	
Total of initial allowance	1	
Investment allowance	1	
Annual allowance (1/2 mark for any correct amount)	2 1/2	
Total of annual allowance	<u>1/2</u>	
<b>Total</b>		<u><u>15</u></u> <u>20</u>

## SOLUTION 5

(a) The 1999 Constitution of the Federal Republic of Nigeria seeks to eliminate multiple taxation at all levels of government as provided for in Part II, Paragraphs 7 to 10, which state that:

- i. In the exercise of its powers to impose any tax or duty on:
- Capital gains, incomes or profits or persons other than companies; and
  - Documents or transactions by way of stamp duties.

The National Assembly may, subject to such conditions as it may prescribe, provide that the collection of any such tax or duty or the administration of the law imposing it, shall be carried out by the government of a state or other authority of a state.

- ii. Where an Act of the National Assembly provides for the collection of tax or duty on capital gains, incomes or profit or the administration of any law by an authority of a state in accordance with paragraph 7 thereof, it shall regulate the liability of persons to such tax or duty in such manner as to ensure that such tax or duty is not levied on the same person by more than one state.
- iii. A House of Assembly may, subject to such conditions as it may prescribe, make provisions for the collection of any tax, fee or rate or for the administration of the law providing for such collection by a local government council.
- iv. Where a law of a House of Assembly provides for the collection of tax, fee or rate or for the administration of such law by a local government council in accordance with the provisions hereof, it shall regulate the liability of persons to the tax, fee or rate in such manner as to ensure that such tax, fee or rate is not levied on the same person, in respect of the same liability by more than one local government council.

**Other possible solutions to multiplicity of taxes in Nigeria include:**

- i. Streamlining the number of taxes in Nigeria in view of the low yields of many of the taxes. This will involve the review of current statutory provisions in Nigeria;
- ii. Reviewing all the existing taxes in Nigeria and harmonise where necessary, as recommended by various study groups;
- iv. Reviewing the Constitution to address the overlap in taxing rights and limit the number of taxes that can be imposed by different levels;
- iv. Abolishing any unorthodox method of tax collection and implementing technology for tax administration; and
- v. Limiting the number of revenue agencies.

**(b) The possible causes of multiple taxation in Nigeria are:**

- i. The number of taxes which local governments have constitutional rights to collect is a major cause of multiple taxation;
- ii. Lack of funding, particularly, for most States may result in multiple taxation where the Service attempts to source for funds through levying of tax notwithstanding whether such tax is being levied either by the Federal or local governments;
- v. Some of the State governments deliberately deny their local governments the revenue due to them. Consequently, a local

- government as a way of survival, desperately and aggressively focuses on any revenue drive that will generate revenue to them;
- iv. Lack of tax education and awareness;
  - v. All the tiers of government usually fail to adequately fund their departments and agencies;
  - vi. Multiplicity of revenue agencies;
  - vii. Overlapping taxing rights as contained in the Constitution and the Taxes and Levies (Approved List for Collection) Act, Cap. T2 LFN, 2004; and
  - viii. Manual tax administration system and unorthodox tax collection.

### **Examiner's report**

The question tests candidates' understanding of the possible causes, and constitutional and other possible solutions to the elimination of multiple taxation.

About 80% of the candidates attempted the question but performance was fair.

The commonest pitfalls of the candidates were their inability to explain the constitutional provisions on how to eliminate multiple taxation.

Candidates are advised to read widely before sitting for the Institute's examinations and be abreast of developments in tax matters.

### **Marking guide**

	<b>Marks</b>	<b>Marks</b>
<b>(a) Elimination of multiple taxes</b>		
For stating that:		
- The 1999 Constitution of the Federal Republic of Nigeria seeks to eliminate multiple taxation;	1	
- The National Assembly provides for the collection of any duty or tax and it shall be carried out by the government of a State or any other authority;	1	
- An Act of National Assembly regulates the liability of persons to specified taxes and such taxes shall not be levied on the same person by more than one State;	1	
- A House of Assembly makes provisions for the collection of specified taxes, levies, etc; and	1	

- A House of Assembly shall ensure that the tax is not levied on the same person in respect of the same liability by more than one local government council. 1
- Other possible solutions  
(1 mark each for any correct solution) 5 10
- (b) **Causes of multiple taxation**  
(1 mark each for any 5 correct solutions) 5  
15

### SOLUTION 6

- (a) **Fountain Hotels Limited**  
**VAT remittable to the Federal Inland Revenue Service (FIRS)**  
**In respect of July 2022 transactions**

<u>Output VAT</u>	₦	₦
VAT on outdoor catering (70% of ₦600,000)	420,000	
VAT on drinks (80% of ₦360,000)	288,000	
VAT on foodstuff (80% of ₦240,000)	<u>192,000</u>	900,000
Less		
<u>Input VAT</u>		
VAT on drinks (75% of ₦150,000 )	112,500	
VAT on foodstuff (75% of ₦210,000)	<u>157,500</u>	<u>(270,000)</u>
<b>Amount remittable</b>		<u><u>630,000</u></u>

#### NOTE

Based on the provisions of the Finance Act, 2019, VAT remittance is now “cash based” as against “invoice based”.

