THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

PATHFINDER

NOVEMBER 2024 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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ICAN/242/Q/B1 **Examination No....................**

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – NOVEMBER 2024

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 any other **COLOUR OF INK** will not be marked.
8. You are required to attempt **Question ONE (Compulsory)**, **TWO Questions in Section B and TWO Questions in Section C.**
9. Check that you have collected the correct question paper for the examination you are writing.

TUESDAY, NOVEMBER 19, 2024

DO NOT TURN OVER UNTIL YOU ARE TOLD TO DO SO

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA
SKILLS LEVEL EXAMINATION – NOVEMBER 2024

FINANCIAL REPORTING

Time Allowed: $3^1/_4$ 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

The following is the trial balance of Konko-Below Plc for the year ended March 31, 2023.

	Dr. ₦'m	Cr. ₦'m
Land and building	1,350	
Plant and machinery	780	
Investment properties:		
Valuation at April 1, 2022	450	
Purchases	391	
Operating expenses	78	
Loan interest paid	10	
Rental of leased plant	110	
Dividend paid	75	
Inventories at April 1, 2022	189	
Trade receivables	266	
Revenue		1,392
Income from investment property		23
Ordinary shares at ₦1 each (fully paid)		750
Retained earnings at April 1, 2022		598
8% loan notes		250
Accm. depreciation at April 1, 2022:		
- Buildings		300
- Plant		130
Trade payables		167
Deferred tax		62
Bank overdraft		27
	3,699	**3,699**

Additional Information:

(i) The land and buildings were purchased 15 years before the beginning of the period. The cost of the land was ₦350million. No land and buildings have been purchased by Konko-Below Plc since that date. On April 1, 2022 Konko-Below PLC had its land and building professionally valued at ₦400million and ₦875million respectively. The directors wish to incorporate these values into the financial statements. The estimated life of the buildings was originally 50 years and the remaining life has not changed as a result of the valuation.

- Later, the estate valuer Messers Ajasoco and company informed Konko-Below PLC that investment properties of the type owned by Konko-Below Plc had increased in value by 7% in the year ended March 31, 2023.
- Plant and machinery, other than the leased plant stated in (ii) below is depreciated at 15% per annum using reducing balance method. Depreciation of building, plant and machinery is charged to cost of sales.

(ii) On April 1, 2022 Konko-Below Plc entered into a lease for an item of plant which had an estimated life of five (5) years. The lease period is also five (5) years with annual rental of ₦110 million payable in advance from April 1, 2022. The plant is expected to have a nil residual value at the end of its life. If purchased the plant would have a cost of ₦460million and be depreciated on a straight-line basis.

The interest rate implicit in the lease is 10%.

(iii) The loan notes was issued on July 1, 2022 with interest payable six monthly in arrears.

(iv) The provision for income tax for the year to March 31, 2023 has been estimated at ₦141.5million. The deferred tax provision at March 31, 2023 is to be adjusted to a credit balance of ₦70.5million.

(v) The inventories at March 31, 2023 were valued at ₦216million.

You are required to prepare:

a. Statement of profit or loss and other comprehensive income for the year ended March 31, 2023. (10 Marks)

b. Statement of changes in equity for the year ended March 31, 2023. (6 Marks)

c. Statement of financial position as at that date. (14 Marks)

(Total 30 Marks)

SECTION B: YOU ARE REQUIRED TO ATTEMPT TWO OUT OF THREE QUESTIONS IN THIS SECTION (40 MARKS)

QUESTION 2

Orak Nigeria Limited is a specialist computer component manufacturer. The company presently has a staff strength of 54 employees and it has two main customers located in the Southwestern part of the country.

However, the relative success of Orak Nigeria Limited over the last few years has attracted interest from a number of potential buyers that want to acquire the company. One of Orak Nig. Limited's main customers, Datamatic Plc, is now considering making a bid for the entire share capital of Orak Nig. Limited thereby effectively bringing Orak's services in-house. Datamatic Plc is of the opinion that the specialist products that Orak Nig. Limited supplies it will now be under their company's control.

The financial adviser to Datamatic Plc has obtained the following information relating to Orak Nig. Limited.

Extract from financial statements of Orak Nig. Limited for the year ended Sept. 30, 2023

	₦'000
Revenue	220,950
Cost of sales	125,820
Other costs	78,030
Profit before tax	17,100
Profit for the year	11,970
Dividend paid	5,850
Non-current assets	80,460
Inventories	20,880
Receivables	13,140
Cash and cash equivalents	2,880
Payables	21,960
Ordinary share capital	9,000
Retained earnings	86,400

Information obtained from computer component manufacturers association (Industry data)

	Ratios
Average P/E ratio (for quoted companies)	9.0
Average annual growth in reported post-tax profit (2022 to 2023)	3.0%
Average pre-tax profit margin	5.1%
Average pre-tax ROCE	13%
Average receivables collection days	78
Average payables payment days	34
Average revenue per employee	₦2,313,000

The finance director of Datamatics Plc has provided the following summary of Datamatics Plc recent performance as at September 30:

	2023	**2022**	**2021**	**2020**
	₦'000	**₦'000**	**₦'000**	**₦'000**
Revenue	881,250	834,000	754,500	757,500
Pre-tax profit	66,000	107,250	116,250	150,750
Dividend paid	6,000	37,500	37,500	37,500

Required:

a. Compute the following ratios for Orak Nig. Limited

- i. Gross profit to capital employed
- ii. Pre-tax profit to capital employed
- iii. Gross profit margin
- iv. Net profit margin
- v. Non-current asset turnover
- vi. Receivables collection period (days)
- vii. Payables payment period (days)
- viii. Inventories turnover (days)
- ix. Revenue per employee (₦)
- x. Dividend cover
- xi. Current ratio
- xii. Quick ratio (12 Marks)

b. Analyse the financial position and performance of Orak Nigeria Limited for the year ended Sept. 30, 2023 and determine if Datamatics Plc's investment in Orak Nig. Limited will be worthwhile. (8 Marks)

(Total 20 Marks)

QUESTION 3

On October, 1 2022 Papaya Plc acquired 90% interest in Bafana Ltd by issuing 1,000,000 ordinary shares at an agreed value of ₦2 per share, paying ₦1,000,000 in cash.

At that time the net assets of Bafana Ltd were as follows:

	₦'000
Property, plant and equipment	1,900
Inventories	700
Trade receivables	300
Cash and cash equivalents	100
Trade payables	(400)
	2,600

The consolidated statement of financial position of Papaya Group Plc as at December 31, were as follows:

	2022	2021
Non-current assets:	**₦'000**	**₦'000**
Property plant and equipment	25,000	23,000
Goodwill	660	--
	25,660	23,000
Current assets:		
Inventories	14,500	12,000
Trade receivables	13,700	11,000
Cash and cash equivalents	760	500
	28,960	23,500
Total assets	**54,620**	**46,500**
Equity attributable to owners of parent		
Ordinary share capital (₦1 each)	11,500	10,000
Share premium account	6,500	5,000
Retained earnings	17,910	15,300
	35,910	30,300
Non-controlling interests	310	--
Total equity	**36,220**	**30,300**
Current liabilities:		
Trade payables	16,900	15,200
Income tax	1,500	1,000
	18,400	16,200
Total equity and liabilities	**54,620**	**46,500**

The consolidated statement of profit or loss for the year ended December 31 2022

	₦'000
Revenue	100,000
Cost of sales	(75,000)
Gross profit	25,000
Administrative expenses	(20,800)
Profit before taxation	4,200
Income tax expense	(1,500)
Profit for the year	2,700
Profit attributable to owners of Papaya PLC	2,610
Non-controlling interests	90
	2,700

The statement of changes in equity for year ended December 31, 2022 (Extract) was as follows:-

	Retained earnings ₦'000
Balance as at December 31, 2021	15,300
Total profit for the year	2,610
Balance at December 31, 2022	17,910

Additional information:

(i) All other subsidiaries are wholly owned.

(ii) Depreciation charged to the consolidated statement of profit or loss amounted to ₦2,100,000.

(iii) There were no disposals of property, plant and equipment during the year.

(iv) Goodwill is not impaired.

(v) Non-controlling interests is valued on the proportionate basis.

Required:

Prepare consolidated statement of cash flows for Papaya Plc for the year ended December 31, 2022, using indirect method in accordance with IAS 7 – Statement of cash flows.

(Total 20 Marks)

QUESTION 4

Ogbagi Plc
Statement of profit or loss and other comprehensive income for the year ended December 31, 2022

	₦'000	₦'000
Revenue:		3,200,000
Interest income		20,000
Gain on sale of plant		16,000
		3,236,000
Expenses:		
Cost of sales	1,920,000	
Staff remunerations	480,000	
Depreciation on plant and equipment	100,000	
Interest expense	16,000	
Other expenses	304,000	
		(2,820,000)
Profit before tax		416,000
Income tax expense		(120,000)
Profit for the year		296,000
Other comprehensive income		
Gain on sale of investment	8,000	
Attributable tax	(2,400)	
		5,600
Total comprehensive income for the year		**301,600**

Ogbagi Plc
Comparative statements of financial position as at December 31

	2022	2021	Increase/(decrease)
	₦'000	₦'000	₦'000
Cash at bank	226,200	240,000	(13,800)
Account receivables	316,000	280,000	36,000
Inventories	280,000	260,000	20,000
Prepayments	38,000	32,000	6,000
Interest receivable	400	600	(200)
Plant and equipment	660,000	600,000	60,000
Investment	56,000	48,000	8,000
Intangible assets	60,000	-	60,000
	1,636,600	1,460,600	176,000
Accounts payables	180,000	168,000	12,000
Staff remuneration payable	20,000	16,000	4,000
Accrued interests	800	-	800
Other expenses payable	7,200	12,000	(4,800)
Current tax payable	64,000	56,000	8,000

Deferred tax liability	34,400	20,000	14,400
Long-term borrowings	280,000	240,000	40,000
Share capital	800,000	800,000	-
Retained earnings	244,600	148,600	96,000
Fair value reserve	5,600	-	5,600
	1,636,600	**1,460,600**	**176,000**

Additional information:

(i) Plants which had a carrying amount of ₦40million was sold for ₦56million cash and new equipment was purchased for ₦200million.

(ii) Intangibles valued at ₦60million were acquired for cash.

(iii) Borrowings of ₦40millon were made during the year and received in cash.

(iv) Dividends paid in cash amounted to ₦200million.

Required:

Prepare statement of cash flows for Ogbagi Plc for the year ended December 31, 2022 in accordance with IAS 7 using direct method.

(Total 20 Marks)

SECTION C: YOU ARE REQUIRED TO ATTEMPT TWO OUT OF THREE QUESTIONS IN THIS SECTION (30 MARKS)

QUESTION 5

a. The IASB Framework states that several measurement bases are used for the elements in financial statements

Explain the following bases of measurement:

i. Historical cost
ii. Current cost or current value
iii. Realisable value (or settlement value)
iv. Present valu (4 Marks)

b. The following information was extracted from the statement of financial position of Wadai Plc, a company newly quoted on the Nigeria Exchange limited (NGX)

	₦'000
Total non-current assets (as at December 31, 2022)	50,000
Closing inventories (as at December 31, 2022)	5,000

A financial analyst interested in investing in the company computed the following ratios, in respect of the company, for the year ended December 31, 2022:

Gross profit margin	25%
Net profit/margin	20%
Inventory turnover ratio	10 times
Net profit/Equity	20%
Equity to current liabilities	50%
Non-current assets/Equity	5 : 4
Non-current assets/Total current assets	5 : 7

You are required to prepare:

i. The statement of financial position as at December 31, 2022. (7 Marks)

ii. The statement of profit or loss for the year ended December 31, 2022. (4 Marks)

(Total 15 Marks)

QUESTION 6

a. Ajorosun Investment Limited has 12 million ordinary shares in issue and ₦4 million of 5% convertible bonds. As at December 31, 2021, there had been no new issues of shares or bonds for several years. The bonds are convertible into ordinary shares in the year 2022 or year 2023 at the following rates:

- At December 31, 2022: 30 shares for every ₦100 of bonds
- At December 31, 2023: 25 shares for every ₦100 of bonds

Total earnings for the year to December 31, 2021 were ₦3,600,000. Total earning for the previous year 2020 were ₦3,300,000. Tax is payable at a rate of 30% on profits.

Required:

Calculate the basic Earnings Per Share (EPS) and diluted EPS for the year 2021, and the comparative figures for the year 2020 for inclusion in the year 2021 financial statements. (8 Marks)

b. As the Finance manager, write a short memo to the board of directors of Ajorosun Ltd, explaining **FOUR** advantages and **THREE** limitations of Earnings Per Share (EPS) as a performance indicator to users of financial statements. (7 Marks)

(Total 15 Marks)

QUESTION 7

a. The preparation of financial statements requires a great deal of professional judgment, honesty and integrity. Therefore, Chartered Accountants should employ a degree of healthy skepticism when reviewing financial statements and any analysis provided by the company's management.

Required:

i. Identify and explain **THREE** major inappropriate practices that can be discovered whilst reviewing your client's financial statements and accompanying analysis. (4½ Marks)

ii. Identify and explain **THREE** fundamental ethical considerations that professional accountants should always consider. (4½ Marks)

b. Despite the largely global adoption of IFRS, users of financial statements still experience problems when comparing financial statements of similar companies.

Required:

Discuss **THREE** reasons why the comparison of primary financial statements is problematic for users. (6 Marks)

(Total 15 Marks)

SECTION A

SOLUTION 1

Konko-Below Plc

a) Statement of profit or loss and other comprehensive income for the year ended March 31, 2023

	Note	₦'m
Revenue		1,392.0
Cost of sales	1	(578.5)
Gross profit		813.5
Operating expenses		(78.0)
Income from investment property		23.0
Fair value gain on Investment properties (7% × ₦450)		31.5
Operating profit		790.0
Finance cost	2	(50.0)
Profit before taxation		740.0
Income tax expenses	3	(150.0)
Profit for the year		590.0
Other comprehensive income:		
Gain on revaluation of land & building	4	225.0
Total comprehensive income		**815.0**

Konko-Below Plc

b) Statement of changes in equity for the year ended march 31, 2023

	Ordinary share ₦'m	Revaluation surplus ₦'m	Retained earnings ₦'m	Total ₦'m
Balance b/f (April 1, 2022)	750	-	598	1,348
Profit for the year	-	-	590	590
Gain on revaluation	-	225	-	225
Dividend paid	-	-	(75)	(75)
Balance to SOFP (March 31, 2022)	750	225	1,113	2,088

Konko-Below Plc

c) **Statement of financial position as at March 31, 2023**

	Note	₦'m
Non-current asset:		
Property, plant and equipment	5	2,170.5
Investment properties (at fair value)	6	481.5
Total non-current assets		2,652.0
Current assets:		
Inventory		216.0
Trade receivables		266.0
Total current assets		482.0
Total assets		3,134.0
Equity and liabilities:		
Equity:		
Ordinary shares of ₦1 each		750.0
Revaluation reserves on land and building		225.0
Retained earnings		1,113.0
Total equity		2,088.0
Non-current liabilities:		
Deferred tax	3 b)	70.5
8% loan notes		250.0
Lease liabilities	7	275.0
Total non-current liabilities		595.5
Current liabilities:		
Trade payables		167.0
Accrued interest expenses	8	5.0
Lease liabilities	7	110.0
Current tax payables		141.5
Bank overdraft		27.0
Total current liabilities		450.5
Total liabilities		1,046.0
Total equity and liabilities		3,134.0

Working notes

Wk 1: Cost of Sales	**₦'m**
Opening inventories	189.0
Purchases	31.5
Closing inventories	(216.0)
Depreciation (Wk 1)	214.5
SOPL	578.5

Wk 2: Lease rentals	**₦'m**
Outstanding lease obligation	385

Net obligation at inception (₦460 110)	(350)
Lease obligation accrued interest	35
Finance cost on loan interest (8% x ₦250m x 9/12)	15
	50

Wk 3a: Income tax expenses	**₦'m**
Current year charges	141.5
Increase in deferred tax (Wk 3b)	8.5
Accrued to SOPL	150.0

Wk 3b: Deferred tax	**₦'m**
Opening balance	62.0
Closing balance	70.5
Increase in deferred tax (Wk 3a)	8.5

Wk 4: Gain on revaluation of land and building:	**Land ₦'m**	**Building ₦'m**
Cost of land and building 31/3/2023	350	700
At valuation 31/3/2023	400	875
Gain on revaluation	50	175

Total gain on revaluation (50 + 175) = ₦225

Wk 5: Schedule of movement in PPE for the year ended March 31, 2023

	Land	**Building**	**P/Equip**	**ROU**	**Total**
Cost/valuation:	**₦'m**	**₦'m**	**₦'m**	**₦'m**	**₦'m**
Balance b/f	350.0	1,000.0	780.0	-	2,130.0
Additions	-	-	-	460.0	460.0
Revaluation	50.0	175.0	-	-	225.0
Balance c/f	400.0	1,175.0	780.0	460.0	2,815.0
Acc. depreciation:					
Balance b/f	-	300.0	130.0	-	430.0
Current year charges	-	25.0	97.5	92.0	214.5
Balance c/f	-	325.0	227.5	92.0	644.5
Carrying amount:					
Balance c/f	400.0	850.0	552.5	368.0	2,170.5
Balance b/f	350.0	700.0	650.0	-	1700.0

Wk 6: Investment properties	**₦'m**
Valuation at April 1, 2022	450.0
Fair value gain (7% x ₦450m)	31.5
Balance to SOFP	481.5

Wk 7: Lease liabilities	**₦'m**
Fair value of Right of Use (ROU)	460.0
Payment made during the year (wk 9)	(110)
Lease Interest	35
Balance to SOFP	**385**

Classified into:	
Non-current	**275**
Current	**110**
	385

Wk 8: 8% Loan Interest	**₦'m**
SOPL Current year charges	15.0
Loan interest paid as per TB	(10.0)
Accrued to SOFP	5.0

Wk 9: Lease amortisation schedule

Year ended	Balance b/f	Lease payment	Balance outstanding	Interest at 10%	Balance c/f
	₦'m	₦'m	₦'m	₦'m	₦'m
2023	460.0	110.0	350.0	35.0	385.0
2024	385.0	110.0	275.0	27.5	302.5
2025	302.5	110.0	192.5	19.3	211.8
2026	211.8	110.0	101.8	8.3	110.0
2027	110.0	110.0	-	-	-

Examiner's report

The question tests the preparation of single entity's final accounts, which requires the presentation of statement of profit or loss and other comprehensive income, statement of changes in equity and statement of financial position.

Majority of the candidates attempted the question and their performance was average.

The commonest pitfall was the inability of most candidates to apply the provisions of IFRS 16 – lease, hence they could not properly identify the Right of Use (ROU) of the leased assets as required under International Financial Reporting Standards. Also, others could not properly account for deferred tax provisions in accordance with IAS 12- Income tax.

Candidates are advised to pay more attention to the preparation of final accounts of single entity as this is a regular area of the syllabus that are examined at this level of the institute's examinations.

Marking guide

		Marks	Marks
a)	**Preparation of statement of profit or loss and other comprehensive income:**		
	Title of the statement	¼	
	Determining the gross profit	¾	
	Determining the profit before taxation	1½	
	Income tax expenses	¼	

	Profit for the year	¼	
	Stating total comprehensive income	½	
	Workings for cost of sales	2	
	Workings for lease rentals	2	
	Workings for gain on revaluation	1½	
	Showing other workings for profit or loss items	1	**10**
b)	**Preparation of statement of changes in equity:**		
	Title of the statement	½	
	Opening balance of components of equity	1½	
	Profit for the year	1	
	Gain on revaluation	1	
	Dividend paid	1	
	Total equity	1	**6**
c)	**Preparation of statement of financial position:**		
	The title of the statement	¼	
	Non-current assets	¾	
	Current assets	1	
	Total assets	¼	
	Components of equity	1	
	Non-current liabilities	1	
	Current liabilities	1½	
	Total equity and liabilities	¼	
	Workings for movement in PPE	5¼	
	Workings for lease amortisation schedule	1	
	Workings for investment properties	¾	
	Workings for lease liabilities	1	**14**
	Total		**30**

SECTION B

SOLUTION 2

(a) **Computation of ratios of Orak Nigeria Limited for the year ended Sept. 30, 2023**

S/N	Ratios		Orak Nig. Limited
i)	Gross profit to capital employed =	$\frac{\text{Gross profit x 100}}{\text{Capital employed}}$	= $\frac{95,130 \text{ x } 100}{95,400}$ = 99.72%
ii)	Pre-tax profit to capital employed =	$\frac{\text{Profit before Tax x 100}}{\text{Capital employed}}$	= $\frac{17,100 \text{ x } 100}{95,400}$ = 17.92%
iii)	Gross profit margin =	$\frac{\text{Gross profit x 100}}{\text{Revenue}}$	= $\frac{95,130 \text{ x } 100}{220,950}$ = 43.05%
iv)	Net profit margin =	$\frac{\text{Profit for the year x 100}}{\text{Revenue}}$	= $\frac{17,100 \text{ x } 100}{220,950}$ = 7.74%
v)	Non-current asset turnover =	$\frac{\text{Revenue}}{\text{Non-current asset}}$	= $\frac{220,950}{80,460}$ = 2.75 times
vi)	Receivables collection period =	$\frac{\text{Trade rec. x 365 days}}{\text{Revenue}}$	= $\frac{13,140 \text{ x } 365 \text{ days}}{220,950}$ = 22 days
vii)	Payables payment period =	$\frac{\text{Trade Payable x 365 days}}{\text{Purchases}}$	= $\frac{21,960 \text{ x } 365 \text{ days}}{125,820}$ = 64 days
viii)	Inventory turnover =	$\frac{\text{Inventories x 365 days}}{\text{Cost of Sales}}$	= $\frac{20,880 \text{ x } 365 \text{ days}}{125,820}$ = 61 days
ix)	Revenue per employee (₦) =	$\frac{\text{Revenue}}{\text{Number of employees}}$	= $\frac{220,950,000}{54 \text{ staff}}$ = ₦4,091,667
x)	Dividend cover =	$\frac{\text{Profit for the year}}{\text{Dividend}}$	= $\frac{11,970}{5,850}$ = 2.05 times

xii) Current ratio $= \dfrac{\text{Current assets}}{\text{Current liabilities}} = \dfrac{36{,}900}{21{,}960}$

$= \underline{\underline{1.68:1}}$

xiii) Quick ratio $= \dfrac{\text{Current assets – inventory}}{\text{Current liabilities}} = \dfrac{36{,}900 - 20{,}880}{21{,}960}$

$= \underline{\underline{0.73:1}}$

(b) **Analysis of financial position and performance of Orak Nig. Ltd for the year 2023**

Based on the ratios calculated and the data provided in the financial statements, here is an analysis of Orak Nigeria Ltd's financial performance and position.

Profitability

(i) Gross profit margin (43.1%)
Orak Nig. Ltd maintains a strong gross profit margin, indicating good control over cost of sales relative to revenue. This level of profitability suggests that the company effectively manages its production and operational costs.

(ii) Net profit margin (7.7%)
While the net profit margin is significantly lower than the gross profit margin, it reflects moderate profitability after accounting for all other costs. This suggests a room for improvement, especially in controlling overhead or financing costs.

(iii) Return on capital employed (ROCE)
- Gross profit to capital employed (65.1%)
- Pre-tax profit to capital employed (13.8%)

These figures suggest that Orak Nig. Ltd generates relatively strong returns on its capital employed, especially when analysing profit before tax.
Datamatics Plc can expect reasonable returns on their investment based on this performance.

(iv) Revenue per employee is 168% higher than the industry average, which is a reflection of the profitability and revenue generation of Orak Nig. Ltd. This is an evidence that the company is able to charge high prices and also put in place cost control measures.

(v) However, we do not have detailed information about the salaries and wages of the employees of Orak Nig. Ltd. If the salaries of the employees of Orak are higher than that of Datamatic Plc, this may lead to demand for higher salaries among the workforce of Datamatics Plc.

(vi) With the acquisition of Orak Nig. Ltd. by Datamatics Plc, which is a larger company, this could further lead to economic of scale and even cheaper supplies.

(vii) As Orak Ltd is currently paying high dividend, this will be good news for shareholders of Datamatics Plc.

(viii) Also pre-tax ROCE and pre-tax profit margin 38% and 5% respectively are higher than industry average which support the view that Orak Nig. Ltd. is able to charge high prices. This would appear to be as a result of specialisation of the service of Orak Nig. Ltd.

(ix) Should Orak Ltd acquire Datamatics Plc, Orak Limited will benefit from price premium thereby generating better profitability for Datamatics Plc.

Liquidity

(i) Current ratio (1.68)
A current ratio above 1 shows that Orak Nig. Ltd has sufficient short-term assets to cover its short term liabilities. This is a good liquidity position, reducing the risk of cash flow problems.

(ii) Quick ratio (0.73)
The quick ratio indicates weaker liquidity after inventories are excluded, suggesting some reliance on inventory turnover to meet liabilities. Datamatics Plc should consider whether this reliance aligns with their risk appetite.

Efficiency

(i) Receivables collection period (22 days)
Orak Nig. Ltd collects receivables efficiently within 22 days on average, which is a positive indicator of cash flow management.

(ii) Payables payment period (64 days)
The company takes about 64 days to pay suppliers, which may suggest they are effective in managing cash flow. However, this could strain supplier relationships if extended further.

(iii) Inventory turnover period (61 days)
Inventory turnover is satisfactory, indicating that Orak is not overstocked and it can efficiently convert inventory into sales.

Investment efficiency

(i) Non-current asset turnover (2.75)
Orak Nig. Ltd current assets turnover is 2.75. However, the industrial average is not provided for comparison.

(ii) Revenue per employee (₦2.313 million)
This is a good productivity ratio, when compared with the industrial average.

Dividend sustainability

- Dividend Cover (2.05)
  The net profit at Orak Nig Ltd covers it dividend more than twice, indicating the sustainability of the company. This is a positive indicator for Datamatics, as it shows the company's ability to distribute profits without jeopardising reinvestment opportunities.

Industry analysis when compared to the computer component manufacturing industry:

(i) Orak Nig. Ltd's profitability is above average in gross profit but slightly below average in net profit.

(ii) Liquidity metrics such as the current ratio are strong, but the quick ratio and reliance on inventory pose potential risks.

(iii) Operational efficiency in receivables collection is better than industrial average, though payables and inventory turnover needs improvement.

(iv) Productivity metrics suggest that the company is slightly behind in revenue per employee but is comparable with industry benchmarks.

Limitations and risks

(i) Net profit margin: The net profit margin is relatively low, indicating that overhead costs and other expenses could be reducing profitability.

(ii) Reliance on inventory: The quick ratio suggests that Orak Nig. Ltd relies on inventory for short term liquidity, posing a potential risk if inventory turnover reduces overtime.

(iii) Customer dependence: Orak Nig. Ltd has only two main customers. A loss of either could severely impact revenue and profitability.

(iv) Receivable collection period of 22 days is exceptionally low when compared with industry average. This is probably due to the fact that Orak Nig. Ltd has only has two main customers making it possible to form close working relationship. Given the specialisation that Orak Nig. Ltd provides, it is likelythat its customers do not want to spoil their relationship by delaying payments. There is no reason to believe that this will change if Datamatics acquires the company.

(v) Payable payment period of 64 days is almost twice the industry average and reflect either a strict cash management policy within Orak Nig. Ltd or a potentially cash flow problem. However, given the high profitability within Orak Nig. Ltd, and its healthy statement of financial position items it would appear that Orak Nig. Ltd has squeezed its suppliers quite hard. If Orak

Nig. Ltd. is acquired by Datamatics Plc, there may be need to change this policy.

(vi) Inventory turnover of 61 days indicates that the production process within Orak Nig. Ltd. is about two months and may be a reflection of the complexity of the manufacturing process that it undertakes. This may largely be as a result of safety checks, which are key features of supply of specialised computer components and the time taken may contribute to the 61-day figure.

Recommendation

Datamatics Plc's investment in Orak Nigeria Limited appears to be worthwhile, based on the following:

(i) Orak Nig. Ltd is generating strong gross profit margins and acceptable ROCE, making it a profitable company.

(ii) Liquidity and operational efficiency ratios are within acceptable ranges.

(iii) Integration of Orak Nig. Ltd's services into Datamatics PLC could reduce costs and increase operational synergies.

However, Datamatics Plc should consider:

(i) Reducing Orak Nig. Ltd's reliance on a few key customers.
(ii) Exploring opportunities to improve net profit margins through better cost management.
(iii) Engaging in proactive management to mitigate risks and maximise returns.

Examiner's report

The question tests the computation and analyses of financial ratios for investment decisions.

Majority of the candidate attempted the question and their performance was above average.

The candidates performed very well in the computation of the required ratios, but most could not give proper interpretation to the computed ratios.

Candidates are advised to pay more attention to the interpretation of financial statements at this level of the institute's examination rather than focusing on computation of relevant financial ratios.

