



**THE INSTITUTE OF CHARTERED
ACCOUNTANTS OF NIGERIA**

PATHFINDER

MAY 2026 DIET

PROFESSIONAL LEVEL EXAMINATIONS

Question Papers

Suggested Solutions

Examiners' Reports and

Marking Guides

FOREWORD

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 of 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.

TABLE OF CONTENTS

	Page
COVER PAGE	1
FOREWORD	2
TABLE OF CONTENTS	3
STRATEGIC BUSINESS REPORTING.....	4 – 40
ADVANCE TAXATION.....	41 – 84
STRATEGIC FINANCIAL MANAGEMENT.....	85 – 123
ADVANCED AUDIT, ASSURANCE AND FORENTIC.....	124 – 165
CASE STUDY	166 – 210

INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA
PROFESSIONAL LEVEL EXAMINATION – MAY 2026
STRATEGIC BUSINESS REPORTING

Time Allowed: 3¹/₄ 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

- (a) NaijaTel Plc acquired 30% of Royal Networks Limited on January 1, 2023 for ₦4.5billion when the fair value of Royal Networks' net assets was ₦15billion. On July 1, 2024, NaijaTel Plc acquired a further 50% stake in Royal Networks Limited, thereby obtaining control. The fair value of NaijaTel's pre-existing 30% interest at the acquisition date was ₦6.5billion. The non-controlling interest (NCI) was measured at a fair value of ₦5.5billion. Deferred consideration of ₦2billion is payable on June 30, 2025 (discount rate 10%).

Royal Networks Limited owns 100% of ConnectNow Limited, a regional subsidiary based in Northern Nigeria. The group reporting date is December 31, 2024 and the presentation currency is the Nigerian Naira (₦).

Extract of statement of profit or loss for the year ended December 31, 2024

	NaijaTel Plc (₦'m)	Royal Networks Limited (₦'m)	ConnectNow Limited (₦'m)
Revenue	40,000	20,000	8,000
Cost of sales	<u>(25,000)</u>	<u>(12,000)</u>	<u>(4,800)</u>
Gross profit	15,000	8,000	3,200
Operating expenses	<u>(6,000)</u>	<u>(3,500)</u>	<u>(1,400)</u>
Operating profit	9,000	4,500	1,800
Finance costs	<u>(1,200)</u>	<u>(800)</u>	<u>(300)</u>
Profit before tax	7,800	3,700	1,500
Income tax expense	<u>(2,400)</u>	<u>(1,100)</u>	<u>(500)</u>
Profit for the year	<u><u>5,400</u></u>	<u><u>2,600</u></u>	<u><u>1,000</u></u>

Additional information

- i. NaijaTel Plc sold bandwidth capacity worth ₦2.4billion to Royal Networks Limited in 2024 at a margin of 20%. At year-end, 25% remained unsold.
- ii. Royal Networks Limited sold equipment to ConnectNow Limited for ₦3billion on January 1, 2024 (original cost ₦2.2billion, useful life 5 years).
- iii. Test at December 31, 2024 showed goodwill relating to Royal Networks Limited had fallen by ₦1.2billion.
- iv. NaijaTel Plc advanced a loan of ₦1.5billion to Royal Networks Limited on July 1, 2024 at 12% p.a. No interest had been recorded by the borrower.
- v. NaijaTel Plc charged Royal Networks Limited ₦400million. The expense was recorded by Royal Networks Limited while the income was not recorded by NaijaTel Plc.
- vi. Prior to control (January 2023 – June 2024), NaijaTel Plc's share of profits in Royal Networks limited amounted to ₦1.2billion, not yet reflected in group reserves.
- vii. Company income tax rate is 30%.

Required:

Prepare the consolidated statement of profit or loss of the NaijaTel Group for the year ended December 31, 2024.

Note: Show all workings

(20 Marks)

- (b) You are the Financial Reporting Manager at NaijaTech Plc. The company recently secured a ₦2.5billion contract to supply and install smart learning tablets across public schools. The contract clearly specifies staged delivery and milestone payments over a 12-month period.

However, the company's CEO tells you he received a private call from a senior government official urging the company to recognise the entire ₦2.5billion as revenue in the current quarter. He also assured you, that the money is guaranteed and asked you to record it to show strong performance. He informed you that government wants this to reflect in their third quarter report. He then instructs you to include the full amount in the current quarter's financial statements.

You are aware that under IFRS 15 – Revenue from Contracts with Customers, revenue should only be recognised when the company satisfies its performance obligations.

Required:

Discuss the ethical issues in this scenario. How should the directive from the CEO be responded to professionally? Support your answer using relevant ethical principles from the ICAN Code of Ethics and the applicable IFRS standards.