- (b) i. **Revenue VAT**  
This is the tax payable on the sale of taxable goods or services which is ultimately paid by the final consumer of the goods or services.

**ii. Zero-rated supplies and services**

Certain goods and services are classified as zero-rate. These goods and services are within the ambit of VAT Act, but the applicable rate is 0%.

These include:

- Non oil exports;
- Goods and services purchased by diplomats; and
- 'Humanitarian donor funded project includes project undertaken by non- government organisations, religious and social clubs or societies recognised by law whose activity is not for profit and in the public interest.

**iii. VAT on export**

All exported goods and services are exempted from VAT. This is in line with the concept of destination principle, which allows for value added taxes to be retained by the country where the taxed product is being sold / consumed.

**Examiner's report**

The question tests the candidates' knowledge of computation of VAT remittable to Federal Inland Revenue Service (FIRS), taking into consideration hotel services rendered on credit and credit purchases made.

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

The commonest pitfall was the candidates' inability to compute VAT remittable to Federal Inland Revenue Service (FIRS), taking into consideration hotel credit services rendered and credit purchases made.

Candidates are advised to read relevant study materials, VAT Act and circulars issued by FIRS for subsequent examinations.

**Marking guide**

(a) Remittance of VAT to FIRS	Marks	Marks
Heading - Name	½	
- VAT remittable to FIRS	½	
- In respect of July 2022 transactions	½	
Output VAT - Outdoor catering	1½	
- VAT on drinks	1½	
- VAT on foodstuff	1½	
Output VAT - VAT on drinks	1½	
- VAT on foodstuff	<u>1½</u>	9

(b) i. <b>Revenue VAT</b> (1 mark each for any two points)	2	
ii. <b>Zero-rated supplier and services</b> (1 mark each for any two points)	2	
iii. <b>VAT on export</b>		
Exemption of exported goods from VAT	1	
Concept of destination principle	<u>1</u>	<u>6</u>
	<b>Total</b>	<b><u>15</u></b>

## **SOLUTION 7**

- (a) Special tax incentives for enterprises in an export processing zone – section 18(1) of Nigeria Export Processing Zones Act Cap. N107 LFN 2004 (as amended).

**Approved enterprises within the zones shall be entitled to the following incentives:**

- i. Legislative provisions pertaining to taxes, levies, duties and foreign exchange regulations shall not apply within the zones;
- ii. Repatriation of foreign capital investment in the Zones at any time with capital appreciation of the investment;
- iii. Remittance of profits and dividends earned by foreign investors in the zones;
- iv. No import or export licenses' shall be required;
- v. Up to 25% of production may be sold in the customs territory against a valid permit and on payment of appropriate duties;
- vi. Rent-free land at construction stage; thereafter rent shall be as determined by the authority;
- vii. Up to 100% foreign ownership of business in the zones allowable; and
- viii. Foreign managers and qualified personnel may be employed by companies operating in the zones.

**Export processing zone allowance – section 35 of CITA (as amended)**

- i. An export processing zone allowance is granted to a company, which has incurred expenditure in its qualifying building and plant equipment in an approved manufacturing activity in an export processing zone. The rate is 100% capital allowance in any assessment year but the company will not be entitled to an investment allowance. Only the tax

written down value of the assets shall be carried forward at the end of the tax holidays.

- ii. The profit or gains of a 100 percent export oriented undertaking established within and outside an export free zone shall be exempt from tax for the first three consecutive assessment years provided that;
- The undertaking is 100 percent export oriented;
  - The undertaking is not formed by splitting or breaking up or reconstructing a business already in existence;
  - It manufactures, produces and exports articles during the relevant year and the export proceeds form 75 per cent of its turnover;
  - The undertaking is not formed by transfer of machinery or plants previously used for any purpose to the new undertaking or where machinery or plant previously used for any purpose is transferred does not exceed 25 per cent of the total value of the machinery of the undertaking; and
  - The undertaking repatriates at least 75 per cent of the export earnings to Nigeria and places it in a domiciliary account in any registered and licensed bank in Nigeria.
- b. Companies registered and operating in the zone shall comply with the provisions of section 55(1) of CITA (as amended) and render returns in the manner prescribed therein, to the Federal Inland Revenue Service, in order to enjoy the exemption from taxes, levies, duties and foreign exchange regulations in accordance with section 8 of the Act and relevant provisions of BOFIA 2020.

All penalties prescribed in CITA and the Federal Inland Revenue Service (Establishment) Act, 2007, may apply to such companies in the event of non-compliance with section 55(1) of CITA.

### **Examiner's report**

The question tests the candidates' knowledge of the special tax incentives and penalties for enterprises operating in an export processing zone.

About 80% of the candidates attempted the question but the performance was below average.

The commonest pitfall was the candidates' inability to explain special tax incentives for enterprises operating in an export processing zone.

Candidates are advised to pay attention to this particular aspect of the syllabus.

**Marking guide**

	<b>Marks</b>
a. <b>Special tax incentives</b> (2 marks each for any six incentives)	<b>12</b>
b. <b>Penalties for non-compliance with Section 55 (1) of CITA (as amended)</b> Penalties prescribed in CITA and FIRS (Establishment) Act, 2007	<u><b>3</b></u>
<b>Total</b>	<u><b>15</b></u>