Marking guide

		Marks	Marks
a)	**Computation of relevant ratios:**		
	Calculation of:		
	Gross profit to ROCE	1	
	Pre-tax to ROCE	1	
	Gross profit margin	1	
	Net profit margin	1	
	Non-current asset turnover	1	
	Receivables collection period	1	
	Payables payment period	1	
	Inventory turnover	1	
	Revenue per employee	1	
	Dividend cover	1	
	Calculation of current ratio	1	
	Quick ratio	1	**12**
b)	**Analysis of financial position and performance**		
	Analysis of financial performance:		
	Any 6 correct points at ¼ mark each	3	
	Analysis of financial position:		
	Any 8 correct points at ½ mark each	4	
	Stating recommendation	½	
	Stating reservation	½	**8**
	Total		**20**

SOLUTION 3

Papaya Plc
Consolidated statement of cash flows for the year ended December 31, 2022

Operating activities:	**₦'000**	**₦'000**
Profit before tax		4,200
Add/less: Adjustment:		
Depreciation		2,100
Cashflow from operation before working capital		6,300
Working capital changes:		
Increase in inventories (Wk 1)	(1,800)	
Increase in trade receivables (Wk 1)	(2,400)	
Increase in trade payables and accruals (Wk 1)	1,300	(2,900)
Cash flows from operation		**3,400**
Taxation paid (Wk 2)		(1,000)
Net cash flows from operating activities		**2,400**
Investing activities:		
Purchase of subsidiary (Wk 4)	(900)	
Purchase of property, plant and equipment (Wk 3)	(2,200)	
Net cash flows from investing activities		**(3,100)**
Financing activities:		
Proceeds from issue of shares (Wk 6)	1,000	
Dividend paid to NCI by cash (Wk 5)	(40)	
Net cash flows from financing activities		**960**
Net Increase in cash and cash equivalents for the year		260
Cash and cash equivalent at the beginning		500
Cash and cash equivalent at the end		760

Working notes

Wk 1: Increase/decrease in working capital

	Inventory	Trade rec.	Trade pay.
	₦'000	₦'000	₦'000
Opening balance	12,000	11,000	15,200
Acquisition of subsidiary	700	300	400
Expected closing balance	12,700	11,300	15,600
Actual closing balance	14,500	13,700	16,900
Increase/decrease	(1,800)	(2,400)	(1,300)

Wk 2: Taxation paid	**₦'000**
Opening balance	1,000
Current year charge	1,500
Expected closing balance	2,500

Actual closing balance	1,500
Cash paid	1,000

Wk 3: Purchase of PPE by cash	**₦'000**
Opening balance	23,000
Acquisition of subsidiary	1,900
Depreciation charge for the year	(2,100)
Expected closing balance	22,800
Actual closing balance	25,000
Additional purchase by cash	(2,200)

Wk 4: Purchase of subsidiary	**₦'000**
Acquisition cost in cash	1,000
Cash portion of net asset acquired	(100)
Cash paid	900

Wk 5: Dividend paid to NCI	**₦'000**
NCI at acquisition (10% x 2,600)	260
Share of post-acquisition profit	90
Expected closing balance	350
Actual closing balance	310
Cash dividend paid	40

Wk 6: Proceeds from issue of shares	Share capital	Share premium	Total
	₦'000	₦'000	₦'000
Opening balance	10,000	5,000	15,000
Shares issue towards the acquisition of subs.	1,000	1,000	2,000
Expected closing balance	11,000	6,000	17,000
Actual closing balance	11,500	6,500	18,000
Shares issued for cash	500	500	1,000

Examiner's report

The question examines the candidates' ability to prepare consolidated statement of cash flows of a simple group, using the indirect method.

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

Those candidates that attempted the question approached it as if they were preparing statement of cash flows for a single entity hence most of them did not make necessary adjustments to reflect the effect of the subsidiary on the cash flow of the group and this led to loss of valuable marks.

Candidates are advised to cover all sections of the syllabus, on group accounts and other related topics for better performance in future examinations.

Marking guide

		Marks
a)	**Preparation of consolidated statement of cash flows**	
	Title of the statement	½
	Determination of cash flows from operating activities	2¾
	Determination of cash flows from investing activities	1
	Determination of cash flows from financing activities	1
	Stating cash and cash equivalents	¾
	Determination of movement in working capital	4
	Workings notes for taxation paid	1½
	Stating working notes for cash purchase of PPE	1¾
	Working notes for purchase of subsidiary	1
	Calculation of dividend paid to NCI	1¾
	Calculation of proceed on issue of shares	4
	Total	**20**

SOLUTION 4

Ogbagi Plc
Statement of cash flows for the year ended December 31, 2022

Operating activities:	**₦'000**	**₦'000**
Cash received from customers (Wk 2)		3,164,000
Cash paid to suppliers (Wk 3)		(1,928,000)
Cash paid to employees (Wk 5)		(476,000)
Cash paid for other operating expenses (Wk 4)		(314,800)
Cash flow from operation		445,200
Interest Received (Wk 7)		20,200
Interest paid (Wk 6)		(15,200)
Taxation paid (Wk 1)		(100,000)
Net cash flows from operating activities		350,200
Investing activities:		
Purchase of plant and equipment by cash (Wk 8)	(200,000)	
Purchase of intangible by cash	(60,000)	
Proceeds from disposal of plant (Wk 9)	56,000	
Net cash flows from investing activities		(204,000)
Financing activities:		
Proceeds from issue of long-term borrowings	40,000	
Dividend paid by cash	(200,000)	
Net cash flows from financing activities		(160,000)
Net increase in cash and cash equivalents for the		(13,800)

year		
Cash and cash equivalents at the beginning		240,000
Cash and cash equivalents at the end		226,200

Working notes

Wk 1: Taxation paid	**₦'000**
Opening balance (56,000 + 20,000)	76,000
Income tax expense (120,000 + 2,400)	122,400
Expected closing balance	198,400
Actual closing balance (64,000 + 34,400)	98,400
Taxation paid	100,000

Wk 2: Cash received from customers	**₦'000**
Opening balance	280,000
Revenue for the year	3,200,000
Expected closing balance	3,480,000
Actual closing balance	316,000
Cash received from customers	3,164,000

Wk 3: Cash paid to suppliers	**₦'000**
Cost of sales	1,920,000
Closing inventories	280,000
Opening inventories	(260,000)
Purchases for the year	1,940,000
Opening balance of account payables	168,000
Expected closing balance	2,108,000
Actual closing balance of account payables	180,000
Cash paid to suppliers	1,928,000

Wk 4: Cash paid for other operating expenses	**₦'000**
Accrued other expenses b/f	12,000
Prepayment b/f	(32,000)
Other expenses charge to SOPL	304,000
Accrued other expenses c/f	(7,200)
Prepayment c/f	38,000
Cash paid	314,800

Wk 5: Cash paid to employees	**₦'000**
Opening balance	16,000
Staff remunerations for the year	480,000
Expected closing balance	496,000
Actual closing balance	20,000
Cash paid	476,000

Wk 6: Interest paid	**₦'000**
Opening balance	–
Interest expense charged to SOPL	16,000
Expected closing balance	16,000
Actual closing balance	800
Interest paid	15,200

Wk 7: Interest received	**₦'000**
Opening balance	600
Interest income for the year	20,000
Expected closing balance	20,600
Actual closing balance	(400)
Interest received	20,200

Wk 8: Plant and machinery	**₦'000**
Opening balance	600,000
Disposal	(40,000)
Depreciation	(100,000)
Expected closing balance	460,000
Actual closing balance	(660,000)
Addition by cash	(200,000)

Wk 9: Disposal of plant	**₦'000**
Carrying amount	40,000
Proceeds from disposal	56,000
Profit on disposal of plant	(16,000)

Wk 10: Investment	**₦'000**
Opening balance	48,000
Gain on fair value of investment	8,000
Expected and actual closing balance	56,000

Wk 11: Retained earnings	**₦'000**
Opening balance	148,600
Profit for the year	296,000
Expected closing balance	444,600
Actual closing balance	(244,600)
Dividend declared and paid	200,000

Examiner's report

The question tests candidates' knowledge of preparation of statement of cash flows of a single entity in accordance with provisions of IFRS 7, using direct method.

Many candidates attempted the question and performance was average.

The commonest pitfall of the candidates was their inability to correctly determine the cashflows from operating activities, using the direct method. Some of the candidates could not determine the cash received from customers, cash paid to suppliers as well cash paid for other operating expenses.

Other candidates also used the indirect method despite the fact that the question specifically requests for the use of direct method and this led to loss of valuable marks.

Candidates are advised to pay special attention to this area of the syllabus and other relevant sections for better performance in future examinations of the institute.

Marking guide

		Marks
a)	**Preparation of statement of cash flows**	
	Title of the statement	¼
	Determining cash received from customers	1¾
	Determining cash paid to suppliers	2½
	Determining cash paid to employees	1¾
	Determining cash paid for other operating expenses	2
	Determining net cash flows from operating activities	1¼
	Determining cash flows from investing activities	1¼
	Determining cash flows from financing activities	1
	Stating cash and cash equivalents	¾
	Workings notes for taxation paid	2¾
	Workings notes for interest paid	1¼
	Workings notes for cash purchase of plant and machinery	1½
	Determining profit on disposal of plant	1
	Determining gain on fair value of investment	1
	Total	**20**

SECTION C

SOLUTION 5

a) **Bases of measurement:**

i. **Historical cost**: Assets are measured at the amount of cash paid, or at the fair value of the consideration given to acquire them. Liabilities are measured at:

- the amount of proceeds received in exchange for the obligation (for example, bank loan or a bank overdraft), or
- the amount of cash that will be paid to satisfy the liability.

ii. **Current cost or current value** is the basis used in current value accounting/current cost accounting. Assets are measured at the amount that would be paid to purchase the same or a similar asset currently. Liabilities are measured at the amount that would be required to settle the obligation currently.

iii. **Realisable value** (or **settlement value**): This method of measurement is relevant when an entity is not a going concern and is faced with liquidation (and a forced sale of its assets). Assets are measured at the amount that could be obtained by selling them. Liabilities are measured at the amount that would be required to settle them currently.

iv. **Present value**. Assets might be measured at the value of the future net cash inflows that the item is expected to generate, discounted to a present value. Similarly, a liability might be measured at the discounted present value of the expected cash outflows that will be made to settle the liability.

b) **Wadai Plc**

i) **Statement of profit or loss for the year ended December 31, 2022**

	Notes	₦'000	₦'000
Revenue	4		40,000
Cost of sales:			
Opening inventory	7	1,000	
Purchases		34,000	
		35,000	
Closing inventory	6	(5,000)	(30,000)
Gross profit	5		10,000
Operating expenses			(2,000)
Net profit for the year	3		8,000

Wadai Plc

ii) **Statement of financial position as at December 31, 2022**

	Note	₦'000
Total non-current assets		50,000
Current assets:		
Inventory		5,000
Other current assets		65,000
Total current assets	2	70,000
Total assets		120,000
Equity and liabilities:		
Equity	1	40,000
Current liabilities	8	80,000
Total equity and liabilities		120,000

Working notes

Wk 1: Determination of equity

$$\frac{\text{Non-current assets}}{\text{Equity}} = \frac{5}{4} = \frac{50{,}000}{\text{Equity}}$$

$$\text{Equity} = \frac{50{,}000 \times 4}{5} = \text{₦}40{,}000$$

Wk 2: Determination of total current assets

$$\frac{\text{Non-current assets}}{\text{Total current assets}} = \frac{5}{7} = \frac{50{,}000}{\text{Total current assets}}$$

$$\text{Total current assets} = \frac{50{,}000 \times 7}{5} = \text{₦}70{,}000$$

Wk 3: Determination of net profit

$$\frac{\text{Net profit}}{\text{Equity}} = 20\%$$

Net profit = 20% x Equity = 40,000 x 20% = **₦8,000**

Wk 4: Determination of revenue

$$\frac{\text{Net profit}}{\text{Revenue}} = 20\%$$

Revenue = Net profit/20% = 8,000/0.20 = **₦40,000**

Wk 5: Determination of gross profit

$$\frac{\text{Gross profit}}{\text{Revenue}} = 25\%$$

Gross profit = 25% x Revenue = 40,000 x 25% = **₦10,000**

Wk 6: Determination of cost of sales

Revenue – gross profit = cost of sales

₦(40,000 – 10,000) = **₦30,000**

Wk 7: Determination of opening inventory

$$\frac{\text{Cost of sales}}{\text{Av. inventory}} = 10 \text{ times}$$

Average inventory = 30,000/10times = ₦3,000

But average inventory = ½(opening inventory + closing inventory)

3,000 = ½(opening inventory + 5,000)

3,000 x 2 = opening inventory + 5,000

6,000 – 5,000 = opening inventory opening inventory = **₦1,000**

Wk 8: Determination of current liabilities

$$\frac{\text{Equity}}{\text{Current liability}} = 50\%$$

Current liability = 40,000/0.5 = **₦80,000**

Examiner's report

The question tests candidates' knowledge of the bases of measurement in accordance with IASB Framework in part a, while part b requires candidates to prepare summarised statement of profit or loss and statement of financial position from various financial ratios by generating relevant figures for the financial statements from the interrelated financial ratios.

Most of the candidates did not attempt this question and the few that attempted performed poorly.

The main pitfall of the candidates was their inability to identify how these financial ratios are related and hence they could not use them to generate relevant figures for the purpose of preparing the summarised financial statements.

Candidates should note that they are expected to be able apply accounting principles and theories at the skills level of the institute examination hence they are advised to emphasise the applications of the various accounting principles and theories in various sections of the syllabus.

Marking guide

		Marks	Marks
a)	Explanation of four bases of measurement at 1 mark each		**4**
b)i	**Statement of financial position:**		
	Determining total current assets	1½	
	Determining equity	1½	
	Calculation of current liabilities	1½	
	Determining non-current assets	1	
	Derivation of closing inventory	1	
	Determining total assets and total liabilities	½	7
b)ii	**Statement of profit or loss:**		
	Determination of revenue	½	
	Estimation of opening inventory	1½	
	Determination of cost of sales	½	
	Determination of gross profit	1	
	Determination of net profit	½	4
	Total		**15**

SOLUTION 6

a)

Ajorosun Investment Limited
Computation of basic EPS and diluted EPS for the year 2021 and 2020

	2021	**2020**
Basic EPS = $\frac{\text{Earnings attributable to ordinary shareholders}}{\text{Weighted average number of ordinary shares}}$	₦3,600,000 / 12,000,000 = **₦0.30 per share**	₦3,300,000 / 12,000,000 = **₦0.28 per share**
Diluted EPS = $\frac{\text{Earnings for Basic EPS + X}}{\text{No. of shares for Basic EPS + Y}}$	₦(3,600,000 + 140,000) / (12,000,000+1,200,000) = ₦3,740,000 / 13,200,000 shares = **₦0.28 per share**	₦(3,300,000 + 140,000) / (12,000,000+1,200,000) = ₦3,440,000 / 13,200,000 shares = **₦0.26 per share**

Where:

X = Interest savings (net of tax) on convertible bond that qualifies for dilution

Y = No. of ordinary shares that would be exchanged for the convertible bond.

Working notes

Test of dilution

$$\text{Incremental EPS} = \frac{\text{Interest savings (net of tax) on convertible stock}}{\text{No. of ordinary shares that would be exchanged for the convertible bond}}$$

(a) Interest savings (net of tax)
Total interest = 5% x ₦4,000,000 = ₦200,000
Interest saving (net of tax) = ₦200,000 (1 – 0.3) = ₦200,000 (0.7) = ₦140,000

(b) No. of ordinary shares in exchange
Conversion ratio: ₦100 bond = 30 shares
₦4m bond = ₦4,000,000/₦100 x 30 shares = 1,200,000 shares

$$\text{Incremental EPS} = \frac{₦140{,}000}{1{,}200{,}000} = ₦0.12 \text{ per share.}$$

Potential shares:
The number of potential shares is calculated using the conversion rate of 30 shares for every ₦100 of bonds. This is because this conversion rate produces more new shares than the other conversion rate of 25 shares for every ₦100 of bonds.

b) **INTERNAL MEMO**

To: Board of Directors, Ajorosun Ltd
From: Finance Manager
Subject: Advantages and limitations of earnings Per Share (EPS)
Date: 19 November, 2024

This memo aims to provide an overview of the advantages and limitations of Earnings Per Share (EPS) as a performance indicator for users of financial statements.

Advantages of EPS

(i) **Simplicity and comparability:** EPS provides a straightforward measure of profitability on a per-share basis, allowing investors to easily compare the earnings performance of different companies within the same industry.

(ii) **Decision-making tool for investors:** Investors often use EPS as a key metric to evaluate potential returns, aiding in decision-making about buying, holding, or selling shares.

(iii) **Market sentiment indicator:** A rising EPS trend indicates strong company performance, often leading to increased investor confidence and positive market sentiment.

(iv) **Basis for valuation metrics:** EPS is a core input in widely used valuation ratios like the Price-Earnings (P/E) ratio, helping investors assess the relative value of a company's stock.

(v) **Trend analysis:** It can be used to evaluate and compare the EPS of the same entity in different years. Thus, it is useful in trend analysis of an entity's EPS.

(vi) **Performance measurement:** It measures performance from the perspectives of investors and potential investors

(vii) **Earning distribution:** It points out earnings distributable to the entity's shareholders

Limitations of EPS

(i) **Ignores capital structure:** EPS does not account for differences in capital structure, such as debt levels. Two companies with similar EPS but different risk profiles (e.g., high vs. low debt) may not be equally attractive.

(ii) **Subject to accounting manipulation and window dressing:** EPS can be manipulated through accounting practices, such as share buybacks or changes in depreciation methods, which may not reflect genuine operational improvements.

(iii) **Fails to consider cash flows:** EPS focuses solely on accounting profits, disregarding cash flows. This limits its usefulness for evaluating a company's ability to meet financial obligations or invest in growth.

(iv) **Inflation:** Inflation is not considered.

(v) **Historical cost information:** Historical information from the financial statement is used, hence it does not take cognizance of time value of money.

(vi) **Differential in accounting policies:** The choice of accounting policies affects EPS of an entity.

While EPS is a widely recognised performance indicator, it should be used alongside other financial metrics to gain a more comprehensive understanding of a company's financial health and prospects.

Best regards,
Finance Manager

Examiner's report

The question examines candidates' knowledge of computation of basic and diluted earnings per share (EPS) and the advantages and limitations of the EPS as performance indicators to users of financial statements.

Few candidates attempted the question and performance was below average.

Most candidates could not correctly calculate the basic and diluted earnings per share (EPS). However, they were able to explain the advantages and limitations of the EPS as a performance indicator to users of financial statements.

Candidates are advised to pay more attention to all areas of the syllabus most especially the relevant international accounting standards at this level of the institute examination.

Marking guide

		Marks	Marks
a)	**Calculation of basic and diluted earnings per share with comparative figures:**		
	Calculation of basic EPS and comparative figures	4	
	Calculation of diluted EPS and its comparative figures	<u>4</u>	**8**
b)ii	**Memo addressed to board of directors explaining advantages and limitations of EPS:**		
	Presentation of report in memo format	2	
	Explaining four (4) advantages at ½ mark each	2	
	Explaining three (3) limitations at 1 mark each	<u>3</u>	<u>7</u>
	Total		**<u>15</u>**

SOLUTION 7

a) **Major inappropriate practices that can be discovered whilst reviewing your client's financial statements and accompanying analysis:**

(i) **Revenue recognition manipulation:** This occurs when a company inflates its revenue by recognising sales that have not yet occurred or by recognising revenue prematurely. For instance, recording revenue from contracts that are not yet fulfilled violates the principle of revenue recognition. This misleads stakeholders about the company's financial performance and inflates profitability.

(ii) **Understatement of liabilities or expenses:** Companies may deliberately omit or understate liabilities (e.g., contingent liabilities) or fail to record expenses to enhance reported profitability or maintain compliance with debt covenants. This distorts the financial position and may lead to inaccurate assessments of the company's solvency.

(iii) **Overstatement of asset values:** Inflating the value of assets such as inventory, accounts receivable, or intangible assets, such as goodwill, can artificially improve a company's statement of financial position. This often involves using unrealistic assumptions or failing to account for impairments. Overstated assets mislead stakeholders about the true net worth and financial stability of the company.

(iv) **Misclassification of expenses:** Companies may intentionally misclassify operating expenses as capital expenditures to improve reported profitability. This inflates current period profits while understating actual costs. A company classifies routine repair and maintenance costs as improvements to non-current assets, which should be expensed in the income statement rather than capitalised on the statement of financial position. This misclassification distorts both the income statement and the statement of financial position misleading stakeholders about the company's operational efficiency and financial position.

(v) **Window dressing of the year-end financial position**

Examples may include:

- Agreeing with customers that receivables are paid on shorter term around year end, so that trade receivables collection period is reduced and operating cash flows are enhanced.
- Modifying the supplier payment cycle by delaying payment normally made in the last month of the current year until first month of the following year. This will improve the cash position.

(vi) **Exercise of judgement in applying accounting standards**

- Reducing the percentage of outstanding receivables for which full provision is made.
- Extending useful life of property, plant and equipment to reduce depreciation charge hence inflating profit.
- Reducing the obsolence provision in respect of slow-moving inventories.

(vii) **In-appropriate transactions recording**

Intentionally failing to correct a number of accounting errors

aii) **Identification and explanation of THREE fundamental ethical considerations that professional accountants should always consider.**

- **Integrity:** Accountants must be honest and straightforward in all professional and business relationships. They should avoid falsifying records or participating in fraudulent reporting. This builds trust and ensures that financial reports are reliable for decision making.

- **Objectivity:** Accountants must not allow bias, conflicts of interest, or undue influence from others to override their professional judgment. For example, pressure from management should not compromise their assessments. Objectivity ensures fair and unbiased representation of financial data.

- **Professional competence and due care:** Accountants must maintain their knowledge and skills to provide competent services, ensuring they apply relevant laws, regulations and standards. This upholds the quality of financial reporting and aligns with stakeholders' expectations.

- **Confidentiality:** Professional accountants must respect the confidentiality of information obtained during their work. This means they should not disclose such information to third parties without proper authority or unless there is a legal or professional obligation to do so.

  Protecting sensitive client or company information builds trust between the accountant and stakeholders while ensuring compliance with legal and professional standards. An accountant working on an acquisition should not disclose financial details to external parties before the information is publicly announced.

- **Professional behaviour:** Accountants must comply with relevant laws and regulations and avoid actions that discredit the profession. This includes behaving ethically, maintaining transparency, and promoting public confidence in the profession.

  Upholding professional behaviour safeguards the reputation of the accounting profession and ensures high standards of practice. Avoiding involvement in tax evasion schemes or fraudulent activities even when pressured by management or clients.

b) **Reasons why the comparison of primary financial statements is problematic for users despite the global adoption of IFRS**

(i) **Differences in application of IFRS:** While IFRS provides a global framework, companies in different jurisdictions may interpret or apply the standards differently due to variations in regulatory guidance or enforcement mechanisms. This creates inconsistencies in financial reporting, making comparisons less reliable.

(ii) **Impact of judgment and estimates:** IFRS requires the use of professional judgment in areas like asset valuation, impairment and revenue recognition. Subjective estimates can differ significantly between companies. Users may find it challenging to identify whether differences are due to operational realities or varying interpretations of IFRS.

(iii) **Local laws and cultural influences:** Despite IFRS adoption, local laws, tax systems, and cultural practices may influence how companies prepare and disclose financial statements. For example, taxation rules can affect reported profits differently across regions. This can reduce comparability even when companies report under the same IFRS standards.

(iv) **Impact of different economic environments:** Companies operating in diverse countries face varying economic environments, such as inflation rates, exchange rates and interest rates. These differences can significantly influence financial results and ratios, making direct comparisons between companies challenging.

A company operating in a high-inflation economy may show distorted asset values or costs compared to a company in a low-inflation economy, despite similar operational performance.

(v) **Use of management estimates and judgments:** Financial statements often rely on management's estimates and judgments, such as in valuing inventory, calculating depreciation, or assessing impairment. These subjective decisions can vary widely between companies, even within the same industry, affecting comparability.

One company may use aggressive assumptions for revenue recognition, while another applies conservative assumptions, leading to different reported earnings despite similar underlying operations.

(vi) **Different accounting policies:** There is still flexibility allowed in the choice of accounting policies adopted by companies. One important choice involves the option to revalue PPE. This will have an impact on assets and equity values in the financial statements (statement of financial position) and also the amount of depreciation in the statement of profit or loss.

(vii) **Different format of financial statements:** A characteristic of IFRS is that it is flexible in terms of how statements are presented. All statements required minimum disclosures but do not specify precise formats. Furthermore the statement of profit or loss can be presented in different formats (by function or by nature) making comparison particularly difficult.

(viii) **Different year-ends:** Company may prepare their financial statements at any month end of their choice. Some companies involved in seasonal trading may chose a year end that presents a more favourable impression of their financial position than is typical for the year, others may not.

These factors highlight the inherent challenges in achieving full comparability of financial statements, even under global accounting standards like IFRS.

Examiner's report

The question tests candidates' knowledge of possible inappropriate practices that could exist in financial statements when carrying out its review. The question also requires candidates to identify and explain fundamental ethical considerations which professional accountants should always consider as well as to state the reasons why comparison of primary financial statements is problematic to users despite the global adoption of IFRS.

Most candidates attempted the question and performance was average.

Majority of the candidates were able to identify and explain major inappropriate practices when reviewing financial statements. They could also clearly state the fundamental ethical considerations that professional accountants should always consider. However, only few of them could state the reasons why comparison of primary financial statements is problematic to users.

Candidates are advised to ensure to cover all sections of the syllabus for better performance in future examinations of the institute.

Marking guide

		Marks	Marks
a)i	Identification and explanation of three (3) major inappropriate practices at 1½ mark each	4½	
ii	Identification and explanation of three (3) fundamental ethical considerations that professional accountants should always consider at 1½ marks each	4½	9
b)	Stating three (3) reasons why comparison of primary financial statement is problematic for users at 2 marks each		6
	Total		**15**

ICAN/242/Q/B2 Examination No..........................

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – NOVEMBER 2024

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 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 any other **COLOUR OF INK** will not be marked.
8. You are required to attempt **Question ONE (Compulsory)**, **TWO Questions in Section B and TWO Questions in Section C.**
9. Check that you have collected the correct question paper for the examination you are writing.

WEDNESDAY, NOVEMBER 20, 2024

DO NOT TURN OVER UNTIL YOU ARE TOLD TO DO SO

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – NOVEMBER 2024

AUDIT AND ASSURANCE

Time Allowed: $3^1/_4$ 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

Hellen Ayee, a Ph.D Accounting degree holder, recently joined a renowned firm of chartered accountants as a new audit staff. She was excited at the insights she gained upon completion of the firm's mandatory orientation period for new hires. During her first assignment at the audit of a medium sized manufacturing entity, she overheard the supervisor and other more experienced members of the audit team discussing a ₦500 million difference between the actual revenue figure as per trial balance and the revenue of ₦75 billion obtained by an audit-intern staff. As the brainstorming session continued, Hellen understood that ₦500 million is material to the financial statements of the manufacturing entity. She also gathered that the audit team had, as part of the approved work programme, tested controls and noted no exceptions. However, the difficulty started when the difference of ₦500 million was recorded. Rightly, Hellen joined the discussion and together with the audit team, they read and understood the substantive work areas of the work programme.

The supervisor, being satisfied with Hellen's contribution, reassigned the audit of revenue to Hellen with the following instructions:

(i) Familiarise yourself with all the work done to date on revenue;
(ii) Perform the substantive analytical procedures on revenue as well as complete other remaining substantive procedures; and
(iii) Document your conclusions.

The supervisor, recognising that the engagement is for the statutory audit of the financial statements of the manufacturing entity meant for filing in Nigeria, and having noted that you are writing the Skills level of the ICAN Examinations and therefore, have sufficient knowledge and relevant experience to review Hellen's work, assigned the responsibility to you.

Required:

a. During the review of Hellen's work, you noted the necessity to explain the objectives and the need for audit and assurance to her.

Required:

i. Explain the objectives of an external audit and differentiate an audit from an assurance engagement. (3 Marks)

ii. Identify the parties to an audit engagement and highlight the key differences between the responsibilities of the directors of the manufacturing entity and the audit firm. (3 Marks)

b. During your review of Hellen's work, she wondered about the rights and duties of the external auditor. S. 404 of the Companies and Allied Matters Act 2020 (as amended), requires the auditor to form an opinion on matters stated in schedule 5 to CAMA.

Required:

Explain to Hellen the matters in schedule 5 to CAMA. (6 Marks)

c. As you were about to complete your review of Helen's work, the audit-intern staff joined and you needed to provide some coaching.

Required:

i. Explain the **FOUR** guidelines used by auditors to determine the reliability of audit evidence (8 Marks)

ii. Define "Analytical procedures" in accordance with ISA 520 (2 Marks)

iii. Explain **FOUR** issues ISA 520 requires the auditor to consider when using analytical procedures in substantive testing (8 Marks)

(Total 30 Marks)

SECTION B: YOU ARE REQUIRED TO ATTEMPT TWO OUT OF THREE QUESTIONS IN THIS SECTION (40 MARKS)

QUESTION 2

The Committee of Sponsoring Organisations of the Treadway Commission (COSO) describes internal control as a process, effected by an entity's board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories: effectiveness and efficiency of operations; in the reliability of reporting; and in compliance with applicable laws and regulations.

Required:

a. Describe an internal control system. (2 Marks)

b. Explain the different types of internal controls. (6 Marks)

c. Explain **FOUR** components of internal controls. (8 Marks)

d. State the **FOUR** limitations of internal controls. (4 Marks)

(Total 20 Marks)

QUESTION 3

The following is an extract from a publication in a financial newspaper:

"Materiality, a fundamental concept in auditing, is the lens through which the independent auditor examines financial statements to ascertain whether they contain material errors or misstatements and whether the audited financial statements present a true and fair view of the company's financial affairs in accordance with the international standards on auditing. To play this fiduciary role effectively, the auditors must be independent of the shareholders and the management team of the entity"; and

During the recently concluded Annual General Meeting (AGM) of New-Level Insurance Plc, the statutory auditors, Messrs Aliyu & Ayodele (Chartered Accountants) informed the shareholders that they are independent of New-Level Insurance Plc, and that they conducted their audit in sufficient detail to identify material errors or misstatement in the financial statements, if any existed. In turn, the shareholders, knowing that the financial statements were audited to levels of materiality, sought to understand from the auditors the areas for improvement noted for management action during the audit.

A fellow ICAN student shared the excerpt with you as part of your discussions.

Required:

a. Explain **"Audit"** and **"Assurance"**. (3 Marks)

b. Explain the concept of **"True and Fair View"**. (4 Marks)

c. Discuss the importance of the **materiality** concept to an external auditor. (4 Marks)

d. State **TWO** reasons to justify the requirement for an auditor to be independent of the audit client. (4 Marks)

e. In terms of ISA 320, **explain** when the statutory auditor is required to apply the concept of materiality. (5 Marks)

(Total 20 Marks)

QUESTION 4

The IFAC Code provides additional guidance for all professional accountants on how to respond to Non-Compliance with Laws and Regulations (NOCLAR).