(10 Marks)

(Total 30 Marks)

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

QUESTION 2

As the finance director, you have just been informed by the group managing director of your company, Agbaye Plc, that your company is planning to make another acquisition. The target company is Arugungu Limited, a private limited liability company that has recently had its application for additional loan rejected by its bankers on the basis that there are insufficient assets to offer as security. However, the financial analyst of your company has been asked to provide more information about Arugungu Limited. Find below the email of the financial analyst to the group MD on Arugungu Limited:

From: Financial analyst

To: Group MD

Date: January 31, 2025

Dear Sir,

Find attached (Appendix 1) the most recent financial statements of Arugungu Limited for the year ended December 31, 2024. For the last eight years, the company has been manufacturing and selling its own brand of antibiotic drugs known as ARUGMOXIN. Over the last fifteen months, the company has invested in developing an online presence. The sales director of Arugungu Limited has also used his extensive contacts to secure a deal with a chain of wholesale pharmaceutical companies. The contract was set up on July 1, 2024 and has generated revenue of ₦34million and a strong profit margin. The managing director of Arugungu Limited now wishes to build on the work of the sales director to develop further sales opportunities. However, Arugungu's Limited bankers that currently provides them with long-term loan and overdraft facilities has rejected Arugungu Limited's application for additional funding.

If you need further information don't hesitate to contact me

Thanks.

Mohammed.

APPENDIX 1:

Arugungu Limited
Statement of profit or loss and other comprehensive income for the year ended
December 31,

	2024	2023
	N'm	N'm
Revenue	128	74
Cost of sales	<u>(82)</u>	<u>(52)</u>
Gross profit	46	22
Other income	2	0.8
Distribution costs	(9.2)	(8)
Administration costs	(18.4)	(10)
Finance costs	<u>(1.6)</u>	<u>(0.8)</u>
Profit before tax	18.8	4
Income tax	<u>(2)</u>	<u>(0.4)</u>
Profit for the year	<u>16.8</u>	<u>3.6</u>

Arugungu Limited
Statement of financial position as at December 31,

	2024	2023
	N'm	N'm
Assets		
Non-current assets:		
Property plant and equipment	8	7.2
Intangible assets - development costs	<u>0.8</u>	<u>0.4</u>
	8.8	7.6
Current assets:		
Inventories	26	24
Trade receivables	9.2	6.4
Cash and cash equivalents	<u>-</u>	<u>0.8</u>
	35.2	31.2
Total assets	<u>44</u>	<u>38.8</u>
Equity:		
Ord share capital ₦1 each	11.2	11.2
Retained earnings	<u>14.8</u>	<u>12</u>
Total equity	<u>26</u>	<u>23.2</u>
Non-current liabilities:		
Loan notes	8.8	8
Current liabilities:		
Trade and other payables	7.2	7.6
Bank overdraft	<u>2</u>	<u>-</u>
	9.2	7.6
Total equity and liabilities	<u>44</u>	<u>38.8</u>

Required:

Draft a report addressed to the group managing director of Agbaye Plc analysing the financial performance and position of Arugungu Limited and also advise the group MD if the planned acquisition should be undertaken.

NOTE: Your report should outline any matter that require further investigation. (Total 20 Marks)

QUESTION 3

- (a) Organisations or reporting entities could be related to one another in different ways. To ensure proper accountability and reliability of information in annual reports, there are guiding principles, rules and regulations on related party transactions.

Required:

In accordance with IAS 24 "*Related Party Disclosures*", what are the basic principles, rules and regulations for handling related party transactions?

(8 Marks)

- (b) The fact that valuation of assets and liabilities are subjective in nature to a great extent was a major take-home from the Executive workshop attended by Mr. Peterson, the new Finance and Administration Manager of Heritage Limited. IFRS 13 "*Fair Value Measurement*" provides useful guidelines on fair value measurements to ensure transparency, comparability and usefulness to users of financial statements.

Mr. Peterson is considering fair value measurements for the company's assets and liabilities for the year ended December 31, 2024. To facilitate this, a number of external valuation specialists were engaged to assist in the measurement of certain assets and liabilities at fair value as provided under IFRS 13 "*Fair Value Measurement*". Among the assets presented for valuation are described in Exhibit 1 and 2 below:

Exhibit 1: Investment property

Heritage Limited owns an investment property located in a region experiencing declining real estate activity. There is no active market data for this property and the expert provided a DCF-based valuation as follows:

Expected rental income: ₦60million per annum for the next 5 years.

Terminal value: ₦800million which was based on capitalisation of ₦80million ROI at 10%.

Suggested discount rate is 12% with a risk-adjusted rate based on local economy condition of 14%.

Exhibit 2: Manufacturing equipment

Heritage Limited is contemplating disposal of a specialised manufacturing equipment which has an acquisition cost of ₦200million with a carrying amount of ₦100million. A third party offered ₦90million for the equipment. It was realised that a similar machine was recently disposed during a forced liquidation for ₦75million.

Required:

Analyse the fair value disclosure requirements under IFRS 13 "*Fair Value Measurement*" that Heritage Limited should comply with as it relates to these two assets.

(12 Marks)

(Total 20 Marks)

QUESTION 4

- (a) Omolewa Nigeria Plc operates a defined benefit pension plan for its employees. The company's actuarial information received for the year ended December 31, 2024, revealed that the present value of defined benefit obligation (DBO) at January 1, 2024, was ₦180million, while the fair value of the plan's assets was ₦160million.

The previous (due to benefit change) and current service costs were ₦10million and ₦25million respectively. Interest cost on obligation was 6% while interest income on plan assets was 5%. The company paid ₦20million employer contributions during the year while, benefits paid to retired employees was ₦15million.