Required:

a. State **FIVE** examples of NOCLAR. (5 Marks)

b. Explain NOCLAR framework as it relates to the professional accountant. (5 Marks)

c. Explain **FIVE** steps the professional accountant will take when he becomes aware of NOCLAR. (10 Mark)

(Total 20 Marks)

SECTION C: YOU ARE REQUIRED TO ATTEMPT TWO OUT OF THREE QUESTIONS IN THIS SECTION (30 MARKS)

QUESTION 5

Qual-Bank Limited, a leading bank in Nigeria, has recently recognised the significance of staying abreast of developments in the digital space and has accordingly deployed a state-of-the-art online enterprise system for all its banking operations. The shareholders, being technologically savvy, are concerned that the statutory auditors may not have the skill and experience to audit a bank such as theirs. They understand that such technological advancement in the bank certainly calls for the deployment of digitally supported audit techniques, if they are to have any confidence in the audit report.

The Institute of Chartered Accountants of Nigeria (ICAN) had since, through so many fora, including mandatory training and conferences, equipped members of the Institute to not only adapt to technological changes in their clients' environment but indeed to be ahead of the curve. It is, therefore, to be expected that Tomiwa, the Lead Partner in Tomiwa Chuks & Co, with a wealth of experience in auditing financial institutions, is also well-versed in the application of digital techniques in the provision of audit services.

Together with his teammates, Tomiwa led effort towards updating the team's risk assessment, planning, execution and reporting phases of the audit of Qual-Bank to reflect the significant changes at the bank and to the admiration of management, directors and shareholders. Specifically, Tomiwa implemented integrated real-time audit software into the audit process to:

(i) Support efforts in ascertaining the accuracy and reliability of financial statements; and
(ii) Assess the online transactions and complex financial data generated by the bank's digital system.

You have also deepened your understanding of digital/IT audit techniques and as part of the Qual-Bank audit team, you are required to:

a. Explain **THREE** likely challenges Tomiwa Chuks & Co would face in its just implemented advanced audit software. (9 Marks)

b. Explain **SIX** methods of obtaining audit evidence for substantive testing. (6 Marks)

(Total 15 Marks)

QUESTION 6

High-Flier Nigeria Limited was incorporated in 2003. This visionary company became known as a symbol of innovation and a commitment to excellence. With the passage of time, the company's success stood firmly on the core principles of transparency, accountability, and the presentation of fair financial statements.

At the heart of High-Flier Nigeria Limited's corporate ethos, is the profound understanding of the principal-agent theory - a concept of paramount significance in the realm of corporate governance. This theory emphasises the need for directors to meticulously render accounts of their stewardship to the shareholders.

This accountability is not a mere formality but the very essence of their corporate narrative.

Required:

a. Explain the Principal-agent relationship. (2 Marks)

b. In the context of the above scenario,
   i. Who is the principal?
   ii. Who is the agent? (2 Marks)

c. Explain the concept of stewardship. (2 Marks)

d. Explain **TWO** reasons for which stewardship account is rendered. (4 Marks)

e. Explain the concept of accountability. (2 Marks)

f. Describe "financial statements". (3 Marks)

(Total 15 Marks)

QUESTION 7

Trade and other receivables often form a substantial part of current assets, and the amounts could be significant to the financial statements of an entity. If not well managed, recovery could be expensive and in some instances some balances may be lost.

You are the staff responsible for the audit of trade and other receivables during the year-end statutory audit of Nano-Manufacturing Limited, a company based in Port Harcourt, Nigeria, with approximately 65% of sales on credit.

Required:

a. Describe **TWO** principal risks of misstatement of the balances of trade receivables balances. (2 Marks)

b. Explain **FOUR** purposes of a direct confirmation of receivables. (6 Marks)

c. Explain the **FOUR** requirements of ISA 505 as they relate to the auditor maintaining control over external confirmation requests. (4 Marks)

d. Enumerate **THREE** steps you would take if the client's management refuses to allow you to send a confirmation request. (3 Marks)

(Total 15 Marks)

SOLUTION 1

a. i. **Objectives of an external audit**

The main objective of an external audit is to enable an auditor to express an opinion as to whether the financial statements of an entity are prepared according to the applicable accounting standards and in compliance with the relevant laws and regulations.

The secondary objectives are to prevent and detect errors and frauds, and to give recommendations for improvements in the internal control system to management or those charged with governance.

Distinctions between an audit and an assurance engagement

Audit	Assurance engagement
• This is a review of all aspects of the financial statements.	This is a review into an aspect of the financial statements.
• It is a reasonable form of assurance with high level, but not absolute. Conclusion is usually expressed in a positive form, for example, "in our opinion, the financial statements are true and fair".	It is a limited form of assurance where the practitioner's opinion is expressed in a negative form, for example, "nothing has come to our attention to suggest that information is misstated".
• An audit takes more time and is more costly.	An assurance engagement takes less time and is less costly.
• The auditor is not limited in his/her review of the entire entity.	The practitioner is limited to a segment of the entity for example, a review of a cash flow forecast.

ii. **Parties to an audit engagement include:**

- The management or those charged with governance of the entity;
- The external auditor; and
- Third parties.

Differences in responsibilities of directors and audit firm

The directors are responsible for:

- The preparation of the financial statements in line with the relevant standards and extant laws and regulations;
- Giving the auditors access to their premises and locations;
- Giving explanations to all the auditors' queries; and
- Providing all records and information required by the auditors.

The audit firm is responsible for the:

- Review and audit of the financial statements of the entity; and
- Expression of opinion on the financial statements of the entity.

b. **Section 407 of CAMA 2020 requires the auditor to form an opinion on matters stated in schedule 5 of CAMA 2020, as provided below:**

- Whether the auditors have obtained all information and explanations which to the best of their knowledge and belief were necessary for the purpose of their audit;
- Whether in the auditor's opinion, proper books of accounts have been kept by the company, so far as it appears from their examination of those books, and proper returns adequate for the purpose of audit have been received from branches not visited by them;
- Whether the company's statement of financial position and (unless it is framed as a consolidated profit or loss account) profit or loss account dealt with by the report agree with the books of accounts and returns;
- 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 the Act in the manner so required and give a true and fair view in the case of:
  - ➢ The statement of financial position, of the state of the company's affairs as at the end of it's year; and
  - ➢ The profit or loss account, of the profit or 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 the virtue of Part 1 of the second schedule of the Act, are not required to be disclosed; and
- In the case of 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.

c. **Coaching aspect to the audit intern staff**

i. **Reliability:** This relates to the integrity and credibility of the evidence. The following factors assist in assessing the reliability of an audit evidence:

- Documentary evidence is more reliable than oral evidence;
- Original documents are more reliable than photocopies;
- Evidence obtained from outsider source is more reliable than one from insider source;
- Evidence from satisfactory internal control is more reliable than the one obtained from poor internal control; and
- Evidence generated by auditor himself is more reliable than evidence from client or internal source.

ii. The standard (ISA 520) defines '*Analytical procedures*' as "evaluations of financial information through analysis of plausible relationships among both financial and non-financial data". Analytical procedures also encompass investigation of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount.

iii. **Analytical procedures in substantive testing**

When using analytical procedures in substantive testing, ISA 520 requires the auditor to:

- Determine the suitability of particular substantive analytical procedures for given assertions – that is, how effective they will be in detecting a particular type of material misstatement;
- Develop an expectation of recorded amounts or ratios and evaluate whether that expectation is sufficiently precise to identify a misstatement;
- Evaluate the reliability of the data from which the expectation has been developed; and
- Determine what level of difference from expected amounts is acceptable without further investigation.

Examiner's report

The question tests candidates' knowledge of audit engagements, matters stated in schedule 5 of CAMA 2020 on audit opinion, and substantive testing principles.

Being compulsory, virtually all the candidates attempted the question, but performance was below average.

The common pitfalls were the misrepresentation of the objectives of an external audit and assurance engagements, and specific functions of the external auditors as they relate to Schedule 5 to Companies and Allied Matters Act 2020 (CAMA).
Candidates are advised to read widely making use of the Institute's Pathfinders and Study Text to prepare for future examinations.

Marking guide

			Marks	Marks
(a)	i.	Objectives of external audit		
		Primary objective	½	
		Secondary objective	½	
		Differences between audit and assurance engagements		
		Any 2 correct points @ 1 each	2	3
	ii.	Parties to an audit engagement		
		Any 2 points @ ½ mark each	1	
		Responsibilities of the directors and audit firm		
		2 correct points for directors @ ½ mark each	1	
		2 correct points for audit firm @ ½ mark each	1	3
(b)		Matters in schedule 5 of CAMA 2020		
		2 marks each for any 3 correct points		6
(c)	i.	Guidelines to determine reliability of audit evidence		
		Any 4 correct points @ 2 marks each	8	
	ii.	Defining analytical procedures	2	
	iii.	Four requirements of ISA 520 to the auditor as regards analytical procedures at 2 marks each	8	18
		Total		**30**

SOLUTION 2

a) **An internal control system**

'An internal control system encompasses the policies, processes, tasks, behaviours, and other aspects of a company taken together to:

i. Facilitate its effective and efficient operation by enabling it to respond appropriately to significant business, operational, financial, compliance and other risks to achieving the company's objectives;
ii. Help to ensure the quality of internal and external reporting;
iii. Help to ensure compliance with applicable laws and regulations; and with internal policies with respect to the conduct of business.

b) **Types of Internal control**

ISA 315 categorises internal controls into the following types:

i. **Performance reviews** - These include reviews and analyses of actual performance against budgets, forecasts and prior period performance. Most of these control activities will be performed by management and are often referred to as management controls. They include supervision by management of the work of subordinates, management review of performance and control reporting (including management accounting techniques such as variance analysis).

ii. **Information processing** - A variety of controls are used to check the accuracy, completeness and authorisation of transactions. These controls are split into two broad groupings:
   - Application controls (controls over master files and standing data and controls over inputs, processing and outputs); and
   - General IT controls.

iii. **Physical controls** - These include controls over the physical security of assets and records to prevent unauthorised use, theft or damage. Examples include limiting access to inventory areas to a restricted number of authorised personnel, and requiring authorisation for access to computer programs and data files.

iv. **Segregation of duties** - This control involves assigning different people the responsibilities of authorising and recording transactions and maintaining the custody of assets. This reduces the likelihood of an employee being able to carry out and conceal errors or fraud.

c) **ISA 315 identifies five components which together make up the internal control system:**

i. **The control environment**

The 'control environment' is often referred to as the general 'attitude' to internal control of management and employees in the organisation.

The control environment includes the views, awareness, and actions of management regarding an entity's internal control. It also includes the governance and functions of management and asserts the premise of an organisation. It is the basis for good internal control, providing guidance and structure.

ii. **The entity's risk assessment process**

Within a strong system of internal control, management should identify, assess and manage business risks, on a continual basis. Significant business risks are any events or omissions that may prevent the entity from achieving its objectives.

Identifying risks means recognising the existence of risks or potential risks. Assessing the risks means deciding whether the risks are significant, and possibly ranking risks in order of significance. Managing risks means developing and implementing controls and other measures to deal with those risks.

ISA 315 requires the auditor to gain an understanding of these risk assessment processes used by the client company's management, to the extent that those risk assessment processes may affect the financial reporting process.

iii. **The information system**

An information system consists of the infrastructure (physical and hardware components), the software, the people, the procedures, and the data within the entity.

ISA 315 requires the auditor to gain an understanding of the business information systems (including the accounting systems) used by management to the extent that they may affect the financial reporting process.

iv. **Control activities (internal controls)**

Control activities are the policies and procedures, other than the control environment, used to ensure that the entity's objectives are achieved. They are the application of internal controls. Control activities are the specific procedures designed to prevent errors that may arise in processing information, or to detect and correct errors that may arise in processing information.

v. **Monitoring of controls**

It is important within an internal control system that management should review and monitor the operation of the controls, on a systematic basis, to satisfy themselves that the controls remain adequate and that they are being applied properly. ISA 315 requires the auditor to obtain an understanding of this monitoring process.

d) **Limitations of internal controls**

Internal control systems are never fool proof. All systems, no matter how effective they may appear to be, have several limitations. These include:

i. Human error may result in incomplete or inaccurate processing which may not be detected by control systems;
ii. Certain types of controls may not be cost-effective to be established in an organisation;
iii. Controls may be in place, but they may be ignored or overridden by employees or management; and
iv. Collusion may render segregation of duties to be ineffective. Collusion means that two or more people work together to avoid a control, possibly for the purpose of committing fraud.

Examiner's report

The question tests candidates' knowledge of internal control system and internal controls.

About 90% of the candidates attempted the question, but the performance was fair.
The common pitfall of the candidates was mix-up of meanings of types and components of internal control.

Candidates ate enjoined to be meticulous in their studies. This would ensure proper assimilation of professional knowledge and scholarship.

Marking guide

		Marks
(a)	Description of internal control	2
(b)	Types of internal control	
	3 correct points @ 2marks each	6
(c)	Components of internal control	
	4 correct points @ 2 marks each	8
(d)	Limitations of Internal control	
	4 correct points @ 1 mark each	4
	Total	20

SOLUTION 3

a. An audit is an official examination of the financial statements of an entity by the auditor. The objective of an audit is to enable the auditor form an opinion as to whether the financial statements of the entity give a true and fair view and are prepared according to applicable financial framework.

An assurance engagement is where a firm is engaged by one party to give an opinion on a piece of information that has been prepared by another party. The opinion is an expression of assurance about the information that has been reviewed. It gives assurance to the party that hired the assurance firm that the information can be relied on.

b. The auditor reports on whether the financial statements give a true and fair view, or present fairly, the position of the entity as at the end of the financial period and of the performance of the entity during the period. The auditor does not certify or guarantee that the financial statements are correct.

Although the phrase 'true and fair view' has no legal definition, the term 'true' implies free from error, and 'fair' implies that there is no undue bias in the financial statements or the way in which they have been presented. In preparing the financial statements, a large amount of judgement is though exercised by the directors.

Similarly, judgement is exercised by the auditor in reaching his opinion. The phrases 'true and fair view' and 'present fairly' indicate that a judgement is being given that the financial statements can be relied upon and have been properly prepared in accordance with an appropriate financial reporting framework.

c. **The materiality concept**

The auditor reports in accordance with the concept of materiality. He gives an opinion on whether the financial statements present fairly in all material respects the financial position and performance of the entity. Information is material if, on the basis of the financial statements, it could influence the economic decisions of users should it be omitted or misstated.

Applying the concept of materiality means that the auditor will not aim to examine every number in the financial statements. He will concentrate his efforts on the more significant items in the financial statements, either because of their value, or because there is a greater risk that they could be omitted or stated incorrectly.

d. **Reasons to justify the requirements for an auditor to be independent of the audit client include:**

i. To avoid undue influence from management of the entity;
ii. To ensure that the auditor complies with all relevant laws and financial reporting requirements; and
iii. To ensure that the auditor does not have any financial or other vested interest in the client's organisation.

e. **ISA 320: *Materiality in planning and performing an audit* requires the auditor to apply the concept of materiality:**

i. When planning and performing the audit;
ii. When evaluating the effect of misstatements on the financial statements and therefore on his audit opinion; and
iii. When assessing the aggregate of all material aspects of the audit at the reporting stage.

Examiner's report

The question tests the candidates' knowledge of audit and assurance, and independence of the auditor on materiality concept.

About 80% of the candidates attempted the question, but performance was just fair. The common pitfall was the candidates' inability to explain the fundamental audit issues.

Candidates are advised to study very well for the next examination and make use of the Institute's Study Text and other relevant publications.

Marking guide

		Marks
(a)	Explanation of audit and assurance	3
(b)	Explanation of true and fair View	4
(c)	Explanation of importance of materiality	4
(d)	Justification of auditors independence	
	(2 marks any two)	4
(e)	Concept of materiality	
	Any 2 correct points @ 2 ½ marks	5
	Total	**20**

SOLUTION 4

a) **Examples of Non-Compliance with Laws and Regulation (NOCLAR) include:**

i. Fraud, corruption, and bribery;
ii. Money laundering, terrorist financing and proceeds of crime;
iii. Securities markets and trading;
iv. Banking and other financial products and services;
v. Data protection;
vi. Tax and pension liabilities and payments;
vii. Environmental protection;
viii. Public health and safety, and
ix. Non compliance with government financial regulations.

b) **Implications of the NOCLAR Framework**

Under the framework, auditors cannot simply resign from an engagement because of identified or suspected NOCLAR without the matter being appropriately addressed.

The NOCLAR framework explains:

i. The process to be followed when a professional accountant encounters a suspected fraud or illegal act (i.e., NOCLAR); and
ii. The circumstances in which a professional accountant would override the fundamental principle of confidentiality and disclose the matter to an appropriate authority (also known as whistle-blowing).

c) **Where a professional accountant becomes aware of a matter relating to NOCLAR, he must:**

i. Obtain an understanding of the matter;
ii. Advise management to rectify, remediate, or mitigate the consequences of non-compliance;
iii. Deter the commission of the non-compliance where it has not yet occurred;
iv. Advise management to disclose the matter to an appropriate authority; and
v. Advise management to determine whether further action is needed by considering the appropriateness of management's response.

Examiner's report

The question tests candidates' knowledge of Non-Compliance with Laws and Regulations (NOCLAR).

About 10% of the candidates attempted the question, and performance was fair.
The pitfall of the candidates was lack of proper coverage of the subject syllabus, especially the current issues in auditing.

Candidates are advised to be up-to-date in their studies, incorporating new and contemporary issues and developments. Additionally, they should always make use of the Institute's Study Text and Pathfinder.

Marking guide

		Marks
(a)	Examples of NOCLAR	
	1 mark each for 5 correct points	5
(b)	Implications of NOCLAR	
	2½ marks each subject to a maximum of 2 points	5
(c)	Steps to take when aware of NOCLAR	
	2 marks each subject to a maximum of 5 correct points	10
	Total	**20**

SOLUTION 5

a) **Likely Challenges with using advanced audit software**

Advanced audit software may need to be written so that it is compatible with the client entity's IT system, and can therefore face challenges in its use, particularly in the following circumstances:

i. When it is being used for the first time for a client, so that the audit firm has high set-up costs;

ii. The client entity changes its accounting system, so that new the audit software would need to be modified substantially;

iii. There may be problems with producing a suitable audit software where the client has an old purpose-written IT accounting system for which there is incomplete system documentation; and

iv. When using copies of client's files, the auditor should insist on observing the copying of the files to make sure that they are correct and genuine.

b) **Methods of obtaining audit evidence for substantive testing include:**

i. **Inspection -** Obtaining evidence about an item by sighting it. For example, an auditor can obtain evidence about the existence of tangible non-current assets by going to look at them or to confirm existence physically;

ii. **Observation** -The auditor can obtain evidence by watching a procedure and seeing how it is carried out, for instance, physical inventory count process;

iii. **Inquiry** - Evidence can be obtained by asking questions. For example, evidence about the existence of trade receivables can be obtained by asking customers on the list of trade receivables to confirm that they do owe the amount of money that the client company asserts;

iv. **Confirmation -** This is a specific type of inquiry where the auditor seeks confirmation from a party outside the entity, for example, from a bank or a customer;

v. **Re-calculation** - The auditor checks the arithmetical accuracy of documents or records, for example, payroll recomputation;

vi. **Reperformance -** The auditor independently re-performs, or carries out procedures or controls originally performed by the client; and.

vii. **Analytical procedures -** These are ratios and comparative analyses computed by the auditor to reveal relationships between actual, expected, and periodic financial and non-financial information.

Examiner's report

The question tests candidates' knowledge of challenges in the implementation of advanced audit software in the audit process and audit evidence.

About 80% of the candidates attempted the question, but performance was only fair. The common pitfall of the candidates was their inability to explain computer audit software and associated issues and challenges.

Candidates are advised to be adequately equipped with modern audit techniques and issues.

Marking guide

		Marks
(a)	Likely challenges Tomiwa Chuks & Co. would face for implementation of advanced audit software	
	3 marks each subject to maximum of 3 points	9
(b)	Methods of obtaining audit evidence for substantive testing	
	1 mark each for any correct 6 points	6
	Total	**15**

SOLUTION 6

a) The relationship between the shareholders of a company and the board of directors is an application of the general legal principle of agency. The concept of agency applies whenever one person or group of individuals acts as an agent on behalf of someone or group (the principal). The agent has a legal duty to act in the best interests of the principal, and should be accountable to the principal for everything that he does as agent.

b) i. The principal is the shareholders.
ii, The agent is the directors.

c) **Stewardship**
The directors play a stewardship role in the affairs of the company. They look after the assets of the company and manage them on behalf of the shareholders. In small companies, the shareholders may be the same people as the directors. However, in most large companies, the two groups are different.

d) **Why stewardship accounts should be rendered**

i. The directors are usually different and distinct from the owners - the shareholders.
ii. To present a record of the financial affairs to the owners at the end of a period.

e) **Accountability**
As agents for the shareholders, the board of directors should be accountable to the shareholders. For the directors to show their accountability to the shareholders, it is a general principle of company law that the directors are required to prepare annual financial statements, which are presented to the shareholders for their approval.

f) **Financial Statements**

The financial statements refer to the compendium comprising:

i. Statement of financial position;
ii. Statement of profit or loss and other comprehensive income;
iii. Statement of changes in equity;
iv. Statement of cashflows; and
v. Statement of value-added.

Examiner's report

The question tests the candidates' knowledge of the Principal - Agent relationship, stewardship and accountability as they relate to audit and financial statements.

About 75% of the candidates attempted the question and the performance was fair. The common pitfall of the candidates was their inability to relate their solutions on Principal and Agent, Stewardship and Accountability to the scenario as required by the question.

Candidates are expected to relate their theoretical knowledge to the practical and relevant requirements of the question.

Marking guide

			Marks	Marks
(a)		Explanation of Principal-agent relationship		2
(b)	i.	Definition of principal	1	
	ii.	Definition of an Agent	1	2
(c)		Explanation of concept of stewardship		2
(d)		Reasons for stewardship		
		Any two correct reasons at 2 marks each		4
(e)		Explanation of concept of accountability		2
(f)		Description of financial statements		
		Stating three correct components		3
		Total		**15**

SOLUTION 7

a) **The principal risks of misstatement of the trade receivables balances are due to:**

i. Receivables being irrecoverable (the valuation assertion);
ii. Receivables being contested by customers (the existence rights and obligations assertions); and
iii. Cut-off between goods outwards and receivables recording being incorrect (the cut-off assertion – an income statement assertion that has a knock-on effect to the audit of trade receivables).

b) **A direct confirmation of receivables is intended to check the following assertions:**

i. **Existence assertion** - That the receivables do in fact exist, and there is no over statement of receivables in the financial statements;

ii. **Rights and obligations assertion** - That the client entity has the legal right to the amounts receivable;

iii. **Valuation assertion** - That the receivables are stated at their appropriate amounts; and

iv. **Cut-off assertion** - That transactions have been recorded in the correct accounting period.

c) **The requirements of ISA 505 that the auditor should maintain control over external confirmation requests include:**

i. Deciding on the information to be confirmed or requested;
ii. Selecting the "confirming party" (for example, the financial director/controller at the entity contacted);
iii. Designing the confirmation requests (including an instruction for responses to be sent directly to the auditor); and
iv. Sending the requests himself.

d) **If management refuse to allow the auditor to send a confirmation request, the auditor should:**

i. Enquire into and validate the reasons for such refusal;
ii. Consider the implications of the refusal on risk assessment and other audit procedures;
iii. Perform alternative audit procedures; and
iv. Communicate with those charged with governance.

Examiner's report

The question tests the candidates' knowledge of substantive procedures as they relate to receivables and ISA 505 - *External confirmations.*

About 80% of the candidates attempted the question, and performance was fair.

The common pitfall of the candidates was their inability to explain the requirements of ISA 505.

Candidates are advised to read widely, especially taking note of relevant International Standards on Auditing (ISAs) in their studies.

Marking guide

		Marks
(a)	Principal risks of misstatement of trade receivable 1 mark each for any 2 points	2
(b)	Purposes of direct confirmation of receivables 1½ mark each for any correct 4 points	6
(c)	Requirements of ISA 505 on auditor's control over external confirmation request 1 mark each for any 4 points	4
(d)	Steps to take on client's management refusal to allow confirmation request 1 mark each for any 3 points	3
	Total	**15**

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – NOVEMBER 2024

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 any other **COLOUR OF INK** will not be marked.
8. A formula sheet and discount tables are provided with this examination paper.
9. You are required to attempt **Question ONE (compulsory), any TWO Questions in Section B and any Two questions in Section C**.
10. Check that you have collected the correct question paper for the examination you are writing.

WEDNESDAY, NOVEMBER 20, 2024

DO NOT TURN OVER UNTIL YOU ARE TOLD TO DO SO

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – NOVEMBER 2024

PERFORMANCE MANAGEMENT

Time Allowed: $3^1/_4$ 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

Kayode Limited (KL) manufactures and sells a product (XW) which is widely used in the construction industry. Although XW (and competitors' products) have sold well for many years, KL believes that products of this type are now reaching the end of their life cycles because of concerns about their long term environmental impact. KL has adopted a strategy which is designed to achieve profitability for XW in what the company believes will be for the short remaining product's lifespan as indicated below:

The only variable cost of manufacturing XW is raw materials. The following table shows the standard variable cost of manufacturing 95 kilograms of XW:

	Kilograms	Purchase Price	Total cost	
Raw material A	50 kg	₦160 per kg.	50 × ₦160	= ₦8,000
Raw material B	30 kg	₦180 per kg.	30 × ₦180	= ₦5,400
Raw material C	20 kg	₦280 per kg.	20 × ₦280	= ₦5,600
Total raw material input	100 kg			₦19,000
Less: Normal loss	5 kg			
Normal output	95 kg			

Last month, KL produced 19,000 kilograms of XW and sold these for ₦368 per kilogram (₦18 per kilogram higher than the budgeted selling price). The actual sales quantity represented a 30% market share and was 5% less than the budgeted sales quantity. When KL was preparing its budget, the budget committee assumed that the company would have a 25% market share.

The actual costs of the raw materials purchased and used last month were as follows:

Raw material A	9,800 kg @ ₦165 per kg =	₦1,617,000
Raw material B	6,800 kg @ ₦175 per kg =	₦1,190,000
Raw material C	4,400 kg @ ₦295 per kg =	₦1,298,000
Total cost		**₦4,105,000**

Required:

a. Determine KL's budgeted and actual contribution for XW for last month. Then, carry out a variance analysis to reconcile the budgeted and actual contribution in as much detail as possible from the information provided. (22 Marks)

b. Critically evaluate the success of the strategy adopted by KL in relation to XW. Justify your answer, having regard to the particular phase of the product's lifecycle (as identified in the question) and making use of the information available from your answer to part (a) above. (8 Marks)

(Total 30 Marks)

SECTION B: YOU ARE REQUIRED TO ATTEMPT TWO OUT OF THE THREE QUESTIONS IN THIS SECTION (40 MARKS)

QUESTION 2

Okekedem Nigeria Limited is considering the use of Activity-Based Costing (ABC) approach in its overhead recovery. The company manufactures 2 products known as Alpham and Betam.

Details of production for the two products are given below:

	Alpham	Betam
Annual production in units	120,000	120,000
Direct labour time per unit in hours	20	25
Number of special parts per unit	10	40
Number of set ups per batch	10	30
Number of sales invoices issued per year	500	2,400
Number of separate materials issued per batch	10	10
Batch size units	10,000	50

The analysis of the overhead costs provided the following information:

S/N	Overhead cost analysis	Amount (₦)	Cost driver
1	Set up costs	2,928,000	Number of set ups
2	Special part handling costs	2,400,000	Number of special parts
3	Customer invoicing costs	1,160,000	Number of invoices
4	Material handling cost	2,520,000	Numbers of batches
5	Other overheads	4,320,000	Labour hours

Required:

a. i. Use the traditional approach to determine the direct labour hourly rate for the company. (1 Mark)

ii. Use the direct labour hour rate to compute the overhead rate attributable to a unit of Alpham and Betam products. (2 Marks)

b. i. Determine the cost driver rate using the ABC approach (9 Marks)
ii. Compute the overhead rate per unit of each products using the ABC approach. (3 Marks)

c. If the unit material and labour costs for the products are as shown below, determine their unit selling prices where the company adheres to a policy of 20% profit margin using the two overhead absorption methods.

	Material cost	Labour	
Alpham	₦400	₦100	
Betam	₦500	₦125	(5 Marks)

(Total 20 Marks)

QUESTION 3

Agege and Sons Bakery Limited uses absorption costing technique in its accounting system. The company produces and sells three bakery products, namely Four Corner Loaf (F), Round Corner Loaf (R) and Executive Loaf (E) which are substitutes for each other. The following standard selling prices and cost data relate to these three products:

Product	**Selling Price**	**Direct materials Per unit**	**Direct labour Per unit**	**Variable expenses**
	Per unit	(₦)		Per unit
F	200.00	25kg at ₦3/kg	1.2 hrs at ₦10/hr	1.2hrs at ₦5/hr
R	250.00	30kg at ₦3/kg	1.5hrs at ₦10/hr	1.5hrs at ₦5/ hr
E	300.00	38kg at ₦3/kg	1.8hrs at ₦10/hr	1.8hrs at ₦5/hr

Annual budgeted fixed production overhead was ₦4,320,000. The company policy is that overhead will be absorbed on a machine hour basis. The standard machine hour for each product and the monthly budgeted level of production and sales for each product are as follows:

Product	F	R	E
Standard machine hour per unit	0.3 hr	0.6 hr	0. 8 hr
Monthly budgeted production and sales (units)	10,000	13,000	9,000

Actual volumes and selling prices for the three products in a particular month are as follows:

Product	F	R	E
Actual selling price per unit (₦)	220	260	320
Actual production and sales (unit)	9,500	13,500	8,500

You are required to:

a. Calculate the following variances for the particular month:

   i. Sales price variance (2 Marks)
   ii. Sales volume variance (2 Marks)
   iii. Sales mix variance; and (3 Marks)
   iv. Sales quantity variance. (3 Marks)

b. Determine the monthly budgeted profit for the company. (6 Marks)

c. Discuss the significance of sales mix variances in a variance accounting system. (4 Marks)

(Total 20 Marks)

QUESTION 4

Paint Masters Limited is a fast growing paint manufacturing company established six years ago. The company sells its products directly to retailers, wholesalers and also accepts special orders directly from customers.

On May 1, 2021 a special order for a gallery painting was received from the Arts Gallery, a non-profit making government department. The work, if the order is accepted, would be carried out in addition to the normal work of the company. As a result of existing commitments, some weekend and overtime working would be required to complete the painting of the gallery.

A part-time accounting trainee has produced the following cost estimates based on the resources required for the contract:

		₦
Direct materials	- Paint Deluxe (book value)	50,000
	- Paint Unique (purchase price)	40,000
Direct labour	- Skilled 300 hours @ ₦150.00	45,000
	- Unskilled 150 hours @ ₦100.00	15,000
Variable overhead	350 hours @ ₦110.00	38,500
Painting equipment depreciation	300 hours @ ₦200.00	60,000
Fixed production costs	250 hours @ ₦150.00	37,500
Estimating Department costs		2,500
Public Relation (PR) costs		10,000
		298,500

The management of Paint Masters Limited is of the view that securing this contract will lead to considerable publicity for the company and is geared to presenting a competitive tender to win the order.

The following notes are relevant to the cost estimate above:

(a) Material Paint Deluxe to be used is currently in stock at a value of ₦50,000. It is of an unusual colour which has not been used for some time. The replacement price of the paint is ₦90,000, while the scrap value of the one in stock is ₦30,000. The project manager does not foresee any alternative use for the paint if it is not used for the gallery painting.

(b) Paint Unique required for the contract is not held in stock. It would have to be bought in bulk at a cost of ₦80,000. 70% of the paint purchased would be used for the contract and no other use is foreseen for the remaining portion of the purchase.

(c) Skilled direct labour is in short supply and to accommodate the gallery painting contract, 50% of the time required would be worked at weekends for which a premium of 30% above the normal hourly rate is paid. The normal hourly rate is ₦150.00 per hour.

(d) Unskilled labour is presently under-utilised, at present 300 hours per week are recorded as idle time. If the painting work is carried out at a weekend, 30 unskilled hours would have to occur at this time, but the employees concerned would be given two hours' time off (for which they would be paid) in lieu of each hour worked.

(e) Variable overhead represents the cost of operating the gallery painting contract.

(f) When not being used by the company, the painting equipment is rented out to outside clients for ₦5,000.00 per hour. This earns a contribution of ₦4,000.00. There is unlimited demand for this facility.

(g) Fixed production costs would be incurred irrespective of the gallery contract.

(h) The cost of the estimating department represents time spent in discussions with the Arts Gallery Committee for the painting contract.

(i) The Public Relation costs relate to miscellaneous expenses allowable for the contract.

Required:

a. Prepare a revised cost estimate using relevant cost approach, showing clearly, the minimum price that the company should accept for the contract. Give reasons for each resource valuation in your cost estimate. (15 Marks)

b. Identify **FOUR** non-monetary factors that should be taken into consideration before accepting the Art Gallery Contract. (5 Marks)

(Total 20 Marks)

SECTION C: YOU ARE REQUIRED TO ATTEMPT TWO OUT OF THE THREE QUESTIONS IN THIS SECTION (30 MARKS)

QUESTION 5

The most recent published results for Tinko Plc. (TP) are shown below:

	Published (₦m)
Profit before tax for year ending 31 December	13.6
Summary of consolidated statement of financial position at 31 December:	
Non-current assets	35.9
Current assets	137.2
Less: Current liabilities	(95.7)
Net current assets	41.5
Total assets less current liabilities	77.4
Borrowings	(15.0)
Deferred tax provisions	(7.6)
Net assets	54.8
Capital and reserves	54.8

An analyst working for a stockbroker has taken these published results, made the adjustments shown below, and has reported his conclusion that 'the management of TP is destroying value'.

Analyst's adjustments to profit before tax:

	(₦m)
Profit before tax	13.6
Adjustments	
Add: Interest paid (net)	1.6
Research and development (R & D)	2.1
Advertising	2.3
Amortisation of goodwill	1.3
Less: Taxation paid	(4.8)
Adjusted profit	16.1

Analyst's adjustments to summary of consolidated statement of financial position at 31 December

	(₦m)	
Capital and reserves	54.8	
Adjustments		
Add: Borrowings	15.0	
Deferred tax provisions	7.6	
R&D	17.4	Last 7 year's expenditure
Advertising	10.5	Last 7 year's expenditure
Goodwill	40.7	Written off against reserves on acquisitions in previous years
Adjusted capital employed	146.0	
Required return	17.5	12% cost of capital
Adjusted profit	16.1	
Value destroyed	1.4	

The Chairman of TP has obtained a copy of the analyst's report.

Required:

a. As the finance controller of TP, explain the principles of the approach taken by the analyst. (5 Marks)

b. Comment on the treatment of the specific adjustments to R&D, Advertising, Interest and Borrowings and Goodwill. (10 Marks)

(Total 15 Marks)

QUESION 6

Oforogere Nigeria Limited is a company located in Onitsha which manufactures motor cycles. The company has two divisions: The engine division and the assembly division.

The engine division manufactures and sells a standard engine as used by the Motor cycle. The engine division supplies the manufactured engines to both the assembly division and external customers. The following information is available for the period in respect of the engine division:

Capacity in Units	100
Selling price to external customer in the intermediate market	₦60,000
Variable cost per unit	₦32,000
Fixed cost per unit based on capacity	₦18,000

The Assembly division of the company can use the engine in the manufacture of motor cycle. The Assembly division currently purchases 10 motor cycle engines at a cost of ₦58,000 per engine.

Required:

a. i. If the engine division is selling all that it can manufacture to outside customers in the intermediate market and ₦6,000 variable costs per engine can be avoided on transfers within the company, due to reduced selling costs, what is the acceptable range, if any, for the transfer price between the two divisions? (2 Marks)

ii. If the engine division has ample idle capacity to handle all assembly divisions needs, what is the acceptable range , if any , for the transfer prices between the two divisions? (3 Marks)

iii. If the engine division is selling all that it can produce to outside customers in the intermediate market, what is the acceptable range, if any, for the transfer price between the two divisions? (4 Marks)

b. Explain the concept of environmental management accounting and state the reasons why companies need to report their environmental activities in Nigeria. (6 Marks)

(Total 15 Marks)

QUESTION 7

PT manufactures and sells a number of products. All of its products have a life cycle of six months or less. PT uses a four stage life cycle model (introduction; Growth; Maturity; and Decline) and measures the profits from its products at each stage of their life cycle.

PT has recently developed an innovative product. Since the product is unique, it was decided that it would be launched with a market skimming pricing policy. However, PT expects that other companies will try to enter the market very soon.

This product is generating significant unit profits during the introduction stage of its life cycle. However there are concerns that the unit profits will reduce during the other stages of the product's life cycle.

Required:

Explain the likely changes that will occur in the unit selling prices and in the unit production costs, compared to the proceeding stage for each of the following:

i. Growth (9 Marks)

ii. Maturity stages of the new products' life cycle (6 Marks)

(Total 15 Marks)

Formulae

Learning curve

$Y = ax^b$

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

a = the time taken for the first unit of output

x = the cumulative number of units produced

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

LR = the learning rate as a decimal

Demand curve

$P = a - bQ$

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

a = price when Q = 0

$MR = a - 2bQ$

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

$$Y = a + bX$$

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)

$$r^2 = \frac{(n\sum XY - \sum x\ \sum Y1)^2}{(n\sum X^2 - (\sum X)^2\ (n\sum y^2 - (\sum X)^2}$$

The Miller-Orr Model

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

Annuity Table

Present value of an annuity of 1 = $\dfrac{1 - (1 + r)^{-n}}{r}$

Where r = discount rate

n = number of periods

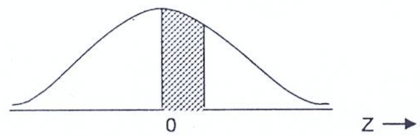
Discount rate (r)

Periods

(n)	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%	
1	0·990	0·980	0·971	0·962	0·952	0·943	0·935	0·926	0·917	0·909	1
2	1·970	1·942	1·913	1·886	1·859	1·833	1·808	1·783	1·759	1·736	2
3	2·941	2·884	2·829	2·775	2·723	2·673	2·624	2·577	2·531	2.487	3
4	3·902	3·808	3.717	3·630	3.546	3.465	3·387	3·312	3·240	3·170	4
5	4·853	4·713	4·580	4·452	4·329	4·212	4·100	3·993	3.890	3·791	5
6	5·795	5·601	5·417	5·242	5·076	4·917	4·767	4·623	4.486	4·355	6
7	6·728	6.472	6·230	6·002	5·786	5·582	5·389	5·206	5·033	4·868	7
8	7·652	7·325	7·020	6·733	6·463	6·210	5·971	5·747	5·535	5·335	8
9	8·566	8·162	7·786	7.435	7·108	6·802	6·515	6·247	5·995	5·759	9
10	9·471	8·983	8·530	8·111	7·722	7·360	7·024	6·710	6.418	6·145	10
11	10·368	9·787	9·253	8·760	8·306	7·887	7.499	7·139	6·805	6.495	11
12	11·255	10·575	9·954	9·385	8·863	8·384	7·943	7·536	7'161	6·814	12
13	12·134	11·348	10·635	9·986	9·394	8·853	8·358	7·904	7·487	7·103	13
14	13·004	12·106	11·296	10·563	9·899	9·295	8·745	8·244	7·786	7·367	14
15	13·865	12·849	11·938	11·118	10·380	9·712	9·108	8·559	8·061	7·606	15
(n)	11%	12%	13%	14%	15%	16%	17%	18%	19%	20%	
1	0·901	0·893	0·885	0·877	0·870	0·862	0·855	0·847	0·840	0·833	1
2	1·713	1·690	1·668	1·647	1·626	1·605	1·585	1·566	1·547	1·528	2
3	2.444	2.402	2·361	2·322	2·283	2·246	2·210	2·174	2·140	2·106	3
4	3·102	3·037	2·974	2·914	2·855	2·798	2·743	2.690	2·639	2.589	4
5	3·696	3·605	3·517	3·433	3·352	3·274	3·199	3·127	3·058	2·991	5
6	4·231	4·111	3·998	3·889	3·784	3·685	3·589	3.498	3.410	3·326	6
7	4·712	4·564	4.423	4·288	4·160	4·039	3·922	3·812	3·706	3·605	7
8	5·146	4·968	4.799	4·639	4.487	4·344	4·207	4·078	3·954	3·837	8
9	5·537	5·328	5·132	4·946	4·772	4·607	4.451	4·303	4·163	4·031	9
10	5·889	5·650	5.426	5·216	5·019	4·833	4·659	4.494	4·339	4·192	10
11	6·207	5·938	5·687	5.453	5·234	5·029	4·836	4·656	4.486	4·327	11
12	6·492	6·194	5·918	5·660	5·421	5·197	4·988	4·793	4·611	4.439	12
13	6·750	6.424	6·122	5·842	5·583	5·342	5·118	4·910	4·715	4·533	13
14	6·982	6·628	6·302	6·002	5·724	5.468	5·229	5·008	4·802	4·611	14
15	7·191	6·811	6.462	6·142	5·847	5·575	5·324	5·092	4·876	4·675	15

NORMAL DISTRIBUTION

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



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

SECTION A

SOLUTION 1

a) **Kayode Limited**

Budgeted contribution last month

Budgeted Selling price/kg	= ₦368 - ₦18	= ₦350
Budgeted VC/kg	= ₦19,000/95kg	= ₦200
Budgeted contribution/kg		₦150
Budgeted sales quantity	= 19,000kg/0.95*	= 20,000kg
Total budgeted contribution	= 20,000 kg × ₦150	= ₦3,000,000

(* Actual sales were 95% of budget)

Actual contribution last month

		₦000
Actual sales = 19,000 kg × ₦368	=	6,992
Total variable cost	=	4,105
Actual contribution		2,887

Materials Price Variance (MPV)

	Std price	Actual Price	Actual Qty	Variance (₦000)
A	₦160	₦165	9,800	49 (A)
B	₦180	₦175	6,800	34 (F)
C	₦280	₦295	4,400	66 (A)
Total	MPV			81 (A)

Material Mix Variance (MMV)

	Actual Qty in Std Mix (5:3:2)	Actual Qty in actual mix	Std Price/Kg ₦	Variance
	(a)	(b)	(c)	(a-b) × (c)
	Kg	Kg	₦	₦000
A	10,500	9,800	160	112 (F)
B	6,300	6,800	180	90 (A)
C	4,200	4,400	280	56 (A)
Total	**21,000**	**21,000**		**34 (A)**

Material Yield Variance (MYV)

Std material cost per kg of output	=	₦19,000/95 kg = ₦200
Actual Yield	=	19,000kg of output
Std Yield = 21,000 kg × 95/100	=	19,950kg of output

MYV = (Actual Yield – Std Yield) × Std RM Cost/kg of output

= (19,000 – 19,950) × ₦200 = ₦190,000 (A)

OR: Alternative Calculation of MYV

Standard quantity in standard mix:

A19,000 × 50/95 = 10,000 kg
B19,000 × 30/95 = 6,000 kg
C19,000 × 20/95 = 4,000 kg
20,000 kg

	Std Q Ty In Std mix (a) Kg	Actual Qty in Std mix (b) Kg	Std Price per kg (c) ₦	Yield Variance (d) = (a-b) × (c) ₦190,000 (A)
A	10,000	10,500	160	80 (A)
B	6,000	6,300	180	54 (A)
C	4,000	4,200	280	56 (A)
Total	**20,000**	**21,000**		**190 (A)**

Sales Price Variance (SPV)

Actual Price – Budgeted Price x Actual Qty = (₦368 – 350)(19,000) = ₦342,000 (F)

Market Size Variance (MZV)

$$MZV = \begin{pmatrix}\text{Budgeted}\\ \text{market}\\ \text{share }\%\end{pmatrix} \times \begin{pmatrix}\text{Actual} & & \text{Budgeted}\\ \text{industry sales} & - & \text{industry sales}\\ \text{in units} & & \text{in units}\end{pmatrix} \times \begin{pmatrix}\text{Budgeted}\\ \text{contribution}\\ \text{per unit}\end{pmatrix}$$

$$= (25\%)\left(\frac{19{,}000}{30\%} - \frac{20{,}000}{25\%}\right) \text{ X (₦150) = 625,000 (A)}$$

Market Share Variance (MSV)

$$MSV = \begin{matrix}\text{Actual}\\ \text{Industry sales}\\ \text{in units}\end{matrix} \times \begin{pmatrix}Actual & & Budgeted\\ market & - & market\\ share\ \% & & share\%\end{pmatrix} \times \begin{matrix}\text{Budgeted}\\ \text{contribution}\\ \text{per unit}\end{matrix}$$

$$= \frac{19{,}000}{30\%} \times (30\% - 25\%) \text{ X ₦150 = 475,000 (F)}$$

Reconciliation of contribution

	₦'000	₦'000
Budgeted Contribution		3,000
Material Price Variance		81(A)
Material Mix Variance	34(A)	
Material Yield Variance	190(A)	
Material Usage Variance		224 (A)
Sales Price Variance		342 (F)
Market Size Variance	625 (A)	
Market Share Variance	475 (F)	
Sales Volume Variance		150 (A)
Actual Contribution		2,887

b) The strategy seems to have centred around trying to achieve an increased share of a declining market. The evidence for this is that market share increased significantly (from budgeted 25% to actual 30%). This helped somewhat to offset the fact that the total market shrank very significantly in by 20.83% (from 80,000 units budgeted to 63,333 units actual).

How was this achieved? It seems likely that the quality of the product was deliberately improved. All of the variances in relation to raw materials are unfavourable. KL may have purchased more expensive versions of the raw materials (MPV ₦81,000 (A)), combined them in ways which made use of the more expensive types B and C (MMV ₦34,000 (A)), and been more stringent in the removal of wastage in production (MYV ₦190,000 (A)).

Was this financially successful? In short, yes. The combined cost of the 3 raw materials referred to above is ₦305,000. But the benefits (in terms of an increased market share and a higher selling price) were ₦342,000 (F) + ₦475,000 (F) = ₦817,000 (F).

So it could be said that there was a net gain from the strategy of (₦817,000 – ₦305,000 = ₦512,000).

Why then was the actual total contribution for the month below budget? Only because of the market size variance (₦625,000 (A)) which was uncontrollable by the company. If the company had not adopted the strategy that it did, then the decrease in contribution experienced would have been far worse than it actually was.

Examiner's report

This is a compulsory question that tests candidates' knowledge of how to handle advanced variance analysis and reconciliation of budgeted contribution with actual contribution. The question also tests with the analysis of Product life cycle as it relates to variance accounting.

Being a compulsory question, it was attempted by most candidates. The candidates recorded average performance.

The pitfall is that most candidates failed to compute material mix and material yield variances. Candidates are encouraged to study the Institute's Study Text when preparing for future examination.

Marking guide

		Marks	Marks	Marks
1a.	Budgeted Contribution Actual Contribution Reconciliation of Budgeted and Actual Contribution		22	
b.	Evaluation of the Product life cycle in variance analysis.		8	**30**

SECTION B

SOLUTION 2

a.i. Labour hourly rate $= \dfrac{₦13,328,000}{5,400,000}$

$= ₦2.468$ per labour hour

a.ii Overhead attributable to each of the Product

AlphamBetam		
Blanket rate	₦2.468	₦2.468
Labour Hours	20	25
Overhead cost per unit	₦49.36	₦61.70

b.i. Computation of cost driver absorption rate

S/n	Activity	Cost Allocated (₦)	Cost Driver	Total Activity(₦)	Cost driver rate (₦)
1.	Set up cost	2,928,000	No. of set up	72,120	40.599
2.	Special handling cost	2,400,000	No. of special parts	6,000,000	0.40
3.	Customer invoicing costs	1,160,000	No. of invoices	2900	400
4.	Material handling cost	2,520,000	No. of batches	2412	1044.77
5.	Other overheads	4,300,000	Labour hours	5,400,000	0.80
6.		13,328,000			

Computation of total activity

Product	No. of setup	No of spare parts	No. of invoice	No. of Batches	Labour hours
Alpham	120	1,200,000	500	12	2,400,000
Betam	72000	4,800,000	2400	2400	3,000,000
Total	72120	6,000,000	2900	2412	5,400,000

b.ii. Determination of total and unit overhead allocation to the Product:

S/n	Particulars	Alpham ₦	Betam ₦
1.	Set up cost		
	120 x ₦40.599	4,872.00	
	7200 x ₦40.599		2,923,128.00
2.	Special Part handling costs:		
	1,200,000 x ₦0.40	480,000.00	
	4,800,000 x ₦0.40		1,920,000.00
3.	Customer invoicing costs:		
	500 x ₦400	200,000.00	
	2400 x ₦400		960,000.00
4.	Material handling costs:		
	12 x ₦1044.77	12,537.00	
	2400 x ₦1044.77		2,507,463.00
5.	Other overhead:		
	2,400,000 x ₦0.80	1,920,000.00	
	3,000,000 x ₦0.80		2,400,000.00
	Total Overhead	2,617,409.00	10,710,591.00
	Units Produced	120,000.00	120,000.00

Unit overhead cost	21.81	89.255.00

c. Selling Price for each Product using Traditional Method

Cost Particulars	**Alpham(₦)**	**Betam(₦)**
Material cost	400.00	500.00
Labour cost	100.00	125.00
Overhead cost	49.36	61.70
Total costs	549.36	686.70
Profit	137.34	171.68
Selling Prices	686.70	858.38

d. Selling Prices for each product using ABC Method

Cost Particulars	**Alpham(₦)**	**Betam (₦)**
Material cost	400.00	500.00
Labour cost	100.00	125.00
Overhead cost	21.81	89.26
Total costs	521.81	714.26
Profit	130.45	178.57
Selling Prices	652.26	892.83

Examiner's report

This question tests candidates understanding of using ABC approach for overhead estimation. The candidates recorded an average performance.

The pitfall noticed was the candidates' failure to determine the cost driver rate of the activities.

Candidates are advised to study the Institute's Study Text when preparing for future examination.

Marking guide

		Marks	**Marks**	**Marks**
2a.i.	Direct Labour hourly rate	1		
ii.	Unit overhead rate	2	3	
bi.	Cost driver rate	9		
ii.	Unit overhead rate using ABC approach	3	12	
c.	Computation of unit selling price		5	20

SOLUTION 3

a. Calculate the Sales Price, Sales volume Profit, Sales mix profit and Sales quantity profit variances

(i) Sales price variance = AS - SS = AQS (ASP - SSP)

For F = (220 - 200) 9,500 = ₦190,000 (F)
For R = (260 - 250) 13,500 = ₦135,000 (F)
For E = (320 - 300) 8,500 = ₦170,000 (F)
Total sales price variance = ₦495,000 (F)

(ii) Sales volume variance:

= (AQS in Standard Proportion - BQ) SSP
F = (9,843.75 - 10,000) 200 = 31,250A
R = (12,796.875 – 13,000) 250 = ₦50,781.25 (A)
E = (8,859.375 - 9,000) 300 = ₦42,187.50 (A)
Total ₦124,218.75 (A)

(iii) Sales mix variance:

= (AQS - AQS in Standard Proportion) SSP

Product	**Standard Proportion**	**Actual Quantity Sales in Std Proportion**
F	10,000 = 0.3125	9,843.750
R	13,000 = 0.40625	12,796.875
E	9,000 = 0.28125	8,859.375
Total	32,000	31,500.000

F = (9,500 - 9,843.75) 200 = ₦68,750 (A)
R = (13,500 - 12,796.875) 250 = ₦175,781.25 (F)
E = (8,500 - 8,859.375) 300 = ₦107,812.50 (A)

Product	**Sales mix variance**	**Sales volume variance**	**Sales Quantity variance**
F	68,750.00 (A)	31,250.00 (A)	100,000.00 (A)
R	175,781.25 (F)	50,781.25 (A)	125,000.00 (F)
E	107,812.50 (A)	42,187.50 (A)	150,000.00 (A)
Total	781.25 (A)	124,218.75 (A)	125,000.00 (A)

Standard Profit per unit

Product	F	R	E
Direct Material	75	90	114
Direct labour	12	15	18
Variable overhead	6	7.50	9.0
Total variable cost	93	112.5	141
Fixed cost	6	12	16
Profit	101	125.5	143
Standard selling price	200	250	300

b. **Monthly Budgeted Profit**

Budgeted Sales

		₦
F =	10,000 x 200 =	2,000,000
R =	13,000 x 250 =	3,250,000
E =	9,000 x 300 =	2,700,000
		7,950,000

Budgeted/Standard Costs

Variable Cost	Material	Unit Cost Labour	Volt	Total variable cost	₦
F	75	12	6 =	93 x 10,000 = 930,000	
R	90	15	7.5 =	112.5 x 13,000 = 1,462,500	
E	114	18	9 =	141 x 9,000 = 1,269,200	3,661,500
					4,288,500
	Fixed Cost (4320000/12)				360,000
	Budgeted Profit				**3,928,500**

c. Significance of Sales Mix Variance

The sales mix is a calculation of the mix or proportion of each product or services sold in relation to the total sales volume and profitability. Sales mix variance is significant because:

(i) It affects profitability;
(ii) It can be used in performance evaluation; and
(iii) It is used for decision-making.

Examiner's report

The question tests candidates' understanding of advanced variance analysis - Sales Price variance, Sales mix variances, Sales volume variances and sales quantity prices. It also tests candidates' ability to determine budgeted contribution as well as the explanation of the implication of sales mix in variance accounting.

The attempt on this question by candidates was very moderate. The candidates recorded average performance.

The Pitfalls noticed were: The candidates' inability to compute the standard mix /proportions on actual sales; and Deduction of annual fixed overhead when what was required is monthly fixed overhead.

Candidates are advised to use the Institute's Study Text intensively when preparing for future examination.

Marking guide

		Marks	Marks	Marks
3a.i.	Sales price variance	2		
ii.	Sales volume variance	2		
iii.	Sales mix variance	3		
iv.	Sales quantity variance	3	10	
b.	Determination of monthly budgeted profit		6	
c.	Significance of sales mix variances in variance		4	20

SOLUTION 4

Suggested Solutions on Relevant Costing principles:

(a) Revised Cost Estimate

		₦
Direct material	Deluxe	30,000
	Unique	80,000
	Skilled	51,750
Direct labour	Unskilled	-
Variable o/h		38,500
Printing press		300,000
Fixed production costs		-
Estimating costs		-
Public relation cost		10,000
		510,250

Reasons for Resource valuation

1 **Direct material – duluxe**

Current stock value of ₦50,000 is irrelevant as it is a sunk cost. As there is no other use for this material replacement is irrelevant. The scrap value of ₦30,000 is an opportunity cost and relevant.

2 **Direct material – unique**

As paint unique is not in stock the purchase price is relevant. The entire ₦80,000 is chargeable though only 70% of the material will be used, as there is no foreseeable use of the remainder.

3 **Direct labour – skilled**

As this is in short supply all labour costs are relevant.

150 hours @ ₦150 per hour = ₦22,500
150 hours @ ₦195 per hour = ₦29,250
₦51,750

4 **Direct labour - unskilled**

The weekend work results in 75 hours' time off in lieu, this with the 120 (150 – 30) other hours worked totals 125 hours which is less than the 300 hours of idle time which are already being paid for, thus there is no incremental cost.

5. **Variable overhead**

This is a future cost which will be incurred if the work is undertaken and therefore is relevant.

6. **Painting Equipment**

The depreciation is a sunk cost and should be ignored. However, the use of the painting machine has an opportunity cost. If this work is undertaken, the machine is not available for hire. The opportunity cost is the contribution which would be earned from hiring:

(300 hours x ₦1,000) = ₦300,000

7. Fixed production cost: As these costs are unaffected by the decision, they should be ignored.

8. Estimating Department cost – these costs are past and sunk

9. Public Relation costs – relevant

(b) Other non-monetary factors that should be taken into consideration are:

- Is there sufficient capacity to undertake the project?
- Is the customer credit worthy?
- Has the company the necessary skills and quality to execute the contract?
- Is the contract likely to lead to future contracts?
- Is these other lucrative contract for the company in future?
- Will project publicity translate to positive contribution to the company?
- Does the company have required expertise?

Examiner's report

This is a popular question which tests computation of revised cost estimate using relevant costing approach. The attempt by candidates was more than average. Performance on this questing remains average.

The pitfall noticed was the inability of candidates to decipher relevant cost items that should be computed and added to the cost estimate.

Candidates are advised to study the Institute's Study Text when preparing for future examination.

Marking guide

		Marks	Marks	Marks
4 a.	Preparation of revised cost estimate		15	
b.	Identify 4 non-monetary factors in accepting the Art Gallery contract		5	20

SOLUTION 5

(a) The analyst has adopted the principles of economic value added (EVA). EVA is an estimate of a firm's economic profit, or the value created in excess of the required return of the company. The idea is that value is created when the return on the firm's economic capital employed exceeds the cost of that capital. This amount can be determined by making adjustments to GAAP accounting as presented by the analyst. Adjustments are made to the reported financial accounting profit and also to the statement of financial position, as follows:

i) Some of the revenue expenditure, such as research and development and advertising, provide future benefits over several years but financial accounting requirements often require such expenditure to be written off in the year in which they are incurred. This understates the value added during a particular period;

ii) The profits computed to meet financial accounting requirements do not take into account the cost of equity finance provided by the shareholders. The only cost of capital that is taken into account is interest on borrowed funds (i.e. the cost of debt finance). Profits should reflect the cost of both debt and equity finance; and

iii) A better measure of the managers' ability to create value is to adjust the traditional financial statements for those expenses that are likely to provide benefits in future periods. The economic value added measure attempts to meet this requirement.

(b) The following comments relate to the treatment of specific adjustments:

Research and development
The expenditure of ₦2.1 million is added back because it represents an investment that will yield future benefits. Therefore, it should be capitalised and allocated to the future periods based on the benefits received in the particular period. The expenditure of ₦17.4 million is added back based on the assumption that the company is continuing to benefit from such expenditures that have previously been written off as depreciation based on the value that has been eroded during the period.

Advertising

Advertising expenditure adds value by supporting future sales arising from increasing customer awareness and brand loyalty. Based on the same justification as research and development expenditure, advertising should be capitalised for the EVA calculation and added back to profits. The ₦10.5m added back in the statement of financial position reflects the costs incurred in building up future income. Some of this cost should be depreciated based on the value of future benefits eroded during the period.

Interest and borrowings

The aim is to ascertain whether value is being added for the shareholders in the sense of whether the funds invested in the business generate a return in excess of the opportunity cost of capital. To do this, a profit figure is calculated that initially does not include any charges for the cost of capital. Interest on borrowings is therefore added back to avoid the situation where the cost of capital on debt finance is included in the traditional profit calculation whereas the cost of equity capital is not. To ascertain the total source of funds invested in the business borrowings are added back to the capital base in the balance sheet. The required return (i.e. the opportunity cost of capital) of ₦17.5m on the resulting capital base is calculated and compared with the adjusted profit of ₦16.1m generated from the funds. This comparison captures the cost of both debt and equity and indicates that value added is a negative figure.

Goodwill

Goodwill refers to price paid for the business in excess of the current cost of net assets. Goodwill payments should therefore add value to the company. Hence the amount written off is added back to profits since it represents part of the intangible assets value of the business. The cumulative write off of ₦40.7m is added back in order to provide a more realistic value of the capital base from which a return should be generated. This is because it represents an element of the value of the business. The value of goodwill should be regularly reviewed and the amount eroded written off against profits.

Examiner's report

The question tests candidates' understanding of economic value added (EVA) principle.

The question was averagely attempted by candidates as it was not a popular question. The candidates recorded low performance.

The pitfall noticed was candidates' lack of understanding of the principles of EVA approach to performance measurement.

Candidates are advised to study the Institute's Study Text when preparing for future examination.