At December 31, 2024, the present value of DBO amounts to ₦210million and a fair value of plan assets of ₦175million.

Required:

- i. Calculate the net defined benefit liability or asset to be recognised in the statement of financial position as at December 31, 2024. (4 Marks)
 - ii. Determine the total defined benefit cost to be recognised in the statement of profit or loss for the year. (2 Marks)
 - iii. Explain the accounting treatment for re-measurements under IAS 19 "*Employee Benefits*" and identify the amount (if any) of re-measurement gain or loss for the year. (2 Marks)
- (b) Elite Group Plc has delayed recognising the past service cost from a defined benefit scheme adjustment, hoping to spread it over several years. The chief finance officer (CFO) argues this makes reported profits more stable and attractive to investors.

Required:

- i. Explain the accounting treatment of past service cost under IAS 19 "*Employee Benefits*" and why Elite Group's approach is incorrect. (4 Marks)
- ii. Discuss the professional and ethical issues arising from the CFO's suggestion, referring to ICAN's Code of Ethics. (4 Marks)
- iii. Evaluate how improper pension reporting can affect users' decisions and the credibility of financial statements. (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

The importance of compliance with accounting standards cannot be over emphasised. Accountants who are responsible for the preparation of financial information must ensure that the information they prepare is technically correct, reports the substance of the transaction and is adequately disclosed, otherwise their actions would be unethical.

Required:

- a. What are the potential consequential effects of non-compliance with accounting standards? (10 Marks)
- b. Discuss the consequences of unethical behaviour? (5 Marks)

(Total 15 Marks)

QUESTION 6

You are a senior financial analyst at Nexus Plc. The company plans to enhance its sustainability and real-time reporting processes. The board is considering adopting blockchain for audit trail transparency and machine learning for predictive analysis.

Required:

- a. Explain how distributed ledger technology (DLT) and machine learning (ML) could transform Nexus Plc's business reporting process. (6 Marks)
- b. Discuss **THREE** limitations or risks associated with the adoption of such technologies. (3 Marks)
- c. Recommend **THREE** quality skills accountants must possess to remain relevant in the evolving digital reporting environment. (6 Marks)

(Total 15 Marks)

QUESTION 7

You are the Financial Controller of Fiwajoye Plc, a bottling company with diverse products. The accountant responsible for preparing the 2024 annual financial statements is considering the accounting treatment of the following and has approached you for guidance.

- (a) On December 31, 2024, Fiwajoye Plc. was the subject of litigation proceeding involving a customer claiming damages in the sum of ₦250million, because she was allegedly injured when drinking BitterSweet, one of the company's products. She had claimed that the company bottled a sharp object inside the content of the product which she swallowed and had to be operated upon in order to remove the object. Fiwajoye Plc. is disputing the claim, maintaining that any injury was due solely to negligence on the customer's part. At December 31, 2024, the case was yet to be decided. (5 Marks)
- (b) Fiwajoye Plc signed a ten-year lease agreement on a premises requiring annual payment of ₦5million in advance on January 1, 2020. The premises were used over the years as event centre to generate rental income. As a result of escalating costs of maintenance, especially on power generation, security concerns and changing lifestyle of patrons, continuing operation of the centre has been found unsustainable. Fiwajoye Plc. discovered that it has no further use of the building. It is not possible to sub-lease the building to another tenant and remodeling cannot be done due to certain provisions of the lease agreement. At December 31, 2024, the present value cost of outstanding lease installments amounted to ₦22.5million. (5 Marks)

- (c) The Managing Director made a proposal that the Fiwajoye Plc's brand name is unique and of significant market persuasion and should, therefore, be included as an asset in the financial statements. Due diligence, including market research by a certified consultant, has been done on this proposal. A valuation of ₦250million was determined to be included in the financial statements at December 31, 2024. (5 Marks)

Required:

Discuss how the above information should be presented in the financial statements of Fiwajoye Plc. for the year ended December 31, 2024.

(Total 15 Marks)

Solution 1

(a)

NaijaTel Group Consolidated statement of profit or loss for year ended December 31, 2024

	₦'m
Revenue (W1)	51,600
Cost of sales (W2)	<u>(31,760)</u>
Gross profit	19,840
Operating expenses (W3)	<u>(9,250)</u>
Operating profit	10,590
Gain on re-measurement of previously held interest (W4)	800
Finance costs (W5)	<u>(1,840)</u>
Profit before tax	9,550
Income tax expense (W6)	<u>(2,972)</u>
Profit for the year	<u>6,578</u>
Attributable to:	₦'m
Owners of NaijaTel Plc	6,610
Non-controlling interests	<u>(32)</u>
Profit for the year	<u>6,578</u>

Workings:

W1: Consolidated revenue

	₦'m
Only post-acquisition subsidiary revenue included. NaijaTel Plc.	40,000
(50% of Royal Network limited annual revenue)	10,000
(50% of ConnectNow annual revenue)	<u>4,000</u>
	54,000
Less: intra-group sale	<u>2,400</u>
Consolidated revenue	<u>51,600</u>

W2: Consolidated cost of sales	N'm
NaijaTel Plc.	25,000
Royal Networks (6 months)	6,000
ConnectNow (6 months)	<u>2,400</u>
	33,400
Less: Bandwidth sale	(2,400)
Add unrealised profit: (wk8a)	120
Add equipment adjustment: (wk8b)	<u>640</u>
Cost of sales	<u>31,760</u>
W3: Operating expenses:	N'm
NaijaTel	6,000
Royal Networks limited (6 months)	1,750
Connect Now limited (6 months)	<u>700</u>
	8,450
Add: Goodwill impairment	1,200
Less: Management charge income	<u>(400)</u>
Operating expenses	<u>9,250</u>
W4: Gain on re-measurement of previously held interest	₦
Carrying amount of associate before obtaining control: Cost:	4.5bn
Share of profits	<u>1.2bn</u>
Carrying value	<u>5.7bn</u>
Fair value at acquisition	6.5bn
Gain (₦6.5 - ₦ 5.7) =	0.8bn
Recognised in consolidated profit or loss.	
W5: Finance Costs:	N'm
Naija Tel Plc	1,200
Royal Networks Limited (₦800 x 6/12)	400
Connect Now limited (₦300 x 6/12)	<u>150</u>
	1,750
Unrecorded loan interest (₦1.5bn x 12% x 6/12)	<u>90</u>
	<u>1,840</u>
W6: Income tax	N'm
NaijaTel	2,400
Royal Networks (6 months)	550
Connect Now (6 months)	<u>250</u>
	3,200
Less: Deferred tax on bandwidth (wk8a)	36
Less: Deferred tax on equipment (wk8b)	<u>192</u>
Income tax expense	<u>2,972</u>

W7: Post-acquisition profits to consolidate

Only 6 months (July–December 2024).

Royal Networks	₦'m
Annual PAT	2,600
Six months	1,300
ConnectNow	
Annual PAT	1,000
Six months:	<u>500</u>
Royal group post-acquisition PAT: (₦1,300 + ₦ 500)	<u>1,800</u>

Note: Since control was obtained on July 1, 2024, Royal Networks and ConnectNow became subsidiaries from that date and only post-acquisition profits (6 months) are consolidated line-by-line.

W8: Consolidation adjustments**(a) Unrealised profit on bandwidth sale**

NaijaTel sold bandwidth to Royal Networks:		2.4bn
Margin = 20% on selling price	₦2.4bn x 20% =	480m
Profit: 25% unsold	₦480m x 25% =	120m
Reduce group profit		120m
Deferred tax	₦120m x 30% =	<u>36m</u>
Net effect		<u>84m</u>

(b) Equipment transfer

Royal sold equipment to ConnectNow:		
Sale price		3.0bn
Cost		<u>2.2bn</u>
Profit		800m
Life = 5 years.		
Excess depreciation	₦800m/5yrs =	<u>160m</u>
2024 adjustment	(₦800m-160m) =	<u>640m</u>
Reduce profit		640m
Tax effect: ₦640m x 30% =		<u>192m</u>
Net reduction		<u>448m</u>

(c) Intra-group loan interest

Loan:		1.5bn
Interest from Jul–Dec:	(₦1.5bn x 12% x 6/12)	= 90m
Borrower omitted expense.		

Adjustment for consolidated finance cost in p or l :	
Finance cost	= 90m
Eliminate lender income if recorded.	<u>Nil</u>
Net group effect	<u>(90m)</u>

(d) Management charges:

Charges	400m
Expense recorded by Royal.	
Income not recorded by NaijaTel.	Nil
Adjustment for consolidated income:	400m

(e) Goodwill impairment

Expense in consolidated profit or loss.	1.2bn
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W9: Consolidated profit for the year

	₦'m
Operating profit	10,590
Finance costs	<u>(1,840)</u>
	8,750
Add gain on step acquisition:	<u>800</u>
Profit before tax	9,550
Income tax expense	<u>(2,972)</u>
Consolidated profit	<u>6,578</u>

W10: Non-controlling interests (NCI) share of profit

	₦'m
Post-acquisition profit attributable to NCI:	
Adjusted Royal group post-acquisition PAT:	1,800
Unrealised profit	<u>(120)</u>
	1,680
Adjustment for loss in equipment	<u>(640)</u>
	<u>1,040</u>
NCI	= (20% x ₦1,040m)
NCI share of goodwill impairment (full goodwill): ₦1,200x 20%	<u>(240)</u>
Net NCI share: (₦208- ₦240)	<u>(32)</u>

Tutorials:

- i. **Step acquisition** under IFRS 3:
 - Remeasure previously held 30% interest to fair value.
 - Recognise gain of ₦800m in profit or loss.