Marking guide

		Marks	Marks	Marks
5 a.	Explanation of the Economic value Added principle (EVA)		5	
b.	Comment on the treatment of specific adjustments like R&D, Advertising, Interest, Borrowings and Goodwill		10	**15**

SOLUTION 6

a.i. The lowest acceptable price from selling Division, The transfer price will be
Transfer price = Variable cost -Avoidable costs +selling Price Less Variable costs

Transfer Price = ₦32,000 - ₦6000 + ₦60,000 - ₦32,000 = ₦54,000
The Transfer Price range is ₦54,000 and ₦58,000

ii. Since the Engine division has idle capacity, it does not have to give up any capacity to external customer.

Thus from the view point of the selling Division (Engine Division)
The transfer price = Variable cost Plus unit contribution on lost sales.
Transfer Price = ₦32,000 + (₦58,000 - ₦58,000/ 10) = ₦32,000 - 0 = ₦32,000.

Since the Assembly division is unwilling to pay more than ₦58,000 that is, the price it is currently paying the outside supplier for the engines, thus the transfer price it is willing to pay as a buying division will be within range.
Hence the transfer price is ₦32,000 and ₦58,000.

iii. The engine division sells all it can produce in the market, it can give some of the engines to assembly division to enable it do its own business. Thus the engines division has opportunity costs for loss of sales or transfers to Assembly Divisions therefore the transfer price.

Transfer Price = Variable costs + Loss contribution
= ₦32,000 + (₦60,000 - ₦32,000) = ₦32,000 + ₦28,000 = <u>₦60,000</u>.

Since the Assembly division can purchase from outside supplier at ₦58,000, it will be not advantageous for the buying divisions, to buy from Engine Divisions at ₦60,000 per unit.

b. Meaning of Environmental management Accounting and reasons why it is reported upon:

Environmental management accounting (EMA) is the generation and analysis of both financial and non financial information in order to support internal environmental management processes. United nations divisions for sustainable development (UNDSD) defined environmental management accounting as the identification, collections, analysis, and use of two types of information (Physical and monetary information) for internal decision making.

Reasons to report environmental activities are:

- It attracts incentive like tax reduction and subsidies;
- It will lead to avoidance of penalties/fines by Federal Environmental Protection Agency (FEPA);
- It can promote research and development that can reduce environmental costs;
- Good EMA report can attract investors especially if the report shows the environment is investor friendly;
- It can promote accurate costing and pricing of products; and
- It can lead to the development of environment management system.

Examiner's report

This question tests candidates' knowledge of transfer pricing approach in Performance Management.

Many candidates attempted the question but failed to understand the requirements of the question. Therefore, the candidates recorded average performance.

The major pitfall noticed was the inability of candidates to understand the mechanism for computing transfer prices under the following situations: Where the manufacturing company can sell all that it manufactured to outside customers; Transfer at a lower variable cost to a division within the company where there are ample idle capacity; and where it can sell all it can produce to outside customers.

Candidates are advised to pay special attention to the requirements of questions before answering them. They should also use the Institute's Study Text when preparing for future examination.

Marking guide

		Marks	Marks	Marks
6a.i.	Transfer Price when selling division can sell all product to external buyer and can transfer to internal users at a reduced variable cost.	2		
ii.	Transfer Price where there is idle capacity.	3		
iii.	Transfer price where the selling division can sell all to outside customers.	4	9	
b.	Explanation of environmental management accounting and reason for the importance of the report on environmental activities.		6	15

SOLUTION 7

(i) **Growth Stage**

Compared to the introduction stage likely changes are as follows:

Unit selling prices

These are likely to be reducing for a number of reasons:

- The product will become less unique as competitors use reverse engineering to introduce their versions of the product;
- PT may wish to discourage competitors from entering the market by lowering the price and hereby lowering the unit profitability; and
- The price needs to be lowered so that the product becomes attractive to customers in different market segments thus increasing demand to achieve growth in sales volume.

Unit production costs

These are likely to reduce for a number of reasons:

- Direct materials are being bought in larger quantities and therefore PT may be able to negotiate better prices from its suppliers thus causing unit material costs to reduce;
- Direct labour costs may be reducing if the product is labour intensive due to the effects of the learning and experience curves; and
- Fixed production costs are being shared by a greater number of units.

(ii) **Maturity Stage**

Compared to the growth stage the likely changes are as follows:

Unit selling prices

These are unlikely to be reducing any longer as the product has become established in the market place. This is a time for consolidation and while there may be occasional offers to tempt customers to buy the product the selling price is likely to be fairly constant during this period.

Unit production cost

Direct material costs are likely to be fairly constant in this stage. They may even increase as the quantities required diminish compared to those required in the growth stage, with the consequential loss of negotiating power.

Direct labour costs are unlikely to be reducing any longer as the effect of the learning and experience curves has ended. Indeed the workers may have started working on the next product so that their attention towards this product has diminished with the result that direct labour costs may increase.

Overhead costs are likely to be similar to those of the end of the growth stage as optimum batch sizes have been established and are more likely to be used in this maturity stage of the product life cycle where demand is more easily predicted.

Examiner's report

The question tests candidates' understanding of likely changes that will occur in unit selling price and unit cost of production in product life cycle situation especially during growth and maturity stages.

Many candidates attempted the question, but performance was poor.

The pitfalls noticed were: Candidates' failure to read the questions to decipher the requirements; and Candidates' failure to limit their discussion to the growth and maturity stages made them miss the points.

Candidates are advised to pay special attention to the requirements of questions before attempting them. They should also use the Institute's Study Text when preparing for future examination.

Marking guide

		Marks	Marks	Marks
7.i.	Explain the changes in unit selling prices and unit production costs on growth stage of a product life cycle.		9	
ii.	Explain the changes in unit selling prices and unit production costs on maturity stage of a product life cycle.		6	**15**

ICAN/242/Q/B5 **Examination No………………..**

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA | Accuracy and Integrity

SKILLS LEVEL EXAMINATION – NOVEMBER 2024

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 any other **COLOUR OF INK** will not be marked.
8. You are required to attempt **Question ONE (Compulsory)**, **TWO Questions in Section B and TWO Questions in Section C.**
9. Check that you have collected the correct question paper for the examination you are writing.

THURSDAY, NOVEMBER 21, 2024

DO NOT TURN OVER UNTIL YOU ARE TOLD TO DO SO

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – NOVEMBER 2024

PUBLIC SECTOR ACCOUNTING & FINANCE

Time Allowed: $3^1/_4$ 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. Following the directive of the Minister of Health to the Medical Research Council (MRC) to relocate its storage facility to the Federal Capital Territory, the Director signed an agreement with Kaftan Nigeria Limited to lease its medical cooling system for a 6-year term beginning from January 1, 2020 at the rate of ₦4.85million per annum payable at the end of each year. The terms of the agreement showed that the medical cooling system has an estimated economic life of 6 years and the facility would have no scrap value by the end of year 4. The following additional information was made available by the director of accounts:

- The lessor entity sets the annual rental to ensure a rate of return on its investment at 12%.
- The fair value of the medical cooling system is ₦22million.
- It is the practice of the entity to use straight line depreciation for assets of similar type.
- The medical cooling system reverts to the lessor and there is no option of renewal.

Required:

i. Prepare the journal entries in the books of the lessor and the lessee at the inception of the lease. (5 Marks)

ii. Justify the choice of the lease based on IPSAS-13-Leases. (2 Marks)

b. i. Identify the features of non-investment properties in accordance with IPSAS 16 - Investment Properties. (5 Marks)

ii. The accountant of Afonja State Development Property Corporation has provided the following information on some properties acquired and managed by the corporation:

- At the Central Business District, a land was acquired in 2020 at the cost of ₦30 million to construct a plaza for rent over its useful life span of 25 years. The cost of construction was put at ₦0.96billion as at the end of the year 2020. Though the plaza would have a residual value of ₦15million, the fair value of the property at the end of the 10th year was put at ₦1.05billion. It is the policy of the entity to depreciate its investment properties using the straight-line method.

- At the Kulende Estate, a building was acquired in 2020 at the cost of ₦410,000,000 while additional ₦98,050,000 was spent to carry out major renovation on the building, which is to be held for capital appreciation.

- At the Tanke area of the town, two different 3-storey buildings which were to be held for capital appreciation were acquired in 2020 at the cost of ₦15,000,000 and renovated at additional cost of ₦8million. The buildings were swapped with a bungalow close to the GRA at a cost of ₦25million, which would be held for capital appreciation.

Required:

Prepare the journal entries in the books of the corporation in accordance with IPSAS 16 - Investment Properties. (4½ Marks)

c. The Bursar of a state-owned university has provided the following information on the University's property, plant and equipment:

i. During the year ended December 31, 2020, office equipment worth ₦72,050,000 was acquired from Woodmate Nigeria Limited and the company charged additional ₦823,680 to cover the installation cost. An agreement was reached to pay 75% of the cost of the equipment during the year while the balance was paid later in January 2021.

ii. In order to commence the award of B.Sc. degree programme in forensic accounting at the 2021/2022 academic session, the State Government through the Commissioner for Education transferred the ownership of a PPE of a defunct Technical College (including buildings and other infrastructures) to the department. The fair value of the PPE taken over was estimated at ₦413,000,000 while the carrying amount in the books of the State Government was ₦582,000,000.

iii. During the year, a forensic laboratory worth ₦1.3billion was donated by a recognised professional accounting body to the University as part of their support towards the commencement of the degree programme. The intervention was to assist in securing a full accreditation from the Nigeria Universities Commission.

iv. During the year ended December 31, 2020, the storage section of the chemistry laboratory owned by the university was gutted by fire. Though the carrying amount of the building as at the date of the fire incidence was put at ₦423,050,000, the fair value of the building after the fire incidence was estimated by a valuer to be ₦218,600,000.

v. On January 1, 2020, the University acquired two (2) blocks of lecture theatres for the faculty of engineering at a cost of ₦0.75billion each. The policy of the university is to depreciate its lecture buildings on straight-line method over 50 years. By the end of the 12th year, a valuer put the fair value of the two buildings at ₦1.25billion.

vi. On January 1, 2020, three (3) project vehicles were acquired for monitoring the Students' Industrial Work Experience Scheme (SIWES) programme at ₦8,250,000 each. The estimated useful life and the residual value at year 4 for each vehicle is ₦0.7million. The university decided to dispose the vehicles for ₦6million at the end of the second year. The accounting policy of the university is to depreciate PPE on straight-line basis.

Required:
Journalise the above entries in the books of the State University in accordance with IPSAS 17 - Property, Plant and Equipment. (8½ Marks)

d. Enumerate measures by which asset impairment can be determined in accordance with IPSAS 21 - Impairment of Non-Cash Generating Units.
(5 Marks)
(Total 30 Marks)

SECTION B: YOU ARE REQUIRED TO ATTEMPT TWO OUT OF THE THREE QUESTIONS IN THIS SECTION (40 MARKS)

QUESTION 2

a. Identify the responsibilities of a Micro Pension Contributor who seeks to operate a Retirement Savings Account (RSA). (5 Marks)

b. Enumerate **FOUR** criteria for eligibility for participation in a Micro Pension Plan and identify **FOUR** documents necessary during registration for a Micro Pension Plan. (4 Marks)

c. Highlight **SIX** provisions of the Pensions Reform Act 2014 (as amended) on the administration of contingent withdrawal in a Micro Pension Plan. (6 Marks)

d. Explain the conditions to be met for an individual to convert from Micro Pension Plan to a mandatory contribution plan. (5 Marks)

(Total 20 Marks)

QUESTION 3

Pension Reform Act 2014 (as amended) established uniform set of rules, regulations and standards for the administration of pension scheme in Nigeria.

You are required to:

a. Explain **SIX** processes of remitting contributions into Retirement Savings Account by contributors as stated in the Act. (6 Marks)

b. Highlight the categories of persons exempted from the Contributory Pension Scheme (CPS) as contained in the PRA (2014) (as amended). (8 Marks)

c. Explain **SIX** procedures for payment of retirement benefits to holders of Retirement Savings Accounts (RSA) as provided by the Act. (6 Marks)

(Total 20 Marks)

QUESTION 4

a. Enumerate **FIVE** benefits of each of the following components of the Treasury Single Account (TSA)
E-payment (5 Marks)
E-collection (5 Marks)

b. Explain **THREE** conditions that need to be met for supplementary funds to be approved. (6 Marks)

c. As an accountant in the Treasury Control Unit of the Office of the Accountant-General of the Federation (OAGF) who has been sent out to conduct an examination of payment vouchers in the central pay office, create a checklist of major concerns. (4 Marks)

(Total 20 Marks)

SECTION C: YOU ARE REQUIRED TO ATTEMPT TWO OUT OF THE THREE QUESTIONS IN THIS SECTION (30 MARKS)

QUESTION 5

Public debt and taxation are the methods used by governments to finance the economic activities of the country. It has also been argued in some quarters that tax financing is preferable to debt financing.

Required:

a. Explain the concept of public debt, "distinguishing between bilateral and multilateral debts". State **ONE** example each. (6 Marks)

b. Explain **TWO** conditions under which debt finance would be preferable (3 Marks)

c. Identify and explain **FOUR** reasons to justify the need for public debts (6 Marks)

(Total 15 Marks)

QUESTION 6

The government, as an instrument of social controls, wholly or partly owns public enterprises.

Required:

Discuss **FIVE** factors to justify the need for public enterprises.

(Total 15 Marks)

QUESTION 7

a. Explain the measures open to a Federal Government in intervening in the activities of an economy. (5 Marks)

b. Enumerate the steps that the Federal Government or its agencies must take before seeking the approval of the National Assembly on their request for external borrowing. (4 Marks)

c. Identify the requirements for raising funds from the domestic capital market by State Government. (6 Marks)

(Total 15 Marks)

SECTION A

SOLUTION 1

a.

i **Medical Research Council (MRC)**

Journal entries

Recognising the lease at inception

S/N	Details	Dr	Cr	Narration
	Lessee:	**₦**	**₦**	
i.	Lease PPE (Generator)	19,938,350		To recognise lease
	Provision for interest	9,161,650		assets and associated
	Lease liability		29,100,000	liability
ii.	Lease liability	4,850,000		Recognition of first
	Bank		4,850,000	instalment paid at the end of year 2020
iii.	Interest expense	1,526,941.67		Interest due in year
	Provision for interest		1,526,941.67	one
iv.	Depreciation charges	3,323,058.33		To recognise
	Accumulated depreciation charges		3,323,058.33	depreciation charges for year 2020
	Lessor			
i.	Account receivable	19,938,350		To recognise asset
	Lease asset (Generator)		19,938,350	leased to the lessee at inception
ii.	Bank	4,850,000		To recognise equal
	Account receivable		3,323,058.33	instalment received in
	Interest earned		1,526,941.67	year 2020

ii This is a clear case of **finance lease** because of the following:

- The lease terms equal the useful economic life of the equipment;
- The present value of the minimum lease payment (₦19,938,350) exceeds 90% of the fair value of the asset which is ₦22,000,000
- The present value of annuity of 12% = 4.111 x ₦4.85m = ₦19,938,350

bi. **Non-investment properties**

- Property held for sale in the ordinary courses of operations or in the process of construction or development for such sale.
- Property being constructed or developed on behalf of third parties e.g., where a service department of a ministry enters into construction contracts with entities external to its government.
- Owner-occupied property including property held for future use as owner-occupied property held for future development as subsequent use as owner-occupied property. Property occupied by employees such as housing for military or police personnel.
- Property that is being constructed or developed for future use as investment property. Until construction or development is complete, at which time the property become investment property; such property does not meet investment property status.
- Property held to provide a social service and which also generates cash flows; and
- Property held for strategic purpose, which could be accounted for in accordance with IPSAS 17 (Property, Plant and Equipment).

ii. **Afonja State Development Property Corporation**

Journal entries

Plaza at Central Business District

Details	Dr	Cr	Narration
	₦'000	**₦'000**	
Investment property	990,000		To recognise the investment
Bank		990,000	property in the books
Accumulated depreciation	378,000		To close the investment pr
Revaluation account	612,000		property account
Investment property		990,000	
Investment property	1,050,000		To reinstate the new value of
Revaluation account		612,000	the investment property
Revaluation surplus		438,000	

Building at Kulende Estate

Details	Dr	Cr	Narration
	₦'000	**₦'000**	
Investment property	508,050		To recognise the investment
Bank		508,050	property in the books

Swapping of 2-storey building

Details	Dr ₦'000	Cr ₦'000	Narration
Investment property	23,000		To recognise the investment property in the books
Bank		23,000	

Swapped investment property

Details	Dr ₦'000	Cr ₦'000	Narration
New investment property	25,000		To recognise gain on the swapping of investment property
Existing investment property		23,000	
Gain on exchange		2,000	

b. **Journal entries for state-owned university**

S/N	Details	Dr ₦'000	Cr ₦'000	Narration
i.	PPE- (Office equipment)	72,873.68		The cost of assets is made up of the purchase cost plus all attributable cost.
	Bank		54,655.26	
	Accounts payable		18,218.42	
	Accounts Payable	18,218.42		On payment of outstanding debt
	Bank		18,218.42	
ii.	PPE	413,000		This is treated as part of take-off grant
	Take over grant		413,000	
	Impairment charges	169,000		Impairment on carrying amount of PPE taken over
	PPE		169,000	
iii.	PPE – Forensic laboratory	1,300,000		Donation received during the year
	Aid and grant received		1,300,000	
iv.	Impairment charges	204,450		Being difference between the carrying amount and the fair value of the building
	Accum. Impairment		204,450	

v.	PPE	1,500,000		Acquisition of PPE
	Bank		1,500,000	
	Revaluation account	1,140,000		To close the account of the carrying amount as well as the corresponding accumulated depreciation
	Accum. Depreciation	360,000		
	Building		1,500,000	
	Building	110,000		To reinstate the current value of the PPE
	Revaluation surplus		110,000	
vi.	PPE	24,750		
	Bank		24,750	Purchase of PPE
	PPE disposal account	24,750		To close the account of the motor vehicle
	Motor vehicle Account		24,750	
	Accum. depreciation	11,325		To close accumulated depreciation account
	PPE disposal account		11,325	
	Bank	6,000		To recognise proceeds from the sale of the motor vehicle
	Loss on disposal	7,425		
	PPE disposal account		13,425	

c. The measures used in identifying impairment of non-cash generating units include:

i. **External sources of information**

- Cessation, or near cessation, of the demand or need for the services provided by the asset;
- Significant long-term changes with an adverse on the entity have been taken place during the period or will take place in the near future, in the technological, legal or government policy environment in which the entity operates.

ii. **Internal sources of information**

- Evidence is available of physical damage of an asset;
- Significant long-term changes with an adverse on the entity have taken place during the period or are expected to take place in near future, in the extent to which, or manner in which, an asset is used or expected to be used. These changes include the asset becoming idle, plans to discontinue or restructure the operation to which an asset belongs, or plans to dispose of an asset before the previously expected date;

- A decision to halt the construction of an asset before it is completed or in a usable condition; and
- Evidence is available from internal reporting that indicates that the service performance of an asset is, or will be, significantly worse than expected.

Examiner's report

The question is in four parts. Part (a) of the question tests candidates' knowledge on the preparation of journal entries in the book of the lessor and lessee at the inception of the lease in accordance to IPSAS 13 - Leases. Part (b) requires the candidates to identify the features of non-investment properties and prepare journal entries in accordance to IPSAS 16 -Investment Properties. Part (c) requires the candidates to prepare journal entries on some transactions as related to property, plants and equipment in accordance to IPSAS 17 - Property, Plants and Equipment, while part (d) requires to enumerate measures by which asset impairment can be determined in accordance with IPSAS 21 - Impairment of Non - Cash Generating Units.
All the candidates attempted the question and their performance was below average

The common pitfalls were the inability of the candidates to understand the provisions of IPSAS 13 - Leases; IPSAS 16 - Investment Properties; IPSAS 17 - Property, Plants and Equipment; and IPSAS 21 - Impairment of Non - Cash Generating Units.

Candidates are advised to have adequate knowledge of the relevant provisions of the syllabus and to make use of the Institute's Pathfinder and the Study Text for better performance in the Institute's future examinations.

Marking guide

		Marks	Marks
ai.	**Journal entries**		
	Correct journal entries - Lessee	3¼	
	Correct journal entries – Lessor	1¾	
ii.	**Type of lease and justification**		
	Type of lease at 1 mark	1	
	Any two (2) justifications at ½ mark each	1	**7**
b.i.	**Description of non-investment properties**		
	Any five (5) descriptions at 1 mark each		5
ii.	**Journal entries**		
	Correct journal entries for Plaza	2	
	Correct journal for building at Kulende	½	
	Correct journal entries for swapping of investment properties	2	**4½**

c. **Journal entries for state-owned university**
Correct journal entries 8½

d. **Sources of information for impairment**
Any five sources at 1 mark each 5
Total **30**

SECTION B

SOLUTION 2

a. The responsibilities of Micro Pension Contributor shall include:

i. Opening of a Retirement Savings Account (RSA) with any Pension Fund Administrator (PFA) of choice;
iii. Making contributions into RSA in accordance with the relevant guidelines;
iv. Requesting for RSA statement from PFA;
v. Updating RSA information on request;
vi. Appointing a next of kin;
vii. Choosing the platform for making contributions;
viii. Deciding to make contingent withdrawals;
ix. Choosing the mode of accessing pension (programmed withdrawal or annuity) from micro pension plan; and
x. Demanding for adequate customer service as provided in the consumer protection framework issued by the Commission.

b. The following persons not below 18 years of age with source of income shall be eligible for participation in micro pension plan under Section 2(3) of the Pension Reform Act 2014:

i. **Criterial for eligibility for participating in micro pension plan**

- Self-employed persons that belong to a trade, profession, cooperative or business association;
- Self-employed persons with a business registration as a company, partnership or enterprise.
- Employees operating in the informal sector who work with or without formal written employment contract.
- Other self-employed individuals.
- Micro Pension Contributors shall be resident in Nigeria.

ii. **The following documents shall be provided at the point of registration:**

- Evidence of membership of a registered association, union or cooperative society
- Certificate of business registration
- Certificate of incorporation
- Letter of employment
- Bank Verification Number (BVN)
- Other documentation as may be specified by the PFA

iii. **Provisions of Pension Reform Act (PRA) 2014 on contingent withdrawal**

- The micro pension contributor shall be eligible to access the portion of his/her contribution available for withdrawal 3 months after making the initial contribution.
- Subsequently, the micro pension contributor can only make withdrawals once in a week from the balance of the contingent portion of the RSA.
- The micro pension contributor may withdraw the total balance of the contingent portion of RSA including all accrued investment income thereto.
- The micro pension contributor may choose to convert the contingent portion of the contributions to the retirement benefits portion at the end of every year.
- The time frame for processing and payment of contingent withdrawals shall not exceed two working days.
- Payment shall be made only to the Micro Pension Contributor's designated bank account.
- The PFA shall approve and pay all requests for contingent withdrawals.
- The PFA shall notify the Commission of all payments made monthly.
- Contingent withdrawals shall be subject to applicable tax laws in accordance with the provisions of Section 10(4) of the PRA 2014.
- At retirement, the Micro Pension Contributor has the option of transferring part or all of his outstanding balance on the contingent portion to his retirement benefits portion.

iv. **Conversion from micro pension plan to mandatory contribution plan**

- The micro pension contributor shall be eligible to participate under Section 2(1) of the Pension Reform Act, 2014 where the secures employment in the formal sector with an organisation that has three (3) or more employees.
- The micro pension contributor shall formally request for conversion, attaching all necessary documents specified in the guidelines for the registration of contributors/members issued by the commission.
- The micro pension contributor shall retain the existing RSA.
- Micro pension contributor may withdraw the total balance of the contingent portion of the RSA prior to conversion.
- Where the micro pension contributor chooses not to withdraw the contingent portion, the balance of the contingent portion shall be merged with the retirement benefits portion of the RSA prior to conversion.
- At conversion, the PFA shall move the micro pension contributor's RSA balance to the appropriate fund under the multi-fund structure.
- Where an eligible contributor fails or refuses to request for conversion to the mandatory contribution after one (1) month of receiving remittance from the new employer, the PFA shall automatically change the status of the contributor upon receiving the second remittance.
- The PFA shall notify the employer of the status of the RSA of the contributor.
- The PFA shall forward monthly returns on conversion to the Commission.

Examiner's report

The question is in four parts. Part (a) of the question requires the candidates to explain the responsibilities of a micro pension contributor, while part (b) requires the candidates to enumerate criterial for eligibility to participate and document necessary requirements and registration for micro pension plan. Also, part (c) of the question requires the candidates to highlight the provisions of Pension Reform Act 2014 (as amended) on the administration of contingent withdrawals in a micro pension plan and part (d) requires the candidates to explain the conditions to be met for an individual to convert from micro pension plan to a mandatory contribution plan.

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

The commonest pitfall was the inability of the candidates to properly identify and explain the provisions of Pension Reform Act 2014 (as amended) as it affects micro pension plan.

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

Marking guide

		Marks	Marks
a	**Responsibilities of a micro pension contributor**		
	Identification of any five responsibilities		5
b. i	**Eligibility criteria for micro pension plan**		
	Any four eligibility criteria at ½ mark each	2	
ii	**Documentation for micro pension plan**		
	Any four documents at ½ mark each	2	4
c.	**Provisions of PRA on contingent withdrawal**		
	Any six provisions		6
d.	**Conditions for conversion from micro pension plan to a mandatory contribution plan**		
	Explanation of any five conditions		5
	Total		**20**

SOLUTION 3

a. **Processes of remitting contributions into Retirement Savings Account by contributors as in the PRA (2014):**

i. Every employee to whom this Act applies shall maintain an account, (in this Act referred to as "Retirement Savings Account") in his name with any Pension Fund Administrator of his choice.

ii. The employee shall notify his employer of the Pension Fund Administrator chosen and the identity of the retirement savings account opened under (i) above.

iii. The employer shall:
- Deduct at source the monthly contribution of the employee; and
- Not later than 7 working days from the day the employee is paid his salary, remit an amount comprising the employee's contribution under paragraph of this subsection and the

employer's contribution to the Pension Fund Custodian specified by the Pension Fund Administrator of the employee.

iv. Upon receipt of the contributions remitted under (iii) above, the Pension Fund Custodian shall notify the Pension Fund Administrator who shall cause to be credited the retirement savings account of the employee for whom the employer had made the payment;

v. Where an employee fails to open such Retirement Savings Account within a period of six months after assumption of duty, his employer shall, subject to guidelines issued by the Commission, request a Pension Fund Administrator to open a nominal retirement savings account for such employee for the remittance of his pension contributions;

vi. An employer who fails to deduct or remit the contributions within the time stipulated in (iii) above shall, in addition to making the remittance already due, be liable to a penalty to be stipulated by the Commission;

vii. The penalty referred to in (vi) above shall not be less than 2 percent of the total contribution that remains unpaid for each month or part of each month the default continues and the amount of the penalty shall be recoverable as a debt owed to the employee's retirement savings account, as the case may be;

viii. An employee shall not have access to his retirement savings account or have any dealing with the Pension Fund Custodian with respect to the retirement savings account except through the Pension Fund Administrator; and

ix. The Commission shall determine the cost of recovery of un-remitted contributions and the sources to defray the cost, which may include the amount recovered as penalty pursuant to (vi) above.

b. **Categories of persons exempted from the Contributory Pension Scheme (CPS) as contained in the PRA 2014:**

i. The categories of persons mentioned in Section 291 of the Constitution of the Federal Republic of Nigeria 1999 (as amended) including the members of Armed Forces, the Intelligence and Secret Services of the Federation;

ii. An employee who is entitled to retirement benefits under any pension scheme existing before the 25th day of June 2004 and has 3 or less years to retire (i.e. fully funded pension scheme);

iii. Any person who falls within the provisions of (i) and (ii) above shall continue to derive retirement benefit under such existing pension scheme as provided for in the Second Schedule to this Act; and

iv. Where an officer exempted under (ii) above dies in service or in the course of duty, the Federal Government Pension Transitional Arrangements Directorate (PTAD) and the Federal Capital Territory Pension Transitional Arrangements Directorate shall cause to be paid, en-bloc to his next- of- kin or designated survivors, a gratuity and pension to which the officer would have been entitled at the date of his death calculated on the basis of applicable computations under the existing Pay-As-You-Go Pension scheme of the public service of the Federation and Federal Capital Territory.

c. Procedures for payment of retirement benefits to holders of Retirement Savings Accounts (RSA) as provided by the Act:

i. A holder of retirement savings account shall upon retirement or attaining the age of 50 years, whichever is later, utilise the balance standing to the credit of his retirement savings account for the following benefits:

- Programmed monthly or quarterly withdrawals calculated on the basis of an expected life span;
- Withdrawal of a lump sum from the total amount credited to his retirement savings account provided that the amount left after the lump sum withdrawal shall be sufficient to procure a programmed fund withdrawals or annuity for life in accordance with extant guidelines issued by the Commission, from time to time;
- Annuity for life purchased from a life insurance company licensed by the National Insurance Commission with monthly or quarterly payments;
- Professors covered by the Universities (Miscellaneous Provisions (Amendment) Act, 2012 shall be according to the University Act; or
- Other categories of employees entitled, by virtue of their terms and conditions of employment, to retire with full retirement benefits shall still apply.

ii. Where an employee retires before the age of 50 years, the employee may request for withdrawal of lump sum of money of not more than 25% per cent of the amount standing to the credit of the retirement savings account, provided that such withdrawals shall only be made after six months of such retirement and the retired employee does not secure another employment.

iii. Where an employee has accessed the amount standing in his retirement savings account pursuant to (ii) above, such employee shall subsequently access the balance in the retirement savings account in accordance with (i) above.

iv. If an officer retires and is less than 50 years, on the advice of suitably qualified physician or properly constituted medical board, certifying that the employee is no longer mentally and physically capable of carrying out the function of his office, the officer may withdraw;

v. The medical board or suitably qualified physician, at the request of the employee, be made once in every two years to review the fitness of the employee and where the medical board certifies that he is now mentally and physically capable of carrying out the functions of his office, he may re-enter the scheme upon securing another employment.

vi. Any employee who disengages or is disengaged from employment before the age of 50 years and is unable to secure another employment within four months of such disengagement may make withdrawal from his retirement savings account in accordance with the provisions of section 7(2) and (3) of the PRA (2014).

vii. If the officer is retired due to total or permanent disability either of mind or body, may withdraw retirement savings account.

viii. Where the employee retires before the age of 50 years in accordance with the terms and conditions of employment, the officer shall be entitled to make withdrawals

Examiner's report

The question is in three parts and it relates to the provisions of Pension Reform Act, 2014 (as amended). Part (a) of the question requires candidates to explain processes of remitting contributions into Retirement Savings Account (RSA). Part (b) of the question requires the candidates to highlight the categories of persons exempted from the Contributory Pension Scheme (CPS), while part (c) requires candidates to explain the procedures for payment of retirement benefits to holders of Retirement Savings Account (RSA).