- ii. **Full goodwill method:**
 - NCI measured at fair value (₦5.5bn).
 - Goodwill = ₦6.75bn.
 - iii. **Only post-acquisition results** (July–December 2024) consolidated line-by-line.
 - iv. **Unrealised profits removed on:**
 - Inventory transaction from subsidiary to parent (upstream)
 - PPE transaction from parent to subsidiary (downstream)
 - v. **Goodwill impairment** charged to group profit or loss and shared with NCI under the full goodwill method
 - vi. **Intra-group balances and transactions** on loan interest and management charges are eliminated or adjusted.
- b) Ethical issues to be discussed by the financial reporting manager (FRM):**
- i) Pressure to manipulate financial statements by prematurely recognising revenue;
 - ii) Political influence interfering with objective financial reporting;
 - iii) Compromise of professional integrity and independence; and
 - iv) Potential for misleading shareholders, regulators (NGX Group) and other investing public.

Professional response:

- i. **Apply IFRS 15:**
Revenue should be recognised only when control of goods or services has been transferred and performance obligations have been satisfied. Since the contract is milestone-based, NaijaTech Plc must recognise revenue over time as each milestone is completed, not in advance.
- ii. **Refer to ethical principles (ICAN Code of Ethics):**
Integrity: The financial reporting manager (FRM) must not prepare or present false or misleading information.
Objectivity: The FRM must resist undue influence from the CEO and government officials.
Professional competence: The FRM must ensure financial statements comply with IFRS.
Professional behaviour: The FRM must avoid actions that could discredit the profession or breach Nigerian laws.
- iii. **Professional action:**
The FRM should formally advise the CEO that recognising the full contract revenue violates IFRS 15 and may attract sanctions from FRC and the Nigeria Exchange Group (NGX Group).

He should recommend recognising revenue based on actual progress or delivery milestones.

If the CEO insists, the financial reporting manager should escalate the matter to the Audit Committee or Board of Directors and ensure that his professional stance is documented.

If ethical compromise becomes unavoidable, he should consider whistle blowing under the Whistle-blower Protection Act (Nigeria) or resign to protect his integrity.

Examiner's report

The question tests candidates' knowledge of how to prepare group consolidated statement of profit or loss in accordance with International Financial Reporting Standards (IFRS) for a specialised entity. Part (b) of the question tests the ethical principles from the ICAN code of Ethics and the applicable IFRS 15- Revenue from Contracts with Customers.

All the candidates attempted the question and their performance was very poor.

The common pitfalls of the candidates were their inability to prepare the group statement from the date control was obtained rather they prepared it from the date of initial investment; they were not able to apply correctly the ethical principles from the ICAN profit or loss Code of Ethics and the applicable IFRS 15- Revenue from Contracts with Customers.

Candidates are advised to pay more attention to the principles of preparing the consolidated group profit or loss in accordance with the relevant IFRS. Candidates should also make use of ICAN Study Texts for better performance in future examinations of the Institute.

Marking guide

	<u>Marks</u>	<u>Marks</u>
(a) Consolidated statement of profit or loss	4	
Presentation of the statement: Calculations or adjustment for		
Consolidated revenue	1	
Consolidated cost of sales	2	
Calculating gain on re-measurement of previously held interest	2	
Income tax	1	
Post-acquisition profits	1	
Unreached profit	1	
Equipment transfer	1	
Intra group loan interest	1	
Management charge	1	
Goodwill Impairment	1	

	Consolidated profit for the year	2	
	Non-controlling interests	<u>2</u>	20
(b)	Ethical and professional issues in the scenario:		
	Ethical issues to discuss	4	
	Professional response:		
	Application of IFRS 15	2	
	Ethical principles in ICAN code of ethics	2	
	Professional action	<u>2</u>	
	Total		<u><u>10</u></u> 30

Solution 2

From: Finance director

To: Group MD

Date: February 2, 2025

Subject: Appraisal of financial performance and position of Arugungu Ltd for the purpose of acquisition

Introduction

The aim of this report is to analyse the performance and position of Arugungu Ltd and determine whether it would be good for acquisition.

Growth and profitability

Growth

Revenue has increased by an impressive 73% in the year. This is mainly due to the appointment of a new sales director who has set up online presence and secured lucrative deals with chain of wholesales pharmaceutical companies generating about 26% of the revenue in year 2024. In addition, with managing directors' extensive contacts, other such deals could be generated in future.

Profitability

Gross profit margin has improved from 30% (2023) to 36% in (2024). It will be helpful to have an analysis of the profit margin of the different segments of the business.

Net profit margin has also improved from 5.4% to 14.7% despite the increase in finance costs, caused by the increase in overdraft and long-term loan borrowings. Overheads associated with running an online business would be lower than those associated with running a normal business outlet

Also, return on capital employed (PBIT/CE) has increased from 15.4% to 58.6% primarily due to the increase in profit margin and increase in asset turnover.

Financial position

Liquidity

The current ratio has declined slightly from 4.1 to 3.8, largely due to reliance on bank overdraft in the current year and a reduction in receivable days. However, quick ratio has slightly increase from 0.95 to 1.0, largely due to paying suppliers more quickly (32days compared to 53 days).

Working capital management

Inventory days have decreased from 168 days to 115 days indicating that Arugungu Ltd is selling their inventories faster, this could be to meet the need of the online sales and the new contracts to meet the pharmaceutical company's order. Despite the reduction, inventory days appeared high in both years, it may be due to the product (shelf -life of the drugs) there is therefore a risk in terms of potential inventory obsolescence.

Receivables days are low (2024; 26days; 2023; 32days) as would be expected with sales that are made predominantly on cash basis. Paying suppliers early is perhaps inadvisable given that the company is now relying on increased overdraft funding. it may be that the company is dealing with suppliers who imposed strict terms of trade.

Capital structure

Despite the fact that Arugungu Ltd are finding it difficult to secure funding from their bankers, the company's gearing remains at a reasonable level (34% in the current year). Also, interest cover is healthy at 12.75 times for year 2024.

Conclusion

From the analysis below and on the assumption that most qualitative factors will be favourable, there is strong case for our company (Agbaye Plc) to invest in Arugungu Ltd. This is because the business is innovative and is growing. The company is also profitable and the profitability is improving year on year.

One concern is the reliance on the overdraft, but this could be resolved by improving working capital management. However, one area that would need investigation is whether the shareholders of the company are paying themselves excessive dividends, that if they are not ploughing back enough profit.

No matter how profitable the company is, the issue relating to dividend payout and business ethics need clarifications before a decision is made as to whether to acquire Arugungu Ltd or not.

Thank you

Finance director.

Appendix

Ratio	Formulae	2024	2023
Gross profit (GP) margin	$\frac{\text{Gross profit}}{\text{Revenue}} \times \frac{100}{1}$	36 %	30%
Net profit margin	$\frac{\text{Profit after tax}}{\text{Revenue}} \times \frac{100}{1}$	14.7%	5.4%
Return on capital employed	$\frac{\text{Profit before interest and tax}}{\text{Revenue}} \times \frac{100}{1}$	58.6 %	15.4%
Current ratio	$\frac{\text{Current assets}}{\text{Current liabilities}}$	3.8 :1	4.1 :1
Quick ratio	$\frac{\text{Current asset} - \text{inventories}}{\text{Current liabilities}}$	1.0 :1	0.95 :1

Inventory turnover period(days)	$\frac{\text{Inventories}}{\text{Cost of sales}} \times \frac{365}{1}$	115 days	168 days
Receivable collection period	$\frac{\text{Receivables}}{\text{Revenue}} \times \frac{365}{1}$	26 days	32 days
Payable payment period	$\frac{\text{Payables}}{\text{Cost of sales}} \times \frac{365}{1}$	32 days	53 days
Gearing	$\frac{\text{Loan notes}}{\text{Equity}} \times \frac{100}{1}$	34%	34%
Interest cover	$\frac{\text{Profit before Interest and tax}}{\text{Interest}}$	12.75 times	6 times

Examiner's report

The question tests candidates' knowledge of report writing to analyse the financial performance and position of a company with a view to advise on a planned acquisition and any other matter that requires further investigation by management.

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

The common pitfalls of the candidates were their inability to correctly prepare reports to highlight the performance and position of a company; under-utilisation of computed ratios to advise on acquisition and other matters that require the investigation of management for informed decisions.

Candidates are advised to prepare more thoroughly on all aspects of ratio analysis, especially on how to use the ratios computation to write reports for management and support decision making. They should acquaint themselves with this section of the syllabus and practice relevant past questions on ratio analysis and the interpretation of financial statements for better performance at this level of the Institute examinations.

Marking guide	Marks
Report format, address and subject	1
Introduction	1
Analysis of financial performance:	
- Growth	2
- Profitability	2
Analysis of financial position:	
- Liquidity	2
Capital structure	2
Conclusion and recommendations	1
Matters for further investigation	1
Correct computation of relevant ratios	<u>8</u>
Total	<u>20</u>

Solution 3

a. Basic principles, rules and regulations for handling related party transactions:

Meaning of a related party

- i. **IAS 24** defines a related party as a person or entity connected to the reporting entity;
- ii. **A person, or a close family member of that person**, is a related party if that person controls or jointly controls the reporting entity, has significant influence over it or is a member of its key management personnel or of the key management personnel of its parent;
- iii. **An entity** is a related party if, among other circumstances, it is a member of the same group, an associate or joint venture of the reporting entity, controlled or significantly influenced by a related person or a post-employment benefit plan for the employees of the reporting entity; and
- iv. **A related party transaction** is a transfer of resources, services or obligations between related parties, regardless of whether a price is charged.

Regulations and principles of related party transactions

- i. **Arm's length principle:** Transactions between related parties should be conducted as if they were unrelated parties, ensuring no conflict of interest.

- ii. **Disclosure requirements:** Companies must disclose related party transactions in their financial statements, including transactions with subsidiaries, associates and key management personnel.
- iii. **Shareholder approval:** Material related party transactions require shareholder approval through a special resolution, with no related party voting on such resolutions.
- iv. **Audit committee approval:** All related party transactions require prior approval from the audit committee of the board.
- v. **Substance over form:** Paragraph 10 of IAS 24 requires that in considering each related-party relationship, attention is directed to the substance of the relationship and not merely the legal form.

b. Fair value disclosure requirements under IFRS 13

Requirement: Heritage Limited holds an investment property and an item of manufacturing equipment.

The fair value hierarchy

IFRS 13 defines fair value as the price that would be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants at the measurement date. It is an exit price based on market participant assumptions.