Majority of the candidates attempted the question and their performance was average.

The commonest pitfall was the inability of the candidates to properly identify and explain the provisions of Pension Reform Act 2014 (as amended).

Candidates are advised to read widely and ensure they have adequate knowledge of the relevant sections of the syllabus. They should also make use of Pathfinders and the Study Text of the Institute and other relevant learning materials on this aspect of the syllabus for better performance in future examinations.

Marking guide

		Marks
a	Processes of remitting contributions into Retirement Savings Account by contributors	
	Explanation of any six processes of remitting contributions	6
b.	Categories of persons exempted from the CPS as contained in the PRA 2014:	
	Any four categories of persons exempted at 2 marks each	8
c.	Procedures for payment of retirement benefits to holders of Retirement Savings Accounts	
	Explanation of any six procedures	6
	Total	**20**

SOLUTION 4

a. Benefits of e-payments and e-collection

e-Payment

i. Provides complete and timely information on government cash resources;
ii. Improve operational control on budget execution;
iii. Enables efficient cash management;
iv. Reduces bank fees and transaction costs;
v. Facilitates efficient payment mechanisms;
vi. Improves bank reconciliation and quality of fiscal data;
vii. Improves liquidity of government;
viii. Allows issuance of warrants and AIEs based on cash plan;

e-Collection

i. It controls and monitors receipts and payments of FGN funds;
ii. It prevents and detects potential and actual fraud;
iii. Its improves planning through MTEF;
iv. Avoids double payments and likely build- up of payment arrears;
v. Creates an accurate cash flow statements that help government to obtain an appropriate line of credit;
vi. Implements cash collection acceleration techniques;
vii. Integrates policy priorities into annual budgets and thereby ensures that available resources are channelled to priority sectors;

ix. No more commercial bank accounts maintain by MDAs;
x. Brings about drastic fall on the ways and means (overdraft) requirement from CBN; and
xi. Supports government budget execution.

viii. Minimises deficits and borrowings within limits set by government; and
ix. Improves transparency and accountability of all FGN receipts.

b. **Conditions for approving supplementary funds**

The conditions under which such requests may be granted are as follows:

i. **Public interest**

The supplementary request must manifestly be in the public interest. This must genuinely be at addressing issues, which have generated interest or debate nationally. For example, the need to fund vaccination in a pandemic situation, which was not earlier, envisaged.

ii. **Urgency**

The need is so urgent that the additional provisions request cannot be deferred till the following year when it will be incorporated in the new estimates. For example, a war situation.

iii. **Unforeseen circumstances**

The need could not be foreseen when the current estimates were being approved.

iv. **Virement impracticable**

The money required cannot be sourced through virement

c. **Examination of payment vouchers**

The checklist shall include:

i. Are all paid vouchers and supporting documents stamped "PAID" and also stamped "CHEQUE SIGNED" to differentiate them from new vouchers?
ii. Are cheque numbers entered on paid vouchers?
iii. Are payment vouchers received in the Central Pay Office (CPO) through schedules controlled serially or through voucher movement register?
iv. Are the payment vouchers properly checked?
v. Is there adequate safeguard to ensure that payments are made only to the right people and for good consideration?

Examiner's report

The question is in three parts. Part (a) of the question requires candidates to enumerate the benefits of e-payment and e-collection of the components of Treasury Single Account (TSA). Part (b) of the question requires the candidates to explain the conditions that need to be met for supplementary funds to be approved and part (c) of the question requires the candidates to create a checklist on how to examine payment vouchers.

Majority of the candidates attempted the question and performance was below average.

The common pitfalls were the inability of the candidates to explain the conditions that need to be met for supplementary funds to be approved, while in part (c), the candidates were unable to create a checklist on how to examine payment vouchers.
Candidates are advised to read widely and ensure they have adequate knowledge of relevant regulations relating to public sector accounting for better performance in the Institute's future examinations.

Marking guide

		Marks	Marks
a	**Benefits of TSA components**		
	Any five benefits of e-payment	5	
	Any five benefits of e-collection	<u>5</u>	10
b.	**Conditions for supplementary fund approval**		
	Identification of any three conditions	3	
	Explanation of conditions identified	<u>3</u>	6
c.	**Examination of payment voucher**		
	Stating any four checklists		<u>4</u>
	Total		<u>**20**</u>

SECTION C

SOLUTION 5

a. **Definition of public debt**

The total amount of loan raised by government directly or through any of the authorised agencies is known as public debt. The loan could be raised within the domestic economy, in which case the creditors are mostly citizens or from outside the economy, in which the creditors are foreigners. The former is commonly known as domestic or internal debt, while the latter is known as external or foreign debt.

In other words, public debt can be defined as total outstanding financial obligations of a government during a given period. It is an important source of capital formation, most especially in developing economies like Nigeria where the low level of income is insufficient for consumption and hence does not permit sustainable savings.

Public debt may be bilateral or multilateral. It is bilateral where the creditors are governments of a given country. For example:

i As at March 2024, Nigeria owed China $5.05 billion;
ii France $652 million; and
iii Germany $125.62 million in bilateral debts.

It is multilateral when multilateral institutions are the creditors for example:

i World Bank;
ii International Monetary Fund (IMF);
iii Islamic Development Bank (IsDB);
iv European Development Bank;
v International Fund for Agricultural Development;
vi International Development Association (IDA); and
vii The African Development Bank (AfDB).

b. Under certain circumstances, debt financing becomes either necessary or preferable.

i During war and other emergencies, when there is need for large pool of funds and additional tax revenue cannot be raised, debt financing becomes inevitable.
ii Where actual tax receipts are falling much below the anticipated volume, while expenditure is not showing a corresponding reduction.
iii Debt financing can be tied to a project where such projects are expected to benefit certain areas or certain sections of the people who can be expected to bear the cost of the project out of the benefit they would

receive. For instance, a particular irrigation project might benefit the farmers of a particular area. In this case, the cost of the project can be met through borrowing and then recovered from the beneficiaries through a levy or some other means.

iv Governments can use debt financing in situations of economic depression to help the country.

v Government can avoid negative effect of taxes on incentives through borrowing especially when tax burden is significantly high.

c. Reasons advanced to justify the need for public debts

The following are some of the reasons that have been advanced to justify the need for a country to borrow:

i **Huge and persistent budget deficit:** The government borrows when its expenditure is greater than its revenue (budget deficit), especially after its taxing capacity has been stretched to the limit.

ii **Balance of payments disequilibrium:** Excessive reliance on foreign resources to sustain domestic production processes and on foreign goods and services beyond the nation's foreign exchange earning capacity may lead government into contracting debt obligations.

iii **Rapid population growth**: In most developing countries, population is growing faster than the level of national output. The need arises for government borrowing to expand public enterprises and public utilities to cater for the welfare of the people.

iv **Implementation of development programmes:** To promote economic development usually requires provision of new and upgrading of existing social and economic infrastructural facilities like roads, railways, electricity, schools and hospitals. The tax revenue of government may be insufficient to execute such projects, hence the resort to borrowing.

v **Economic instability**: A stable economy naturally provides an enabling environment for economic growth and development. Public debt of the internal type may be contracted to control inflation, while both internal and external borrowings may be used to stimulate economic activities during economic depression.

vi **Natural disasters**: Government has the responsibility to provide relief to victims of natural disasters, such as earthquakes, floods and fire disasters, famines, sectarian violence and other natural calamities. Government borrowing may be justified because such occurrences are never expected nor budgeted for.

vii **Fluctuations in government revenue**: Most countries operate mono cultural economies depending on only one (or very few) export product for foreign exchange earnings. A sudden poor performance of such product in the international market would reduce income considerably and adversely affect budget implementation. Any country that finds herself in such a situation may have no option than to borrow to bridge the financial resource gap.

viii **War-time borrowing**: Financial resources needed to prosecute wars are usually beyond the capacity of government. Hence, the need to borrow arises to avoid devastating consequences of defeat.

ix **Debt servicing**: New debt with favourable terms and conditions may be undertaken to service old debts thereby reducing the burden of debt on the economy.

Examiner's report

The question is in three parts. Part (a) of the question requires the candidates to explain the concept of public debt "distinguishing between bilateral and multilateral debt". Part (b) of the question require the candidates to explain the conditions under which debt finance would be preferable, while part (c) requires the candidates to identify and explain reasons to justify the need for public debts.

Majority of the candidates attempted the question and their performance was very good.

The common pitfalls were the inability of the candidates to distinguish between bilateral and multilateral debt, while in parts (b) and (c) few of the candidates could not satisfactorily explain the conditions under which debt finance would be preferable and explain reasons to justify the need for public debts respectively.

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

Marking guide

		Marks	Marks
a.	**Concept of public debt**		
	Explanation of the concept of public debts	2	
	Distinguishing between bilateral and unilateral debts	2	
	One example each.	2	6
b.	**Conditions under which debt finance would be preferable**		
	Explanation of two conditions at 1½ marks each		3
c.	**Reasons advanced to justify the need for public debts**		
	Identification of any four reasons at ½ mark each	2	
	Explanation of any four reasons identify at 1 mark each	4	6
	Total		**15**

SOLUTION 6

Factors to justify the need for public enterprises:

i **Market failure:** The operation of market mechanism presupposes that the economic activities are guided by rational expectation, that is, profitability. However, there are differences in endowment which in most cases determines productivity and returns. Therefore, public undertakings are required in areas of the economy which the government deems necessary or very crucial, but which investors may not be willing to touch because of the huge capital and risks involved in such ventures. Furthermore, investment in such areas of the economy may take a longer time to materialise. It is for these reasons that public enterprises are established to operate in such essential industries of the economy

ii **Merit goods**: The goods or services considered to be of utmost necessity such as education, health care services, water supply and the likes cannot be left in the hands of private investors. They would be under-supplied because consumers would not be able to pay the market prices of these goods. Generally, the supply of such services should be adequate and should be available at low or near zero prices in order to encourage more consumption or participation. In the case of education, for example, the government may insist that every child up to a certain age must benefit from free education. In some cases, free medical services are provided for certain categories of people such as pregnant women as well as people over 75 years. But when private investors dominate the provision and supply, the prices may be beyond the reach of the people. For example, private tertiary institutions in Nigeria embark on aggressive advertisement for students, whereas, public tertiary institutions are burdened with over-population. Hence, the need for these services to be provided by government through the establishment of public enterprises thereby making prices become bearable for the populace.

iii **Strategic or security consideration**: Sometimes, governments set up public enterprises because of the very nature of the projects. Currency and mint, for example 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 public enterprises.

iv **Promote growth of the economy**: Usually, the objective or goal of the government is that the country should grow and develop at an optimum rate. This happens if the various components of the country have steady access to capital stock which may not be readily available through market mechanism. Therefore, public undertakings directly add to the capital assets of the economy in the form of roads, bridges, factories and the likes. Without public undertakings, certain areas of the country's economy may be starved of the capital they require to function even though such areas of the economy are very important. Hence, another reason why public enterprises are established is to inject capital into areas of the economy which ordinarily private investors may shy away from. The establishment of an Agriculture Development Bank, Bank of Industry are examples to ensure that capital is provided for investors in those sectors that lack funding.

v **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, indirectly, the movement of the economy can be guided.

vi **Natural resources**: One of the potent reasons for public undertakings is the case of some natural resources like forests, mines, and so on. 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 expected. This may result in a large scale and quick denuding of the land thereby causing soil erosion and upsetting the ecological balance. A public enterprise or undertaking given the same task would operate based on a defined systematic policy of extraction thereby avoiding damage to the soil structure and environment.

Examiner's report

The question requires candidates to discuss factors to justify the need for public enterprises.

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

The common pitfalls were the inability of few candidates to identify and explain factors to justify the need for public enterprises.

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

Marking guide

	Marks	Marks
Factors to justify the need for public enterprises:		
Identification of any five factors	5	
Explanation of the five factors identified at 2 marks each	<u>10</u>	<u>15</u>
Total		<u>15</u>

SOLUTION 7

a. The following are the measures open to a Federal Government in intervening in the activities of an economy:

i. **Fiscal policy**
It relates to government expenditure and tax measures aimed at controlling aggregate demand and hence the economy. It may be expansionary or contractionary depending on the objective(s) being pursued. Its components include taxation, expenditure, national budget, borrowing or public debt and subsidies

ii. **Monetary policy**
This refers to the conscious and deliberate action on the part of the monetary authorities to control money supply, the general credit availability, the direction and cost of credit within the economy. It is aimed at influencing intermediate variables for the purpose of manipulating target variables. It comprises the use of measures such as open market operations, cash reserve ratio, liquidity ratio, bank rate or discount rate, credit ceiling, sectoral allocation, moral suasion and mandatory deposit.

iii. **Commercial policy**
It relates to a set of rules and regulations that influence the country's imports and exports. It consists of tariffs, quotas and other form of trade restrictions design to promote exports, generate income and employment and restrict imports in order to reduce commercial deficits.

b. The following steps are required to be taken by the Federal Government or its agencies before seeking the approval of the National Assembly on their request for external borrowing:

i. The FG must seek approval of the annual borrowing programme;

ii. Approval of the terms and conditions of external loans as contained in the annual borrowing programme must be sought by the FG;

iii. The FG must seek approval of overall limits, for the amounts of consolidated debt of the federal, state and local governments, to be set by the President on the advice of the Honourable Minister of Finance (HMF); and

iv. There must be prior authorisation in the Appropriation or other Act or Law for the purpose for which the borrowing is to be utilised.

c. **Requirements for raising fund from the domestic market by state governments.**

In order to raise fund from the domestic capital market, a state government must conform to the requirements of the Investment and Security Act, 2007 as stated below:

i. **Compliance with constitutional provisions:**

In accordance with Section 120 of the 1999 Constitution (as amended), state governments must ensure any borrowing is approved by the State House of Assembly. Borrowing must align with the legal framework governing public finance and borrowing in Nigeria.

ii. **Approval from the Federal Government**:

As per the Debt Management Office (DMO) Act, 2003, state governments must obtain approval from the Federal Ministry of Finance through the Debt Management Office (DMO) before accessing the domestic capital market.

iii. **Adherence to the Fiscal Responsibility Act (FRA) 2007:**

The FRA imposes specific requirements on borrowing by state governments:

- Borrowing must be strictly for capital expenditure or human development projects.
- The loan must demonstrate clear economic benefits.
- The state must show a viable repayment plan, ensuring debt sustainability.

iv. **Debt Sustainability Analysis (DSA):**

The DMO conducts a debt sustainability analysis to assess whether the state's existing debt profile and proposed borrowing are sustainable.

v. The consent of the Federal Ministry of Finance to state's request to borrow from the capital market

vi. **Credit worthiness and credit rating:**

States are typically required to obtain a credit rating from a recognised agency to demonstrate their financial capacity and repayment ability. A profile of the assets and liabilities of the state in the last five years in addition to a 5- year projection

vii. **Preparation of an offer document (Prospectus):** A profile of the state showing its population, major industries, their locations and other major projects embarked upon. The information has to be submitted with an application to the Securities and Exchange Commission (SEC) as well as the Nigerian Exchange Limited (NGX)

viii. **Registration with the Securities and Exchange Commission (SEC)**
The borrowing programme must be registered with the Securities and Exchange Commission (SEC), which is responsible for regulating the Nigerian capital market.

ix. **Applications to Securities and Exchange Commission (SEC):**
The application shall, amongst other documents, be accompanied by an original copy of an irrevocable letter of authority giving the Accountant General of the Federation the authority to deduct at source from the statutory allocation due to the body, in the event of default by the body in meeting its payment obligations under the terms of the loan and the relevant trust deed.

x. **Legislative approval**
The borrowing must be approved by the state's legislature, ensuring that it aligns with the state's budgetary and developmental priorities. Legislative approval provides legal backing for the issuance of bonds or other securities.

xi. **Open and transparent bidding process**
States may be required to conduct an open and transparent bidding process for the selection of financial advisors, underwriters and other intermediaries in the borrowing process.

xii. **Collateral or revenue backing**
The state may need to provide guarantees, such as internally generated revenue (IGR) or statutory allocations from the federation account, as security for the borrowing.

xiii. **Adherence to capital market rules**
The borrowing must comply with capital market rules, including listing requirements for bonds on the Nigerian Exchange (NGX) or Financial Market Dealers Quotation (FMDQ) Exchange.

xiv. **Engagement with professional advisors**
States must engage professionals such as financial advisors, issuing houses and legal counsel to structure and manage the borrowing process effectively. These professionals ensure compliance with legal, financial and market standards.

xv. **Independent revenue verification**
States must demonstrate adequate revenue-generation capacity to repay the debt. Verification by independent auditors may be required to confirm revenue streams.

xvi. **Alignment with development goals**
Borrowing plans must be tied to specific developmental projects, ensuring alignment with the state's medium to long-term goals.

Examiner's report

The question is in three parts. Part (a) of the question requires candidates to explain the measures open to Federal Government in intervening in the activities of an economy. Part (b) of the question requires the candidates to enumerate the steps that the Federal Government or its agencies must take before seeking the approval of the National Assembly on their request for external borrowing, while part (c) of the question asks the candidates to identify the requirements for raising funds from the domestic capital market by state governments.

Few of the candidates attempted the question and their performance was poor.

The commonest pitfall was the inability of few candidates to enumerate the steps that the Federal Government or its agencies must take before seeking the approval of the National Assembly on their request for external borrowing. Also, few candidates were unable to identify the requirements for raising funds from the domestic capital market by State Government.

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

Marking guide

		Marks	Marks
a.	Measure used for intervening in the economy by FG		
	Identification of any two measures	1	
	Explanation of any of the two measures identified at 1½ marks each	3	
	Any example of each of the two measures at ½ mark each	<u>1</u>	5
b.	Measures to be taken before seeking approval of NASS for external borrowing		
	Identification and explanation of any four measures		4
c.	Requirements for raising funds from domestic market by state government		
	Any four requirements identified at 1½ marks each		<u>6</u>
	Total		<u>**15**</u>

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – NOVEMBER 2024

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 any other **COLOUR OF INK** will not be marked.
8. You are required to attempt **Question ONE (compulsory), any TWO Questions in Section B and any Two questions in Section C**.
9. Check that you have collected the correct question paper for the examination you are writing.

THURSDAY, NOVEMBER 21, 2024

DO NOT TURN OVER UNTIL YOU ARE TOLD TO DO SO

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – NOVEMBER 2024

CORPORATE STRATEGIC MANAGEMENT & ETHICS

Time Allowed: $3^1/_4$ 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

Gold Bank Plc is a leading commercial bank in Nigeria. Since inception in 2005, it has been at the forefront of the development, deployment and marketing of diverse internet driven banking products. These services complement traditional banking products, which Gold Bank Plc offers to its over ten million customers across Nigeria, with branches in Africa, Europe, and North America.

However, the last couple of years have been particularly challenging for Gold Bank Plc. Net profit grew at an average of 15% between 2010 and 2017, but declined to 5% between 2017 and 2021. Banking surveillance report revealed that this decline is attributable to increased customer preference for Financial Technology (FinTech) services which are not part of Gold Bank Plc's portfolio of banking products. FinTech is a group of emerging Information Technology (IT) and internet-driven financial services. Such services include digital wallets, digital lending, digital payments, blockchain, and digital wealth management. Consequently, the Board of Directors of Gold bank Plc decided that a key component of the bank growth strategy in the coming years is to diversify into the Fintech market.

Since its inception in 2005, Gold Bank Plc has been developing its internal capacity to innovate and deploy IT driven financial services. This has given the organisation a reputation as one of the most innovative institutions in Nigeria's banking industry. This reputation was achieved through consistent investment in IT infrastructure, attraction, development and deployment of highly qualified IT professionals. The bank is also known for its robust management support system, which is evidenced by the creation of a separate, but highly organised department saddled with the responsibility of developing, deploying, maintaining and overseeing the bank's IT and cybersecurity infrastructure. However, diversification into Fintech requires additional resources, such as bigger internet bandwidths, specialised computer hardware and software, and human resources with skills and experience in Fintech. Unfortunately, Gold Bank plc does not currently possess these.

Nigeria's Fintech market is currently made up of tech start-ups, most of which are currently small in terms of size, number of employees, but big in terms of asset value and volume of transactions processed annually. As a bourgeoning market, it is estimated that Nigeria's Fintech industry will double in market size and value in the next two years. Thus making it one of the fastest growing sectors in Nigeria. This is partly because more traditional banking customers are switching to Fintech services.

Currently, the biggest Fintech company in Nigeria is Oceanwave Limited with a current market value estimated to be in excess of ₦5 billion. Entry into the industry is highly regulated with several legal requirements. One of these is high paid-up capital requirement. Also, the resources and IT infrastructure requirements for setting up a Fintech company pose a strong barrier for new entrants into the industry. Consequently, there are only five Fintech companies that are registered to do business in Nigeria.

The Board of Directors of Gold Bank Plc is to decide between two options as entry strategy into Nigeria's Fintech space: organic growth or acquisition strategies. To this end, the bank is already in acquisition talks with Barterwave, the third largest Fintech company in Nigeria.

Required:

You have been engaged as a consultant to provide advice to Gold Bank Plc on its strategic initiatives.

a. Advise the Board of Directors of Gold Bank Plc on the potential benefits and drawbacks of pursuing organic growth. (10 Marks)

b. From the scenario above, use the Johnson and Scholes framework to advice on how Gold Bank Plc can use Critical Success Factors (CSF) to achieve competitive advantage through diversification into the Fintech market. (7 Marks)

c.

d. Using SWOT analysis, advise on the chances of success of Gold Bank Plc with the proposed organic growth strategy of diversification into the Fintech market. (10 Marks)

e. Advise the management of Gold Bank Plc on the likely drawbacks of pursuing acquisition as a growth strategy as the company is considering acquiring Barterwave Limited. (3 Marks)

(Total 30 Marks)

SECTION B: YOU ARE REQUIRED TO ATTEMPT TWO OUT OF THE THREE QUESTIONS IN THIS SECTION (40 MARKS)

QUESTION 2

Every business venture involves risk. Often the higher the risks, the higher the expected return. However, it is important that owners of businesses have clear understanding of the types and dynamics of risks involved in business engagements. As an expert in business risk management, you are expected to explain the following to a set of young entrepreneurs who are just starting their businesses:

a. Measuring risks (3 Marks)
b. Prioritising risks (3 Marks)
c. Related and Correlated risk factors (3 Marks)
d. Objective and subjective risk perception, using an appropriate illustrative table (7 Marks)
e. Role of the risk manager (4 Marks)

(Total 20 Marks)

QUESTION 3

Gafar is uneducated and has worked as a messenger for most of his adult life. He recently won ₦500 million in a raffle draw. He has procured 50 hectares of land at Alabata village where he hopes to establish a large poultry farm in the sum of about ₦250 million. He has been advised to reach out to stakeholders in the poultry industry in the region to ensure their optimal cooperation towards the successful and highly profitable running of the farm. However, Gafar is not clear about who the stakeholders are and he consequently approaches you as an expert in Corporate Governance for some assistance.

You are required to clarify the following in ways that Gafar will fully understand them:

a. What are the general responsibilities of an organisation towards its stakeholders, and what is the important objective of corporate governance with respect to stakeholders? (5 Marks)
b. State **ONE** example and **ONE** problem of indirect claim. (5 Marks)
c. Explain **FIVE** categories of stakeholders. (10 Marks)

(Total 20 Marks)

QUESTION 4

Professional accountants are expected to be ethical in decision making. Adeolu works in an audit firm whose services have been enlisted to audit the accounts of a large manufacturing company in Nigeria. Adeolu was sent as the head of the team to the company.

During the audit process, a lot of financial infractions that resulted in material misstatements in the financial statements were discovered.

When it was clear to the company's management that these misstatements have been discovered, Adeolu, on the instruction of the Managing Director was invited to the office of the Financial Controller (FC), who is also a professional accountant, and was offered 50 million naira to ignore the impact of the misstatements in issuing the audit report. The FC was pressurised by the MD that he should convince Adeolu whom he knows was his classmate in the university to accept the ₦50 million and issue an unqualified audit report. He also threatened that failure to do this might cost him his job. Interestingly, the MD is an uncle of the FC's wife. He got the job by virtue of this relationship.

Adeolu's mother needs an urgent surgery which is to cost the sum of 18 million naira. His wife also will soon put to bed, and he has no idea how to raise the money required to prepare for the arrival of the baby. No doubt the offer of ₦50 million is very tempting, but Adeolu remembers what he has learnt about the critical steps to be taken in arriving at ethical decisions.

You are required to:

a. Explain the critical steps to be taken in arriving at an ethical decision and relate these to the scenario above. (8 Marks)

b. Identify the ethical threats an accountant in business might be exposed to, their classifications and relate these to the situation of the FC of the company in question. (10 Marks)

c. State how a person will take moral decisions, if the person is moral in accordance with the four-step model of moral behaviour and the scenario documented in this question. (2 Marks)

(Total 20 Marks)

SECTION C: YOU ARE REQUIRED TO ATTEMPT TWO OUT OF THE THREE QUESTIONS IN THIS SECTION (30 MARKS)

QUESTION 5

After a long economic recession, Nkechi and Saburi have come together to establish a plastic company and the board of directors have drawn the corporate code of ethics for the company.

a. Explain the concept of corporate code of ethics. (2 Marks)

b. Discuss **THREE** basic reasons for developing a company's code of ethics. (6 Marks)

c. Highlight SIX general statements that a corporate code of ethics specify. (3 Marks)

d. Highlight **FOUR** statements of corporate code of ethics in respect of the company's employees and **FOUR** in respect of the customers. (4 Marks)

(Total 15 Marks)

QUESTION 6

The ethics of an organisation is shaped by its corporate culture.

a. Using the Johnson and Scholes cultural web, describe the contents of corporate culture. (12 Marks)

b. Use the Edgar Schein model to describe the level of corporate culture in an organisation. (3 Marks)

(Total 15 Marks)

QUESTION 7

You are being interviewed for a job as a risk manager and you are required to:

a. Specify the role of a risk manager. (3 Marks)

b. Discuss the TARA framework for risk management. (4 Marks)

c. Explain the roles of management and board in risk management. (8 Marks)

(Total 15 Marks)

SECTION A

SOLUTION 1

a. Internal development strategy is pursued when an organisation develops and deploys its internal competencies and capabilities to achieve organisational growth.

Potential benefits of growth through internal development are as follows:
Firstly, it will provide more latitude for management to control Gold Bank Plc's growth, thus ensuring that progress is achieved within the means of the entity. Adopting this strategy ensures that adequate resources are available for the success of the growth initiative.

Secondly, it will provide opportunity for Gold Bank Plc to identify, develop and deploy its core competencies for successful growth and improved competitive advantage. These core competencies include a robust management support system and the possession of needed resources, which has made Gold Bank the most innovative bank in the industry

Thirdly, Gold bank Plc can fill identified resource gaps by acquiring such from the market. For example, a shortfall in skills needed for diversification into the Fintech market can be met through recruitment of needed human resources from the labour market.

Drawbacks of pursuing internal development strategy are as follows:

First, the growth that Gold Bank Plc can achieve will be limited to its internal capabilities. In pursuing this strategy, the bank may deny itself access to competencies and capabilities which can be provided by other firms through mergers and acquisition.

Second, the time lag between when internal capabilities are deployed and when Gold Bank plc commences the rollout of Fintech services may be significant. The development and rollout process may also be very costly. It will also take some time to build the bank's reputation as a Fintech service provider. All these gaps and costs are eliminated with mergers and acquisitions.

Third, internal development would require adaptation/modification of available resources for them to be usable for the Fintech business including reskilling/upskilling of existing staff. This poses some risks as the quality of Fintech services provided by the bank may not offer competitive advantage to the entity.

Fourth, Diversification into the Fintech business may require a significant change in the management structure of the entity. This feat could be difficult to achieve.

b. Critical Success Factors (CSF) are components of an organisations strategy that can offer competitive advantage.

Johnson and Scholes proposed a six-step approach to using CSF to gain competitive advantage:

Step 1: Identify the CSF that significantly determine the profitability of the business. In doing this, it is useful for the firm to consider the 4Ps of marketing: Price, Product, Place and Promotion. From the given scenario, Gold Bank Plc can improve on the quality and type of products currently on offer in the Fintech market and improve same; while charging lower rates than the competitors.

Step 2: Identify the critical competencies that will deliver high profit and competitive advantage. It means identifying which competencies that the firm should build to achieve business success. For example, the firm may need to deploy resources to strengthen the quality of its product. There is no critical competency mentioned in the scenario. However, Gold Bank Plc can deploy resources that will either ensure high quality Fintech services or achieving low-cost operations.

Step 3: Develop critical competencies (identified in step 2) that will deliver profitability and competitive advantage. Requisite inputs that will deliver competitive advantage in the FinTech market should be developed and deployed by Gold Bank Plc.

Step 4: Identify Key Performance Indicators (KPIs) for each critical competency identified in step 2.

Step 5: Emphasise the development of critical competencies of each aspect of the firm's performance in such a manner that it will be difficult to replicate or be matched by competitors.

Step 6: Monitor the achievement of the firm's KPI to ensure that set targets are met and competitive advantage is achieved

c. SWOT ANALYSIS

Strength: The resources and competencies that an entity possesses.
From the given scenario, these include, experience spanning over a decade in the financial services sector, strong IT infrastructure, highly skilled and qualified IT personnel, strong innovation capabilities, strong management support system, organisational structure that supports rendering of IT driven financial services, and large customer base.

Weaknesses: Resources and competencies that the organisation currently lack, but are critical to the success of its strategies and achievement of its goals.
From the given scenario, these include: inadequate internet bandwidth, inadequate computer hardware and software, lack of adequate skilled manpower in Fintech.

Opportunities: Factors in the external environment that can be exploited to deliver competitive advantage and realisation of corporate goals.
From the given scenario, these include: a rapidly growing Fintech market increasing number of customers are switching to Fintech services.

Threats: Factors in the external environment that may hamper the success of the entity's strategies and hinder the achievement of corporate goals.
From the given scenario, these are: size and activities of Oceanwave Limited and other competitors. These sum up to make the FinTech market highly competitive. Also, there are strong entry barriers into the Fintech business such as high capital base, IT infrastructure, and regulatory requirements.

Conclusion:
The success of Gold Bank Plc in the Fintech business depends on if its strengths and opportunities are stronger than weaknesses and threats. When strengths and opportunities are stronger, then it is very likely that Gold Bank Plc will succeed in the proposed Fintech business. However, if weaknesses and threats are stronger, then the chances of failure of Gold Bank Plc in the Fintech business is higher.

d. **Drawbacks of acquisition as a growth strategy:**
Cost of acquiring Barterwave Limited may be high enough to encourage many of its current shareholders to sell off their shares, thus lowering the return on investment of the buyer (Gold Bank Plc). Also, adopting acquisition as a growth strategy may lead to a loss of proportional ownership of the entity as acquisition may lead to a change in ownership structure. Furthermore, the integration of both Barterwave and Gold Bank into a single entity could be challenging given the fact that both firms have different management structures, corporate cultures and compensation management systems. It may also lead to the acquisition of liabilities, which Barterwave may be carrying as may be shown in its financial position statement.

Examiner's report

This scenario based compulsory Strategic Management question tests the following aspects of growth strategy:

a. Benefits and drawbacks of organic growth;
b. Johnson and Scholes framework to use Critical Success Factor (CSF) for competitive advantage;
c. SWOT Analysis of organic growth strategy; and
d. Drawbacks of acquisition as a growth strategy.

Virtually all the candidates attempted this question.

Performance was below average, as less than 40 percent of the candidates scored up to 50 percent of the marks allocated to this question.

Many candidates did not demonstrate adequate knowledge of Johnson and Scholes framework for use of Critical Success Factor (CSF) for competitive advantage.

Candidates are advised to pay serious attention to the use of Critical Success Factor for competitive advantage.

Marking guide

		Number of points	Marks per point	Total	
a)	Definition of internal development strategy	1	2	2	
	Potential benefits	6	$1^1/_4$	5	
	Drawbacks	8	$1^1/_4$	5	
					10
b)	Definition of CSF	1	1	1	
	Steps	6	1	6	
					7
c)	**Strengths:**				
	Definition	1	½	½	
	Bullet points	5	½	2½	
	Weaknesses	1	½	½	
	Definition				
	Bullet Points	3	½	1½	
	Opportunities	1	½	½	
	Definition				
	Bullet Points	1	1	1	
	Threats	1	½	½	
	Definition				
	Bullet Points	1	1	1	
	Conclusion	2	1	2	
					10
d)	Drawbacks of acquisition as a growth strategy	3	1	3	
					3
	Total				**30**

SECTION B

SOLUTION 2

a. **Measuring risks:** Measuring risk means assigning quantitative values to risk. Risk measurements can be financial measurements (for example, a measurement of the expected loss) or non-financial (for example, a measurement of expected injuries to employees at work). However, not all risks can be measured.

Where risks are assessed in qualitative terms, risk management decisions become a matter of management judgement. When risks are quantified, the risk can be managed through setting targets for maximum risk tolerance and measuring actual performance against the target.

b. **Prioritising risks**: Risk prioritisation is the process of ranking risks based on their likelihood of occurrence and the potential impact they may have on the organisation, project, and activity. Within a system of risk management, companies need to establish a process for deciding which risks are tolerable, which are not and which might need more control measures to reduce the risk. (Sometimes, it might be decided that control measures are excessive, and that money can be saved by reducing the controls, without increasing risk above acceptable levels).

Deciding on priorities for risk management might be a matter of management judgement. Some companies and non-business entities use formal techniques to help them with the prioritisation of risk. One of such techniques is risk dashboard.

c. **Related and correlated risk factors:** Related risk factors are risks that are interconnected, and therefore may influence one another. These connections can arise because they share common causes, affects similar stakeholders, or trigger secondary risk. Understanding and managing related risks is crucial in preventing cascading failures and ensure a comprehensive risk management strategy. Examples may include economic recessions which may lead to reduced consumer spending (marketing risk) which may lead to a reduced consumer spending (operational risk).

d. **Correlated risk factors**: Correlated risks are underlying variables or conditions that simultaneously influence multiple risks, creating a relationship between them. Examples of correlated risks may include inflation, which can drive up costs (operational risks) and reduce purchasing power (market risk). Risks might be positively correlated (both go up or down together) or negatively correlated (one falls as the other increases). Correlation might be due to the risks having a common cause or because one type of risk might give rise to the other.

Objective and subjective risk perception

Objective risk perception

Risk is objectively perceived/ assessed when all variables (likelihood and impact) can be measured accurately (where hard information is available). Assessment of a risk based on objective measurement of likelihood and impact is usually more robust than if based on subjective judgement. This will affect the risk management strategy. In many cases, it is difficult to assign a value to likelihood or impact with any degree of accuracy. In such cases, risks are subjectively perceived/ assessed. Assessment of a risk based on objective measurement of likelihood or impact is usually more robust than if based on subjective judgment.

Subjective risk perception

Subjective risk perception refers to the personal and individual judgment about the likelihood and severity of a risk. Subjective risks are based on psychological, social, cultural, and emotional factors.

The following table contains illustrations of risks where impact and likelihood might be objective or subjective:

Objective likelihood measurement	**Subjective likelihood measurement**
Quality failure in a batch of components (based on previous manufacturing experience).	An oil well disaster occurring this year in Siberia.
Objective impact measurement	**Subjective impact measurement**
The change in interest payments as a result of a 1% increase in interest rates.	Change in revenue due to change in consumer taste.

e. **Role of the risk manager**

The role of a risk manager includes:

i. Helping with the identification of risks;
ii. Establishing 'tools' to help with the identification of risks;
iii. Establishing modelling methods for the assessment and measurement of risks;
iv. Collecting risk incident reports (for example, health and safety incident reports);
v. Assisting heads of departments and other line managers in the review of reports by the internal auditors;
vi. Preparing regular risk management reports for senior managers or risk committees; and
vii. Monitoring 'best practice' in risk management and encouraging the adoption of best practice within the entity.

Examiner's report

This Risk Management question tests the following:

a. Measuring risks;
b. Priotising risks;
c. Related and correlated risk factors;
d. Objective and subjective risk perception; and
e. Role of Risk Manager.

More than 80% of the candidates attempted this question.

Performance was average as about half the number of candidates who attempted this question scored more than 50 percent of the marks allotted to it.

The candidates who performed poorly could not effectively distinguish between related and correlated risk factors, and objective and subjective risk perception.

Candidates at this level of the examination must be able to demonstrate knowledge of basic concepts such as these.

Marking guide

	Description	Number of points	Marks per point	Total
a)	Measuring risks	3	1	3
b)	Prioritising risks	3	1	3
c)	Related risk factors	3	½	1½
	Correlated risk factors	3	½	1½
d)	Objective risk perception	2	1	2
	Subjective risk perception	1	1	1
	Diagram	4 segments	1 per segment	4
e)	Role of the risk manager	4	1	4
	Total			**20**

SOLUTION 3

a. A stakeholder is any group or individual who has a stake or interest, or some expectation from an organisation and can affect or be affected by the achievement of the entity's objectives. An organisation has a responsibility to meet at least some of the expectations of its stakeholders. If a company fails to meet any of the expectations of its stakeholders, they might lose interest in the entity. If a company wishes to remain associated with its stakeholders, it must do something to satisfy these expectations. The expectations of different groups of stakeholders are not the same, and they are often inconsistent with each other. The objectives of corporate governance should be to provide enough satisfaction for each stakeholder group.

b. Indirect stakeholder claims are claims that are not made directly by a stakeholder or stakeholder group but are made indirectly on their behalf by someone else. For example:

- A small customer of a very large company is too powerless to make claims in his own name;
- Future generations have a claim on what a company does today, for example if the company's operations can preserve or destroying the environment, future generations will be affected. They are not yet alive and able to express their claims directly, and someone else must think about their interests for them; and
- Terrorist groups may claim to represent the interests of people in their region or country.

The problem with indirect stakeholder claims is that it is not always possible to be sure that the stakeholders are being properly represented and their claims correctly expressed.

Categories of stakeholders

i. **Narrow and wide stakeholders**
Narrow stakeholders are those that are the most affected by the actions and decisions of the organisation. Narrow stakeholder groups for a company usually include shareholders, directors, other management, employees, suppliers, and those customers who depend on the goods produced by the company. Wide stakeholders are those groups that are less dependent on the organisation. Wide stakeholders for a company may include customers who are not particularly dependent on the company's goods or services, the government, and the wider community (as distinct from local communities in which the company operates, which may be narrow stakeholders). Companies have more responsibility and accountability to narrow stakeholders than to wide stakeholders.

ii. **Primary and secondary stakeholders**
A primary stakeholder group for a company is a group that is essential for the continuation of the company as a going concern. Customers, suppliers, and employees may be primary stakeholders. Secondary stakeholders are those that the organisation does not directly rely on for its continued survival, at least in the short term. Primary stakeholders have strong influence over a company's decisions and actions.

iii. **Active and passive stakeholders**
Active stakeholders are those that seek involvement in the company's activities and decisions. These stakeholders may be a part of the company's normal decision-making and operating processes, such as management and employees. Other active stakeholders who are external to the company may

include, for example government regulators or environmental pressure groups. Passive stakeholders are those stakeholders who do not usually try to get involved with a company's policy making. They may have a strong interest in what the company does, but they do not want to get actively involved in the decision-making. The government and local communities may be examples of passive stakeholders.

iv. **Voluntary and involuntary stakeholders**
A voluntary stakeholder is someone who becomes a stakeholder voluntarily. They include employees (who could move to a job with a different employer), customers (who could buy goods from another company) and shareholders (who could sell their shares). Involuntary stakeholders are those who do not choose to be stakeholders but have no choice. These include local communities, stakeholders who suffer from the effect of the company's operations on the environment, and future generations. Most competitors are also involuntary stakeholders.

v. **Legitimate and illegitimate stakeholders**
Legitimate stakeholders are those with a 'right' to make a claim on the company (a 'legitimate' claim). Illegitimate stakeholders are those that do not have such a 'right'. Deciding whether stakeholders have legitimate or illegitimate claims on a company may depend on a person's viewpoint and the distinction is therefore to some extent a matter of judgement. Examples of illegitimate stakeholders may be certain lobby groups or pressure groups (for example, animal rights activists) or charity organisations. In some countries, rebel groups or terrorists may be illegitimate stakeholders with considerable influence over a company's activities.

vi. **Known and unknown stakeholders**
Known stakeholders are those that the company knows about. Unknown stakeholders are those whose existence the company is not aware of. This distinction may be relevant when a company has operations that affect the environment or is planning new activities that will have an environmental impact. The company will not necessarily be aware of all the stakeholders that will be affected by its activities – for example animals, insects, and sea creatures. It may be argued that before implementing any new business strategy a company should carry out a thorough investigation to identify unknown stakeholders and consider the impact of its strategy on them.

vii. **Internal and external stakeholders**
Internal stakeholders of a company are inside the company and a part of it. Two insider stakeholder groups in a company are the equity shareholders and the directors. External stakeholders are outside the company and are not a part of it. These include government agencies and the wider community.

Examiner's report

This is a Governance question covering the following areas:

a. General responsibilities of an organisation to its stakeholders and objectives of corporate governance to stakeholders;
b. Problems of indirect claim; and
c. Categories of stakeholder.

Less than 60 percent of the candidates attempted this question.

Performance was poor, as less than 40 percent of the candidates who attempted this question, scored up to 50 percent of the marks allocated to the question.

Many candidates did not understand the categories of stakeholder, as they mistook them for stakeholder groups.

Candidates are admonished to master these concepts as they are important in governance.

Marking guide

	Description	Number of points	Marks per point	Total
a)	Responsibilities of organisations to stakeholders	5	1	5
b)	Example and problem of indirect claim	2	2½	5
c)	Categories of stakeholders	5	2	10
	Total			**20**

SOLUTION 4

a) The critical steps to arrive at an ethical decision in business include:

Step 1: Identification of the Moral Issue
The individual must be able to recognise the relevant moral issue or moral dilemma whenever there is an ethical aspect to a situation. He or she must be able to recognise that a moral decision has to be taken.

Scenario
The moral dilemma in this case is whether or not to window dress the audit report to cover the financial infractions in the company.

Step 2: Recognition/selection of the course of action.
The decision-maker must be able to recognise and select the course of action that is morally correct.

Scenario
Adeolu must be able to recognise that the professional and morally correct action is to reject the offer of N50 million and present an accurate and objective audit report.

Step 3: Accessing the significance of the threats
The decision maker must identify the significance of the threats to compliance with the fundamental principles of integrity and objectivity.

Scenario
One of the threats is very significant because much money is involved (N50 million) and Adeolu is a close associate to the FC. This may impair objectivity and integrity.

Step 4: Prioritisation/ preference for right line of action
The decision- maker must give priority to the right line of action above all other considerations (for example, self-interest).

Scenario
Adeolu must not prioritise the needs of his mother and wife over what is ethical from the professional point of view.

Step 5: Demonstration of moral strength
The decision-maker must have enough moral strength to implement the decision that he selects in Steps 2 and 3.

Scenario
Adeolu must act accordingly.

Step 6: Introducing safeguards.
Safeguards can be introduced to reduce the threat to compliance with integrity and objectivity.

Scenario
One of the safeguards that can be introduced is for Adeolu to request for replacement in the engagement team

4b. **Identification of unethical actions/ethical threats**

The unethical actions/ethical threats that an accountant could be exposed to include:

i. Breaking a law or regulation: Illegal activity is always unethical;
ii. ignoring technical standards, such as financial reporting standards or auditing standards;
iii. Lying to the external auditors or regulators; and
iv. Issuing a report that is misleading and misrepresents the facts.

Classification of ethical threats

i. Self-interest threats: By doing what the senior management expects, the accountant might expect to benefit from personal rewards, such as a bonus, a higher salary or promotion;

ii. Intimidation threats: There might also be a threat from senior management that the accountant might not receive a bonus or might be expected to resign unless he agrees to do what senior management ask;

iii. Familiarity threats: In some cases, an accountant might be expected to agree to what senior management ask because he has known them for a long time and should be expected to trust them to do 'what is right' for the company;

iv. Advocacy threats: This might occur when group of individuals within an organisation advocate for a particular position or interest that may compromise objectivity; and

v. Self -review threats: There might be a threat from the management of the company by attempting to audit their own company account by dictating what to be done by independent team of auditors.

Relating the threats to the situation of the FC:

There is the intimidation threat as the MD had threatened the FC with the possibility of losing his job.

There is also the familiarity threat as the FC is related to the MD by marriage and also a classmate of Adeolu.

4c. How a moral or ethical person would take moral decisions given the four-step model of moral behaviour.

Step 1: **Identify the ethical issue**

Scenario: Adeolu should identify all the ethical issues involved in the auditing of the account. His appointment to lead the team of auditors to do the job is based on his knowledge and experience. Adeolu is faced with the dilemma of accepting ₦50 million gift in order to accept or reject the provision of unqualified audit report.

Step 2: **Consideration of the threats that compliance with the fundamental ethical principles could create**

Scenario: In this case, there are threats to the principles of integrity, objectivity, professional behaviour, professional competence and due care.

Step 3: **Consideration of the significance of the threats to the compliance with the fundamental principles**

Scenario: The significance of the threat will depend on how committed Adeolu is to the ethics of his profession as an auditor and, the extent in which the threats could compromised objectivity.

Step 4: **Consider safeguarding the ethical threats and find solution**.
The step to take so as to ensure moral decisions is for Adeolu and his auditing team to adhere to the right course of action that is morally correct.

Examiner's report

This is a scenario-based Ethics question on ethical threats and safeguards.

More than 80 percent of candidates who attempted this question, however, performance was below average as not more than 30 percent of the candidates who attempted it scored 50 percent of the marks allotted.

The common pitfall was candidates' inability to relate their responses to the scenario provided. This is a major distinction between Foundation and Skills levels of the examination. Candidates must master this skill as they will require it at higher levels of the examination.

Marking guide

	Description	No of points	Marks per point	Total
a)	Identification of steps	4	½	2
	Explanation of steps	4	½	2
	Application to the scenario	4	1	4
b)	Identification of unethical actions/ethical threats	2	1	2
	Classification of ethical threats	5	1	5
	Relation to the given scenario	2	1½	3
c)	Points mentioned	4	¼	1
	Scenario explained	4	¼	1
	Total			**20**

SECTION C

SOLUTION 5

a. A corporate code of ethics is a written set of guidelines that outlines the principles, values, and behaviour expected of employees within an organisation. It serves as a moral compass, guiding decision-making and actions to ensure that the organisation operates with integrity, accountability, and transparency.

A corporate code of ethics is a code of ethical behaviour, issued by the board of directors of a company. It is a formal written statement, and should be distributed or easily available to all employees. The decisions and actions of all employees in the company must be guided by the code.

b. Reason 1: Managing for compliance - The company wants to ensure that all its employees comply with relevant laws and regulations, and conduct themselves in a way that the public expects. For example, companies providing a service to the general public need to ensure that their employees are polite and well-behaved in their dealings with customers.

Reason 2: Managing stakeholder relations - A code of ethics can help to improve and develop the relations between the company and its stakeholders, by improving the trust that stakeholders have in the company. The code might therefore include the ethical stance of the company on disclosing information to stakeholders and the investing public (openness and transparency) and on respecting the rights of stakeholders.

Reason 3: Creating a value-based organisation - A company might recognise the long-term benefits of creating an ethical culture, and encouraging employees to act and think in a way that is consistent with the values in its code of ethics. (It could be argued that an ethical company, like a well-governed company, is more likely to be successful in business in the long term. However, there is no firm evidence to prove this point, and it is therefore a matter of opinion.

c. **Six general statements that a Corporate Code of Ethics specify**;

i. A code of conduct should specify that compliance with local laws is essential. In addition, employees should comply with the policies and procedures of the company. There might be a statement that any employee who fails to comply with the company's code of conduct will face disciplinary action.

ii. The code might also include an overview of business conduct, and the need to protect the company's reputation and 'good name'.

iii. It might also contain statements about the values of the company, such as:

- Acting at all times with integrity;
- Protecting the environment;
- The 'pursuit of excellence'; and
- Respect for the individual.

d. A code of ethics in respect of employees might include statements about:

   i. Human rights, including the right of all employees to join legally authorised organisations such as a trade union or political party;
   ii. Equal opportunities for all employees, regardless of gender, race, ethnic origin, religion, age, disability or sexual orientation;
   iii. Refusal to tolerate harassment of employees by colleagues or managers;
   iv. Concern for the health and safety of employees
   v. Respect for the privacy of confidential information about each employee; and
   vi. Company policy on giving or receiving entertainment or bribes.

   A code of ethics in respect of customer's might include statements about:

   i. Fair dealing with customers;
   ii. Product safety and/or product quality;
   iii. The truthfulness of advertisements; and
   iv. Respect for the privacy of confidential information about each customer.

Examiner's report

This Corporate Governance question tests candidates' knowledge of corporate code of ethics.

This question was attempted by more than 80 percent of the candidates, with average performance, as about 50 percent of the candidates who attempted it scored 50 percent of the marks allotted.

Those candidates who performed poorly were unable to discuss the basic reasons for developing a company's code of ethics.

Candidates are advised to develop a full understanding of these concepts.

Marking guide

	Description	No of points	Marks per point	Total
a)	Definition of corporate code of ethics	1	2	2
b)	Basic reasons for developing company's code of ethics: Identification	3	1	3
	Explanation	3	1	3
c)	Statements that corporate codes of ethics specify	6	½	3
d)	Statements of corporate codes of ethics in respect of employees	4	½	2
	Statements of corporate codes of ethics in respect of customers	4	½	2
	Total			**15**

SOLUTION 6

a. According to Johnson and Scholes, the cultural web consists of six inter-related elements within an organisation:

Routines and rituals: These are 'the ways things are done around here'. Individuals get used to established ways of doing things. For example, a team meeting held first thing on Monday mornings.

Stories and myths: These describe the history of an organisation, and to suggest the importance of certain individuals or events. History is passed by word of mouth. Stories and myths help to create an impression of how the organisation got to where it is, and it can be difficult to challenge established myths and consider a need for a change of direction in the future. For example, a past achievement.

Symbols: These are representations of the nature of the organisation. Examples of symbols might be a company official vehicles, an office or building, a logo or a style of language.

Power structure: Organisations are influenced by the individuals who are in position of power. In many business organisations, power is obtained from management position. However, power can also come from personal influence or experience and expertise.

Organisation structure: The culture of an organisation is affected by its organisation and management structure. Hierarchical and bureaucratic organisations might find it particularly difficult to adapt to change and are often conservative in their outlook.

Control systems: Performance measurement and reward systems within an organisation establish the views about what is important and what is not so important. Individuals will focus on performance that earns rewards. For example, it has been suggested that cash bonus systems help to create the profit-driven culture in investment banks.

b. According to Schein, there are three levels of culture that members of an organisation acquire.

The outer skin: At one level, the culture of a company is evident in what an observer can see by visiting the company, and in the values that it states. The facilities and surroundings in which employees work help to create culture. So too does the way that employees dress. Culture is also seen in the way that employees talk to each other and interact with each other. A company might have a formal code of ethical behaviour, which is intended to shape the attitudes of all its members. However, stated values and mission statements are often expressed in general terms, such as 'providing a service to the community' and 'providing the best quality of service to customers'.

An inner layer: At this second level, the employees in a company share common views on specific issues. This layer of culture can be seen in the ethical stance that the company takes. Inner layer is expressed in relation to specific issues, such as: Should we trade with companies or governments in politically repressive countries? Should we buy goods from suppliers who use slave labour or child labour?

The heart: The third level of culture is the company's paradigm. This is a term for the shared assumptions and attitudes about what really matters, that are taken for granted and rarely discussed. These affect the way that the organisation sees itself and the environment in which it operates, and is the real 'core' culture of the organisation. A paradigm is not written down, and it is difficult to identify or explain. The 'paradigm' has also been described as the reason why the organisation exists.

Examiner's report

This Ethics question tests corporate culture with respect to Johnson and Scholes cultural web and Edgar Schein's model on level of corporate culture.

About 70% of the candidates attempted this question.

Performance was average, as about half of these candidates scored not less than 50% of the marks allotted.

Those candidates who performed poorly mixed up the two models tested in this question.

Candidates are enjoined to take due care in handling questions.

Marking guide

	Description	No. of points	Marks per point	Total
a)	Elements of cultural web: Identification	6	½	3
	Explanation	6	1½	9
b)	Levels of culture: Identification	3	½	1½
	Explanation	3	½	1½
	Total			**15**

SOLUTION 7

a. **Role of Risk Manager:**

i. Helping with the identification of risks;
ii. Establishing 'tools' to help with the identification of risks;
iii. Establishing modelling methods for the assessment and measurement of risks;
iv. Collecting risk incident reports (for example, health and safety incident reports);
v. Assisting heads of departments and other line managers in the review of reports by the internal auditors;
vi. Preparing regular risk management reports for senior managers or risk committees; and
vii. Monitoring 'best practice' in risk management and encouraging the adoption of best practice within the entity.

b. **The TARA framework for risk management**

The TARA framework for risk management stands for:

i. Risk transfer has been described: A common method of risk transfer is to buy insurance, and transfer risk to the insurance company.

ii. Risk avoidance usually means 'not doing' something or withdrawing from an activity that creates risk. It could make sense to avoid risk if the risk is too high for the expected returns. In order to make entrepreneurial profits however, some business risks have to be taken.

iii. Risks can be reduced by various measures. In particular, risks of errors and fraud can be reduced by means of a sound system of internal control.

iv. Accepting Risk:

- If the risk is not too great, and the cost of reducing; and
- Transferring the risk would not be worthwhile, exposure to a risk may be acceptable.

c. **Role of the management and board in risk management**

i. Identification of key risks (although the board of directors might take on the responsibility, with advice from management and auditors);

ii. Assessment of risks and for designing and implementing risk controls;

iii. Monitoring the effectiveness of risk controls, and keeping risks under review;

iv. Regularly report risks and risk management to the board of directors.

v. Drafting of company's policy on risk and providing guidance on the company's risk appetite.

Examiner's report

This Risk Management question tests candidates' knowledge of:

a. Role of a risk manager;
b. TARA framework for risk management; and
c. Roles of management and board in risk management.

About 80 percent of the candidates attempted this question, and performance was good as more than 60% of the candidates scored more than 50 percent of the marks allotted.

Candidates who performed poorly could not distinguish between the roles of management and board in risk management.

Candidates are advised to note the distinction between the roles of management and board.

Marking guide

	Description	No. of points	Marks per point	Total
a)	Role of risk manager	3	1	3
b)	TARA: Identification	4	½	2
	Explanation	4	½	2
c)	Role of management and board in risk management	4	2	8
	Total			**15**

ICAN/242/Q/B3 **Examination No....................**

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – NOVEMBER 2024

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 any other **COLOUR OF INK** will not be marked.
8. You are required to attempt **Question ONE (compulsory), any TWO Questions in Section B and any TWO questions in Section C.**
9. Tax and Capital Allowances rates are provided with this examination paper.
10. Check that you have collected the correct question paper for the examination you are writing.

TUESDAY, NOVEMBER 19, 2024

DO NOT TURN OVER UNTIL YOU ARE TOLD TO DO SO

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – NOVEMBER 2024

TAXATION

Time Allowed: $3^{1}/_{4}$ 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

ABC Limited was incorporated on December 7, 2019, with an authorised share capital of ₦2,500,000. It is engaged in general merchandising.

It commenced business on July 1, 2020. The accounting year-end is November 30, each year. The statement of profit or loss of the company has revealed the following:

	Year ended November 30, 2021		**Period ended November 30, 2020**	
	₦	**₦**	**₦**	**₦**
Gross turnover		125,600,000		87,200,000
Cost of sales		(92,944,000)		(65,400,000)
Gross profit		32,656,000		21,800,000
Dividend received (gross)		432,100		432,100
Rent received		660,000		600,000
		33,748,100		22,832,100
Expenses:				
Salaries and wages	3,890,000		3,625,000	
Rent and rates	1,200,000		1,200,000	
Transport and travelling	421,300		300,500	
Repairs and maintenance	86,000		380,000	
Donations and subscriptions	570,000		400,000	
Utilities – electricity, gas, water, etc	201,360		195,200	
Allowance for doubtful debts	320,000		210,000	
Bad debts	92,000		85,000	
Income tax provision	425,000		387,000	
Printing, photocopying and stationery	187,100		124,600	
General expenses	89,000		82,000	

Legal and other professional

charges	370,000		419,000	
Audit fees	600,000		500,000	
Bank charges and commission	628,000		436,000	
Depreciation	903,500	(9,983,260)	423,500	(8,767,800)
Net profit		**23,764,840**		**14,064,300**

Additional information provided:

		2021 ₦	2020 ₦
(i)	**Repairs and maintenance comprise:**		
	Cost of new plant not captured in property, plant and equipment (PPE)	0	125,000
	Cost of furniture excluded in PPE	0	182,000
	Repairs of motor vehicles and other equipment	86,000	73,000
		86,000	380,000
(ii)	**Donations and subscriptions are composed of:**		
	Donations to the MD's church	400,000	250,000
	Donations to XYZ Club	120,000	100,000
	Subscriptions for relevant journals	50,000	50,000
		570,000	400,000
(iii)	**Legal and other professional charges comprise:**		
	Retainership fees	250,000	250,000
	Legal cost of acquiring a new lease	0	85,000
	Legal cost of defending a tax appeal	120,000	0
	Legal cost of renewing a long lease	0	36,000
	Legal cost of defending traffic offence	0	48,000
		370,000	419,000

(iv) The company acquired the following qualifying capital expenditure:

Asset	**Date of purchase**	**Cost ₦**
Plant	July 1, 2020	2,480,000
Furniture	July 1, 2020	520,000
Fixtures and fittings	July 7, 2020	650,000
Motor vehicle	December 2, 2020	2,400,000

Required:

Compute the company's income tax liabilities for the relevant assessment years.

(30 Marks)

SECTION B: YOU ARE REQUIRED TO ATTEMPT TWO OUT OF THE THREE QUESTIONS IN THIS SECTION (40 MARKS)

QUESTION 2

Mr. Apa Eniapampa was appointed the General Manager, Finance of Apaapa-eni Nigeria Limited in Sambisa, Lagos State, on April 1, 2020 on a basic salary of ₦50 million annually. His contract of employment entitles him to professional allowance, furnished accommodation, car, payment of utility bills and annual bonus.

During the year 2021, his employers made available to him total cash emoluments of ₦80,350,000, including bonus of ₦12 million. He contributed 5% of his salary to the social security scheme.

He also contributed 5% of his basic salary to the employer for the accommodation and furnishing provided.

He earned the following other incomes during the year:

a. Trading income of ₦5,200,000. No capital allowance is claimable.

b. A dividend of ₦500,000 from his membership of an approved unit trust scheme.

c. Interest of ₦2,000,000 from National Rural Bank.

He had two dependent children both of whom were pursuing degree courses. One was at the university in the country while the other was at the University of Hull in the United Kingdom. He financed a life assurance policy with the following details:

Yearly premium - ₦10 million
Sum assured - ₦120 million

Required:
Compute the chargeable income of Mr. Apa Eniapampa for the relevant year of assessment. **(Total 20 Marks)**

QUESTION 3

Opion Nigeria Limited has been in business for so many years. The company is engaged in the sale of plastics.

The company filed its tax returns up to December 31, 2020, on due dates. Due to harsh economic environment and change in management, it experienced a downward trend in its gross turnover, effective January 1, 2021. Based on the foregoing, it could not file its monthly Value Added Tax (VAT) returns as and when due.

You were appointed as the tax consultant in February 2022. The financial records of the company for the year ended December 31, 2021, revealed the following:

	Jan	Feb	Mar	April	May	June	July	Aug	Sept	Oct	Nov	Dec	Total
	₦'000	₦'000	₦'000	₦'000	₦'000	₦'000	₦'000	₦'000	₦'000	₦'000	₦'000	₦'000	₦'000
Gross turnover	2,500	2,250	2,100	2,000	1,850	1,720	1,600	1,500	1,480	1,450	1,510	1,485	21,445
Opening inventory	(180)	(200)	(190)	(175)	(162)	(159)	(148)	(136)	(135)	(130)	(128)	(125)	(1,868)
Purchases	(1,900)	(1,640)	(1,505)	(1417)	(1,297)	(1,179)	(1,060)	(984)	(975)	(978)	(1,062)	(1,061)	(15,058)
	420	410	405	408	391	382	392	380	370	342	320	299	4,519
Closing inventory	200	190	175	162	159	148	136	135	130	128	125	121	1,809
Gross profit	620	600	580	570	550	530	528	515	500	470	445	420	6,328

Additional information provided:

(i) The monthly VAT returns relating to 2021 financial year were filed in January 2022.

(ii) For the following months, sales returns were yet to be adjusted in the gross turnover:

	₦'000
January 2021	200
February 2021	150
March 2021	100

Required:

Compute the:

a. Monthly VAT payable (13 Marks)

b. Penalties payable by the company for failing to file monthly VAT returns as and when due on transactions for the year ended December 31, 2021 (7 Marks)

(Total 20 Marks)

QUESTION 4

The Federal and State governments have primary responsibilities for tax matters including initiating proposals for amendments to tax laws. There are, however, other stakeholders which the government must collaborate with to ensure the success of the National tax policy (NTP), 2017.

Required:

Explain the responsibilities of the following stakeholders according to the NTP:

a. The government including revenue agencies (5 Marks)

b. The taxpayer (5 Marks)

c. Professional bodies, tax practitioners, consultants and agents. (5 Marks)

d. Media and advocacy groups (5 Marks)

(Total 20 Marks)

SECTION C: YOU ARE REQUIRED TO ATTEMPT TWO OUT OF THE THREE QUESTIONS IN THIS SECTION (30 MARKS)

QUESTION 5

Section 105 of CITA, having been amended by the Finance Act 2019 states that, "regulated securities lending transaction" means any securities lending transaction conducted in accordance with rules made by Securities and Exchange Commission (SEC).

The provisions of the Investment and Securities Act, Securities and Exchange Rules 2013 (as amended) and other extant laws and regulations control the operations of SEC lending in the Nigerian Capital Market.

The taxation of SEC lending transactions is influenced by the Companies Income Tax Act Cap. C21 LFN 2004 (CITA) (as amended) and other relevant tax laws.

A would-be investor approached you for your advice on the tax implications of the operation of the regulated securities lending transactions ('Sec Lending') in Nigeria.

Required:

Discuss the following in respect of 'SEC Lending' in Nigeria:

a. Taxation of dividend and interest received, fees and other benefits, taking into consideration the relevant provisions of CITA (as amended) (7 Marks)
b. Tax treatment of dividend and interest received by an individual (2 Marks)
c. Documents and transactions that are tax- exempt from stamp duties (6 Marks)

(Total 15 Marks)

QUESTION 6

The basis of assessment used by the relevant tax authority for the determination of personal income tax liability of an individual shall be on actual year basis. It is, however, pertinent to note that in determining the gross income of an individual, income from employment is based on actual year basis, while unearned incomes are based on the preceding year basis.

The Sixth Schedule of the Personal Income Tax (Amendment) Act, 2011 (as amended) states the deductions that are tax exempt and relief allowance claimable in the computation of chargeable income of an individual.

Required:

Discuss the following, taking into consideration the provisions of Personal Income Tax (Amendment) Act, 2011:

a. **FOUR** tax exempt deductions (12 Marks)
b. Computations of consolidated relief allowance (CRA) (3 Marks)

(Total 15 Marks)

QUESTION 7

Withholding tax is a tax deducted from payments made to a taxable person for the supply of goods and services.

It is not another form of tax but simply an advance payment of tax. In certain cases, the withholding tax deducted at source is the final tax in the hands of the recipients.

Since the introduction of the withholding tax scheme, there have been challenges affecting the scheme.

Required:

a. Explain the term 'Contract of supplies'. (5 Marks)

b. Explain **FIVE** challenges bedeviling the withholding tax scheme in Nigeria. (5 Marks)

c. The Tax Appeal Tribunal, in one of its judgements, exempted contracts, which are outright sales and purchases of goods and property in the ordinary courses of business.

   Required:
   Explain the criteria laid out in the judgement for the ascertainment of what constitutes 'sales in the ordinary course of business'. (5 Marks)

(Total 15 Marks)

NIGERIAN TAX RATES

1. **CAPITAL ALLOWANCES**

	Initial %	Annual %
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 and 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 Up to August 31, 2023 (10%); and Finance Act 2023 (NIL)
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.

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

   After the relief allowance and exemption had been granted, the balance of income shall be taxed as specified in the tax table above.
4. COMPANIES INCOME TAX RATE: 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) and 3% of assessable profit, with effect from September 1, 2023 (Finance Act 2023)
6. CAPITAL GAINS TAX 10%
7. VALUE ADDED TAX 7.5%
8. HYDROCARBON TAX 15% (Petroleum prospecting Licence and Marginal Fields Companies)
   30% (Petroleum Mining Lease Companies)

SOLUTION 1

ABC Limited
Computation of income tax liabilities
For assessment years 2021 and 2022

a)

Assessment year (A.Y)	**Basis period**
2021	1/7/2020 – 30/11/2020
2022	1/12/2020 – 30/11/2021

b) **Computation of adjusted profit**

	Year ended November 30, 2021 (A.Y 2022)		**Period ended November 30, 2020 (A.Y 2021)**	
	₦	**₦**	**₦**	**₦**
Net profit per accounts		23,764,840		14,064,300
Add: disallowable expenses				
Cost of new plant not captured in property, plant and equipment (PPE)	0		125,000	
Cost of furniture excluded in PPE	0		182,000	
Donations - M.D's church	400,000		250,000	
- XYZ Club	120,000		100,000	
Allowance for doubtful debts	320,000		210,000	
Income tax provision	425,000		387,000	
Legal and other professional charges:				
Cost of new lease	0		85,000	
Cost of defending a tax appeal	120,000		0	
Cost of renewing long lease	0		36,000	
Cost of defending traffic offence	0		48,000	
Depreciation	903,500	2,288,500	423,500	1,846,500
		26,053,340		15,910,800
Dividend received (gross)		(432,100)		(432,100)
Adjusted profit		25,621,240		15,478,700

c) **Computation of income tax liabilities**
Assessment year 2021

	₦
Adjusted profit	15,478,700
Capital allowances	(2,121,177)
Total profit	13,357,523

Companies income tax payable (20% of total profit) ₦2,671,504.60

Tertiary education tax payable (2% of assessable profit) ₦309,574.00

Assessment year 2022	**₦**
Adjusted profit	25,621,240
Capital allowances	(2,028,425)
Total profit	23,592,815
Companies income tax payable (30% of total profit)	₦7,077,844.50
Tertiary education tax payable (2.5% of assessable profit)	₦ 640,531.00

NOTE

Minimum tax computation is not applicable because the company is not up to 48 calendar months in business.

Computation of capital allowances

	Plant	**Furniture**	**Fixtures and Fittings**	**Motor vehicles**	**Total**
Initial allowance (%)	50	25	25	50	
Annual allowance (%)	25	20	20	25	
Investment allowance (%)	10	0	0	0	
	₦	₦	₦	₦	₦
Assessment year 2021					
Cost	2,480,000	520,000	650,000		3,650,000
Cost- Assets excluded in PPE	125,000		0		307,000
		182,000			
	2,605,000	702,000	650,000		3,957,000
Initial allowance	(1,302,500)	(175,500)	(162,500)		1,640,500
Annual allowance	(135,677)	(43,875)	(40,625)		220,177
Investment allowance					260,500
					2,121,177
W.D.V. c/f to A.Y 2022	1,166,823	482,625	446,875		
Assessment year 2022					
Addition – cost	0	0	0	2,400,000	2,400,000
	1,166,823	482,625	446,875	2,400,000	
Initial allowance	0	0	0	(1,200,000)	1,200,000
Annual allowance	(325,625)	(105,300)	(97,500)	(300,000)	828,425
					2,028,425
W.D.V. c/f to A.Y. 2023	841,198	377,325	349,375	900,000	

Examiner's report

The question tests the candidates' knowledge of the computation of taxes payable by a company.

This being a compulsory question, about 100% of the candidates attempted the question and their performance was above average.

The common pitfalls of the candidates were their inability to:

i) Capture the costs of plant and furniture omitted in PPE as disallowable expenses;
ii) Reflect these costs as additions to the relevant assets in the computation of capital allowances for assessment year (A.Y.) 2021; and
iii) Prorate the annual allowance in A.Y. 2021.

Candidates are advised to read widely and be conversant with the provisions of the Companies Income Tax Act Cap. C 21 LFN 2004 (as amended) before sitting for the subsequent examination to enhance better performance.

Marking guide

		Marks
Heading	- Name of company	¼
	- Computation of income tax liabilities	¼
	- Assessment years	¼
Basis period (½ mark for each of the 2 correct basis periods)		1
Computation of adjusted profit		
Net profit accounts (½ mark for each of the 2 points)		1
Disallowable expenses (1 mark for each of the 16 points)		16
Dividend received (gross) (1 mark for each of the 2 points)		2
<u>Assessment year 2021</u>		
Adjusted profit		½
Capital allowances		½
Total profit		½
Companies income tax payable		¼
Tertiary education tax payable		¼
<u>Assessment year 2022</u>		
Adjusted profit		½
Capital allowances		½
Total profit		½
Companies income tax payable		½
Tertiary education tax payable		½

Computation of capital allowances

Heading	¼
<u>Assessment year 2021</u>	
Cost (1/4 mark each for any correct cost)	¾
Assets disallowed (capital in nature)	2/4
Initial allowance (¼ mark each for any correct allowance)	¾
Annual allowance (¼ mark each for any correct allowance)	¾
Investment allowance	¼
<u>Assessment year 2022</u>	
Cost – Addition	¼
Initial allowance	¼
Annual allowance (¼ mark each for any correct allowance)	1
Total	**30**

SOLUTION 2

Mr. Apa Eniapampa
Computation of chargeable income
For 2021 assessment year

Earned income:	**₦**	**₦**
<u>Income from employment:</u> Basic salary	68,350,000	
Bonus	12,000,000	80,350,000
Income from trade		5,200,000
		85,550,000
Add: Unearned income		
Interest received from National Rural Bank		2,000,000
		87,550,000
Less: Tax exempt item:		
Life assurance premium		10,000,000
Gross income		77,550,000
Less: Consolidated relief allowance		
(1% of ₦77,550,000 or ₦200,000, whichever is higher, +20% of ₦77,550,000)		16,285,500
Chargeable income		61,264,500

NOTE

The dividend received from an approved unit trust scheme is tax exempt, hence the exclusion in the computation.

Examiner's report

The question tests the candidates' knowledge of the computation of personal income tax (PIT) of an employee.

About 80% of the candidates attempted the question but the performance was fair.
The commonest pitfall of the candidates was their inability to compute the correct consolidated relief allowance (CRA).

Candidates are advised to read relevant texts on taxation, ICAN Pathfinders and Study Text.

Marking guide

	Marks
Heading - Name of company	1
- Computation of income tax liabilities	1
- Assessment year	1
Basic salary	2½
Bonus	2½
Income from trade	2½
Interest	2½
Life assurance premium	2½
Computation of consolidated relief allowance:	
- 1% of ₦77,550,000	1
- ₦200,000	1
- whichever is higher	½
- 20% of ₦77,550,000	2
Total	20

SOLUTION 3

a) **Opion Nigeria Limited**
Computation of monthly VAT payable

Month of transaction	(A) Gross turnover	(B) Sales returns	(C) Gross turnover (Net)	(D) Output VAT (07.5%)	(E) Cost of sales	(F) Input VAT (07.5%)	(D) – (F) Monthly VAT remittable
	₦'000	₦'000	₦'000	₦'000	₦'000	₦'000	₦'000
Jan. 2021	2,500	200	2,300	172.50	1,880	141.00	31.50
Feb. 2021	2,250	150	2,100	157.50	1,650	123.75	33.75
March 2021	2,100	100	2,000	150.00	1,520	114.00	36.00
April 2021	2,000		2,000	150.00	1,430	107.25	42.75
May 2021	1,850		1,850	138.75	1,300	97.50	41.25
June 2021	1,720		1,720	129.00	1,190	89.25	39.75
July 2021	1,600		1,600	120.00	1,072	80.40	39.60
Aug. 2021	1,500		1,500	112.50	985	73.88	38.62
Sept. 2021	1,480		1,480	111.00	980	73.50	37.50
Oct. 2021	1,450		1,450	108.75	980	73.50	35.25
Nov. 2021	1,510		1,510	113.25	1,065	79.88	33.37
Dec. 2021	1,485		1,485	111.38	1,065	79.88	31.50
Total	21,445	450	20,995	1,574.63	15,117	1,133.79	440.84

Note:

Cost of sales = Opening inventory + purchases – closing inventory

b) **Opion Nigeria Limited**
Computation of monthly VAT penalties

Month	Jan	Feb	March	April	May	June	July	Aug	Sept	Oct	Nov	Dec	Monthly total
	₦	₦	₦	₦	₦	₦	₦	₦	₦	₦	₦	₦	₦
Jan. 2021	-	-	-	-	-	-	-	-	-	-	-	-	-
Feb. 2021	50,000	-	-	-	-	-	-	-	-	-	-	-	50,000
March 2021	25,000	50,000	-		-	-	-	-	-	-	-	-	75,000
April 2021	25,000	25,000	50,000		-	-	-	-	-	-	-	-	100,000
May 2021	25,000	25,000	25,000	50,000	-	-	-	-	-	-	-	-	125,000
June 2021	25,000	25,000	25,000	25,000	50,000	-	-	-	-	-	-	-	150,000
July 2021	25,000	25,000	25,000	25,000	25,000	50,000	-	-	-	-	-	-	175,000
Aug. 2021	25,000	25,000	25,000	25,000	25,000	25,000	50,000	-	-	-	-	-	200,000
Sept. 2021	25,000	25,000	25,000	25,000	25,000	25,000	25,000	50,000	-	-	-	-	225,000
Oct. 2021	25,000	25,000	25,000	25,000	25,000	25,000	25,000	25,000	50,000	-	-	-	250,000
Nov. 2021	25,000	25,000	25,000	25,000	25,000	25,000	25,000	25,000	25,000	50,000	-	-	275,000
Dec. 2021	25,000	25,000	25,000	25,000	25,000	25,000	25,000	25,000	25,000	25,000	50,000	-	300,000
Total	300,000	275,000	250,000	225,000	200,000	175,000	150,000	125,000	100,000	75,000	50,000	-	1,925,000

Examiner's report

The question tests candidates' knowledge of filing of monthly value added tax (VAT) returns and the penalties payable for non-filing of same.

About 50% of the candidates attempted the question but the performance was poor. Most of the candidates did not adjust for sales returns in the ascertainment of net gross turnover for the months of January to March 2021 before computing the output VAT. Additionally, they found it difficult to ascertain the penalties payable for late filing of monthly VAT returns.

Candidates are advised to make use of the Institute's Pathfinders and Study Text in their preparations for subsequent examination.

Marking guide

				Marks	Marks
a)	Computation of monthly VAT payable				
	Heading	-	Name of company	½	
		-	Computation of monthly VAT payable	½	
	Computation of monthly VAT:				
	Input VAT (½ mark each for any correct answer)			6	
	Output VAT (½ mark each for any correct answer)			<u>6</u>	13
b)	Computation of monthly VAT penalties				
	Heading	-	Name of company	½	
		-	Computation of monthly VAT penalties	½	
	Computation of monthly VAT penalties:				
	(½ mark each for any correct amount)			<u>6</u>	<u>7</u>
	Total				<u>**20**</u>

SOLUTION 4

Stakeholders and their responsibilities as per the National tax policy (NTP), 2017

(a) **The government**

All levels and arms of government, ministries, extra-ministerial departments and agencies where applicable shall:

(i) Implement and regularly review tax policies and laws;

(ii) Provide information on all revenue collected on a quarterly basis;

(iii) Ensure adequate funding, administrative and operational autonomy of tax authorities; and

(iv) Ensure a reasonable transition period of between three and six months before implementation of a new tax.

(b) **The taxpayer**

A taxpayer is a person, group of persons or an entity that pays or is liable to tax. The taxpayer is the most critical stakeholder and primary focus of the tax system. The taxpayer shall consider tax responsibilities as a civic obligation and constant duty that must be discharged as and when due. The taxpayer shall be entitled to:

(i) Relevant information for the discharge of tax obligations;

(ii) Receive prompt, courteous and professional assistance in dealing with tax authorities;

(iii) Raise objections to decisions and assessments and receive response within a reasonable time;

(iv) A fair and impartial appeal; and

(v) Self-representation or by any agent of choice, provided an agent acting for financial reward shall be an accredited tax practitioner.

(c) **Professional bodies, tax practitioners, consultants and agents**

They shall:

(i) Act in accordance with professional code of conduct and ethics;

(ii) Not aid and abet tax evasion and corrupt practices; and

(iii) Actively promote effective tax compliance.

(d) **Media and advocacy groups**

They shall:

(i) Promote tax education and awareness;

(ii) Articulate, protect and advance tax payers right;

(iii) Advance accountability and transparency in the utilisation of tax revenue;

(iv) Ensure accurate, objective and balanced reporting in accordance with their professional code of conduct and ethics; and

(v) Ensure that aspiring political office holders clearly understand the tax policy and the Nigeria tax system and are able to articulate their plans for the tax system to which they will be held accountable.

Examiner's report

The question tests the candidates' knowledge of the other stakeholders the government must collaborate with and their responsibilities to ensure the success of the National tax policy (NTP).

About 80% of the candidates attempted the question but performance was fair.
Many of the candidates displayed poor knowledge of National tax policy (NTP), 2017, as they could not explain the responsibilities of the various stakeholders.
Candidates should be conversant with the provisions of the relevant tax laws and circulars.

Marking guide

		Marks	Marks
a)	**The government**		
	1¼ marks each for any correct answer		5
b)	**The taxpayer**		
	1¼ marks each for any correct answer subject to a maximum of 4 points		5
c)	**Professional bodies tax practitioners consultants and agents**		
	- Acting in accordance with professional code of conduct and ethics	2	
	- Not aiding and abetting tax evasion and corrupt Practices	2	
	- Actively promoting effect tax compliance	1	5
d)	**Media and advocacy groups**		
	1¼ marks for any correct answer subject to a maximum of 4 points		5
	Total		**20**

SOLUTION 5

Taxation of a SEC lending based on the provisions of CITA (as amended)

(a) **Dividend and interest received**

The relevant provisions of the Act as they apply to dividend and interest received are as follows:

i) **Section 9 of CITA (as amended)**

Under section 9(1) (c) of the Act, gross dividend and interest received by a lender and borrower, being income, are taxable.

ii) **Section 23 of CITA (as amended)**

Despite the provision of section 9 (1) (c) of CITA which regards gross dividend and interest received by a lender and borrower as taxable, section 23(1)(t) and (u) of the Act, provides that dividend received by a lender from a borrower or by an agent from a borrower under SEC Lending is a franked investment income, hence it is not subject to further tax in the hand of the lender.

Given the provisions of section 23(1) of the Act, interest received by an agent from a lender under SEC lending is tax exempt in the hand of the agent.

iii) **Section 24 of CITA (as amended)**

Interest paid by a lender to an agent or a borrower under a SEC Lending is an allowable deduction under section 24(1)(l) of the Act.

iv) **Section 27 of CITA (as amended)**

Dividend generated by a borrower, and paid to an agent or lender under SEC Lending will not be an allowable deduction to the borrower in accordance with section 27(1) (l) of the Act.

v) **Section 78 of CITA (as amended)**

The interest received by a borrower from a lender is liable to withholding tax deduction as provided under section 78 of the Act.

Where the borrower receives beneficial interest from the lender through the agent, the responsibility to deduct withholding tax rests with the agent.

Where the agent remits interest to the borrower, the agent is to deduct withholding tax.

vi) **Section 80 of CITA (as amended)**

Under this section of the Act, payment of a dividend from a borrower to an agent shall not be subject to deduction of withholding tax.

vii) **Fees, rights, bonuses and other benefits**

Under section 9(1)(h) of CITA, rights, bonuses, profits, fees and other benefits received by a borrower or lender under a SEC Lending are taxable income.

(b) **Dividend and interest received by an individual under a SEC Lending**

Given the fact that the above stated exemptions and concessions provided in CITA relate to persons taxable under CITA, dividend and interest received under SEC Lending by individuals are not tax exempt.

(c) Documents and transactions that are exempt from stamp duties are:

(i) All documents issued by the Securities and Exchange Commission (SEC) in relation to a SEC Lending;

(ii) Shares, stocks or securities returned to a lender or its recognised agent by a borrower in accordance with the rules of Securities and Exchange Commission (SEC) Lending;

(iii) Receipts given by any person under a Securities and Exchange Commission (SEC) Lending; and

(iv) Shares, stocks or securities transferred by a lender to its agent or borrower in furtherance of a Securities and Exchange Commission (SEC) Lending.

Examiner's report

The question tests the candidates' knowledge of taxation of regulated securities lending transactions in respect of dividend and interest received, fees, and other benefits for individuals and companies.

About 35% of the candidates attempted the question and performance was poor.

The commonest pitfall of the candidates was their inability to explain the taxation of dividend, interest received, and other fees in respect of regulated securities lending transactions.

Candidates are advised to cover the syllabus adequately before sitting for ICAN examination.

Marking guide

		Marks
a)	Taxation of dividend and interest received - CITA (1 mark for any correct point)	7
b)	Tax treatment of dividend and interest received by an individual- PITA (2 marks for correct discussion of tax/statement of dividend and interest received by an individual)	2
c)	Documents and transactions exempt from stamp duties (1½ marks for any correct point)	<u>6</u>
	Total	**<u>15</u>**

SOLUTION 6

(a) **Tax-exempt deductions based on Personal Income Tax (Amendment) Act, 2011**

The following deductions are tax exempt:

(i) ***National housing fund contribution***

The National Housing Fund Act Cap LFN 2004, provides that a Nigerian earning an income of ₦3,000 and above per month in either the public or private sector of the economy shall contribute 2.5 per cent of his basic monthly salary to the Fund. Employers who fail to deduct or remit are liable to pay a penalty of ₦50,000 whilst self-employed persons are to pay ₦5,000 or one year imprisonment on conviction or both. The employer is to deduct the contribution from the employee's monthly salary and remit to the Federal Mortgage Bank of Nigeria within one month of making the deduction. The Act mandates the Federal Mortgage Bank of Nigeria to collect, manage and administer the fund. Contributions made to the fund are tax deductible.

(ii) ***National health insurance scheme***

The National Health Insurance Scheme (NHIS) was set up by The National Health Insurance Act, Cap N42 LFN 2004, for the purpose of providing health insurance which shall entitle persons insured under the scheme and their dependants the benefits of prescribed good quality and cost effective health services as set out in the Act.

The Act provides that an employer who has a minimum of ten employees may, together with every person in his employment, pay contribution under the scheme, at such rate and in such manner as may be determined, from time to time, by the Governing Council for the Scheme.

In the public sector (Federal), the employer is expected to pay 3.25%, while the employee pays 1.75% which translate to 5% of the employee's consolidated salary. In the case of the private sector and other tiers of government, the employer is expected to pay 10% while the employee pays 5% representing 15% of the employee's basic salary. The employer may decide to pay the entire contribution. Sometimes, the employer may also undertake extra contributions for additional cover to the benefit package.

An employer under the scheme shall cause to be deducted from an employee's wages the negotiated amount of any contributions payable by the employee.

The employer's contributions and the contributions in respect of its employees are to be paid into the account of a designated health maintenance organisation. Contributions to the scheme are tax deductible.

(iii) ***Life assurance premium***

A deduction of the annual amount of any premium paid by the individual during the year preceding the year of assessment to an insurance company in respect of insurance on his life or the life of his spouse.

(iv) ***National pension scheme***

The Pension Reform Act 2014 (PRA), established a uniform contributory pension scheme for payment of retirement benefits of employees. The scheme applies to all employees in both the public and private sectors who are in employment in an organisation in which there are 15 or more employees.

The rate of contribution to the scheme shall be a minimum of 8% of employee's monthly emolument (i.e. basic salary, housing allowance and transport allowance) as contribution for employees in the public and private sectors and 10% of the monthly emoluments as employer's contribution.

However, contributions made by an employee to the scheme shall be tax deductible.

Notwithstanding the foregoing mode of contribution to the scheme, an employer may agree or elect to bear the full burden of the scheme, provided that in such a case, the employer's contribution shall not be less than 20% of the monthly emoluments of the employee.

It is pertinent to state that the tax relief is only limited to pension contributions to schemes, provident or retirement benefits fund that are recognised under the Pension Reform Act, 2014.

(v) ***Gratuities***

Gratuity is money paid to an employee who is retiring or leaving his employer after several years of service. Gratuity is tax deductible.

(b) **Computation of consolidated relief allowance**

"Gross emolument" means wages, salaries, allowances (including benefits-in-kind), gratuities, superannuation and any other income derived solely by reason of employment.

"Gross income" means income from all sources less non-taxable income, income on which no further tax is payable, tax-exempt items listed in paragraph (2) of the sixth schedule, all allowable business expenses and capital allowance – section 33 (2) and (3) of PITA 2004 (as amended).

Consolidated relief allowance (CRA) is granted at the higher of ₦200,000 or 1% of gross income plus 20% of gross income.

Examiner's report
The question tests the candidates' knowledge of four tax exempt deductions and computations of consolidated relief allowance (CRA), taking into consideration the provisions of Personal Income Tax (Amendment) Act, 2011(as amended).

About 85% of the candidates attempted the question but performance was poor.
The commonest pitfall was the candidates' inability to explain the tax exempt deductions in the computation of personal income tax.

Candidates are advised to read ICAN Study Texts and Pathfinders.

Marking guide

		Marks	Marks
a)	**Tax-exempt deductions**		
	(3 marks for any correct answer subject to a maximum of 4 points)		12
b)	**Computation of consolidated relief allowance:**		
	Definition of gross emolument	½	
	Definition of gross income	½	
	₦200,000	½	
	1% of gross income	½	
	20% of gross income	1	3
	Total		15

SOLUTION 7

a. The term "Contract of Supplies" covers all forms of supplies, deliveries, or the like through competitive bidding tenders, LPOs or other arrangements, whether oral or written. The term does not cover the across counter cash sales or supplies in the ordinary course of sales.

Contract, which is outright sale and purchase of goods and property in the ordinary course of business are exempted from withholding tax.

Section 73 of CITN and Section 81 of PITA empowered the Finance Minister to add to the above list from time to time through official gazette.

b. **Challenges bedeviling the withholding tax scheme in Nigeria**

Since the introduction of withholding tax into the Nigerian tax system, the scheme has been bedeviled by so many challenges. Some of the challenges affecting the withholding tax scheme include:

(i) It could discourage hard work by Revenue Officers as it is self-accounting in nature;

(ii) Bureaucracy in the process of claiming withholding tax credit;

(iii) Penalty for failure to deduct - Taxpayers who are essentially obliged under the income tax law to register for income tax, does so as an unpaid agent of the relevant tax authority. Therefore, penalising the tax agent for failure to deduct withholding tax may be considered as counter-productive considering that the tax agent is not paid for assisting the relevant tax authority in this regard;

(iv) Appropriate WHT rate to apply to transactions - In some cases, tax agents are in dilemma as to determine and apply WHT rate correctly on different transactions; and

(v) Bureaucracy in the process of withholding tax refund - Taxpayers are subjected to rigorous audit process before refunds are made to them.

c. On November 30, 2020, the Tax Appeal Tribunal (TAT), Lagos Zone, in the case of Tetra Pak West Africa Limited Vs Federal Inland Revenue Service, ruled that sales in the ordinary course of business shall not be liable to withholding tax (WHT).

The TAT laid the following criteria in ascertaining what constitutes "sales in the ordinary course of business":

(i) The inclusion of the transaction/activity in the objects of the memorandum of association;

(ii) The nature and practice of the taxpayer's business and industry;

(iii) The history of the taxpayer in relation to the activity; and

(iv) The frequency of the type of transaction.

Examiner's report

The question tests the candidates' knowledge of "contract of supplies", challenges bedeviling withholding tax scheme, and criteria laid out in the Tax Appeal Tribunal judgement for the ascertainment of what constitutes 'sales in the ordinary course of business".

About 65% of the candidates attempted the question but the performance was average.

Many of the candidates could not explain the criteria laid out in the judgement of the Tax Appeal Tribunal for the ascertainment of what constitutes sales in the ordinary course of business.

Candidates are advised to adequately cover the syllabus and read the Institute's Pathfinders and Study Text when preparing for future examination.

Marking guide

		Marks	Marks
a)	**Explanation of the term "Contract of suppliers"**		
	- Definition	2	
	- Stating tax exemption of sale and purchase of goods in the ordinary course of business	2	
	- Stating that the Finance Minister has the prerogative to elongate the list	<u>1</u>	5
b)	**Challenges bedeviling the withholding tax system**		
	(1 mark each for any correct solution)		5
c)	**Criteria in the ascertainment of what constitutes "sales in the ordinary course of business"**		
	- Inclusion of the transaction in memorandum of Association	2	
	- Nature and practice of the taxpayer's business and Industry	1	
	- History of the taxpayer's in relation to the activity	1	
	- Frequency of the type of transaction	<u>1</u>	<u>5</u>
	Total		**<u>15</u>**