Inputs to valuation are ranked in a three-level hierarchy:

- **Level 1:** quoted prices, unadjusted, in active markets for identical assets or liabilities.
- **Level 2:** inputs other than quoted prices that are observable, directly or indirectly, such as prices of similar assets or observable market data.
- **Level 3:** unobservable inputs used, where observable inputs are not available; the entity uses the best information available about the assumptions market participants would make.

Exhibit 1: The investment property

Measurement approach: There is no active market for the property and no observable transactions for identical or similar properties. Fair value is therefore estimated using the income approach, by discounting the expected rental cash flows and a terminal value. The significant inputs, the discount rate and the

assumed terminal value, are unobservable, hence, the measurement falls within **Level 3** of the hierarchy.

Choice of discount rate: Fair value reflects the assumptions of market participants. Given the declining level of real-estate activity in the area, market participants would require a higher return for the additional risks. The risk-adjusted rate of 14% is therefore more appropriate than the unadjusted rate of 12%.

Indicative valuation. Using a discount rate of 14% over the five-year horizon:

Present value of rental income:	₦
₦60m × annuity factor (14%, 5 years) 3.4331	205.98
Present value of terminal value:	
₦800m × discount factor (14%, year 5) 0.5194	<u>415.50</u>
Estimated fair value of the investment property	<u>621.48</u>

For comparison, a 12% discount rate would produce a fair value of approximately ₦670.2m. The fair value is highly sensitive to the discount rate, which is itself a reason to classify the measurement as Level 3 and to disclose the sensitivity.

Disclosure: Heritage Limited should disclose the valuation technique and the inputs used, quantitative information about the significant unobservable inputs (the discount rate and the terminal value), a description of the valuation process, a sensitivity analysis showing the effect of reasonably possible changes in those inputs and a reconciliation of the opening and closing fair values.

Exhibit 2: The manufacturing equipment

With the characteristics of this manufacturing equipment:

- Inputs consist of the recent offer of ₦90m;
- Forced sale price of ₦75m;
- There is no active market for the specialised equipment;
- There is also observable market transaction for similar asset (forced sale), but this may not reflect orderly transaction; and
- The offer from a third party of ₦90m is more aligned with market participant assumptions.

Conclusion: The fair value of the equipment is approximately ₦90m. As it is derived from an observable, market-based offer for the asset rather than from quoted prices in an active market, the measurement is best classified within Level 2 of the hierarchy.

Disclosures: Heritage Limited should disclose the valuation level, the input used and the reason the forced-sale price was rejected. If the equipment also meets the criteria in IFRS 5 – Non-current Assets Held for Sale and Discounted Operations, it would be classified as held for sale and measured at the lower of its carrying amount and fair value less costs to sell. The equipment should be classified as Level 3. The inputs are based on non-binding offer and management judgment and limited observable market data.

Level 3 inputs are observable and are based on the entity's own assumptions, reflecting what market participants would use when pricing the asset or liability.

For fair value measurements of these assets, IFRS 13 requires:

- i. Valuation techniques used and reasons for choosing a particular technique. for example, discounted cash flow and market or cost approach;
- ii. Key observable inputs and rationale;
- iii. Quantitative sensitivity analysis showing effect of changing inputs;
- iv. Reconciliation of opening and closing balances for level three items;
- v. Transfers between levels with explanations;
- vi. Gains and losses recognised in profit and loss and other comprehensive income; and
- vii. Heritage must disclose detailed assumptions and methods for the investment property, asset retirement obligation and equipment, ensuring transparency for users.

Examiner's report

Part (a) of the question tests candidates' knowledge on the basic principles, rules and regulations on related party transaction. Part (b) tests on the analysis of the fair value disclosure requirements under IFRS 13- Fair Value Measurement of assets.

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

The common pitfalls of the candidates were their inability to apply the provisions of IAS 24 and IFRS 13 correctly and difficulty to applying correctly the provisions of these standards to practical situations.

Candidates are advised to pay more attention to the provisions and application of relevant International Financial Reporting Standards (IFRS) and practice reporting issues in the financial statements for better performance in future examinations.

Marking Guide	Marks	Marks
(a) Regulations and principles guiding related party transactions:		
Meaning of related party transactions	2	
Guiding principles, rules and regulations	<u>6</u>	8
(b) Fair value measurement under IFRS 13:		
Fair value hierarchy	1	
Exhibit 1: Investment property	5	
Exhibit 2: Manufacturing equipment	5	
Conclusion to Heritage Limited	<u>1</u>	
Total		<u>12</u> <u>20</u>

Solution 4

(a)

i) Calculation of net defined benefit liability at December 31, 2024

	Liability	Asset
	R'm	R'm
1/1/2024	(180)	160
31/12/2024	<u>(210)</u>	<u>175</u>
	<u>(30)</u>	<u>15</u>

Net liability R (30) + R15 = R(15m)

Net liability is R15 million

ii) Calculation of total defined benefit cost in the statement of profit or loss:

	R'm
Current service costs	10
Past service costs	25
Interest in DBO 6% x R180m	10.8
Return on DBA 5% x R160m	<u>(8.0)</u>
DBO charges to profit or loss	<u>37.8</u>

iii) Re-measurements – Explanation and amount

	Obligations	Assets
	₤'m	₤'m
PV/FV b/f	180	160
Current service costs	10	
Past service costs	25	
Interests and returns	10.8	8.0
Cash contribution		20
Benefit paid	<u>(15)</u>	<u>(15)</u>
Expected for the year	(210.8)	173
Actuarial (differences)	<u>0.8</u>	<u>2</u>
PV/FV c/f	<u>210</u>	<u>175</u>

Total actuarial gain = ~~₤~~2.8m

(b)

i) Past service cost – Accounting treatment

- IAS 19 requires immediate recognition of past service cost in profit or loss when the plan amendment or curtailment occurs;
- Deferral or spreading over future periods is not allowed under current IAS 19; and
- Elite group's action violates this rule, overstating net profit and understating liabilities.

ii) Professional and Ethical Issues (ICAN Code of Ethics)

- **Integrity** – CFO's suggestion involves deliberate misrepresentation.
- **Objectivity** – Pressure to meet earnings targets can impair judgment.
- **Professional competence and due care** – Accountant must apply IAS 19 accurately.
- **Professional behaviour** – Misstating pension costs can damage public trust.
- **Confidentiality** – Must maintain discretion but not conceal unethical practices.

iii) **Impact on users' decision and credibility**

- Misleading profits can influence investment decisions based on false performance.
- Understated liabilities distort the company's solvency and gearing ratios
- Analysts, auditors and regulators credibility can be damaged. (for example, FRC Nigeria).
- It may lead to restatements, sanctions, and reputational harm.

Examiner's report

Part (a) of the question tests candidates' knowledge on calculating defined benefit liability and total defined benefit cost for the statement of financial position, remeasurements and the accounting treatment under IAS 19- Employees Benefits. Part (b) tests candidates' knowledge on the accounting treatment of past service costs; professional and ethical issues and evaluation of how improper pension reporting can affect users' decisions.

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

The common pitfalls of the candidates were their lack of understanding of the requirements of the question as it relates to practical application and in-depth knowledge of the principles of IAS 19- Employee Benefits and presentation in the financial statements. Majority of the candidates cannot state how the ethical principles can guide accountants in a potential ethical conflict.

Candidates are advised to pay more attention to the provisions and application of relevant International Financial Reporting Standards (IFRS) on key financial reporting issues in the financial statements for better performance in future examinations.

Marking guide	Marks	Marks
(a) (i) Calculation of net defined benefit liability or asset	4	
(ii) Total defined benefit cost in profit or loss	2	
(iii) Accounting treatment for re-measurements under IAS 19 – Employee benefits	<u>2</u>	
		8
(b) (i) Accounting treatment of past service cost under IAS 19 – Employee benefits	4	

(ii) Professional and ethical issues (ICAN code of Ethics)	4	
(iii) Impact of improper pension reporting on users decisions and credibility	<u>4</u>	
Total		<u><u>12</u></u> <u><u>20</u></u>

Solution 5

a. Potential consequential effects of noncompliance with accounting standards

Accounting standards exist to ensure that financial statements are relevant, reliable, comparable and understandable. Noncompliance with accounting standards can have several potential consequential effects that can have significant and far-reaching impacts on a company's financial health, reputation, and overall success, among which are:

- i. **Financial statements will not show true and fair:** The financial statements will no longer give the true and fair view or fair presentation, of the activities of the entity; will not be reliable as required by CAMA 2020 and by IFRS and therefore mislead the users who rely on them;
- ii. **Loss of investor confidence and higher cost of capital:** Inaccurate or misleading financial reporting will lead to a loss of investor confidence. Once the market doubts the reliability of the financial statements, investors and lenders demand a higher return for the additional risk, raising the entity's cost of capital and restricting its access to finance;
- iii. **Fall in share price:** Potentially resulting in a decline in stock price;
- iv. **Risk of delisting:** A listed entity that persistently fails to comply with reporting requirements risks suspension or delisting from the stock exchange;
- v. **Regulatory sanction:** Noncompliance with accounting standards can attract unwanted attention from regulatory bodies, such as securities and exchange commissions or financial regulatory authorities, which may lead to fines, penalties or even litigation. The Financial Reporting Council of Nigeria, acting under the FRC Act 2011 (as amended 2023), may require the accounts to be revised and may impose penalties, enforcement action and other sanctions on the entity and its directors;

- vi. **Reputation damage:** Noncompliance can damage a company's reputation and credibility with stakeholders, including customers, suppliers, and employees. The reputation of the entity, its directors and the wider accounting profession is harmed and the damage to trust is often long-lasting;
- vii. **Financial restatement:** In cases of material noncompliance, the financial statements must be corrected and restated. This is a time-consuming process, and the cost and disruption of restatement fall on the entity;
- viii. **Loss of comparability arising from financial restatement:** The prior periods lose their comparability;
- ix. **Increased audit fees:** Noncompliance can lead to increased audit fees, as auditors may need to perform additional work to ensure that financial statements are accurate and compliant;
- x. **Difficulty in obtaining financing:** Noncompliance can make it more difficult for companies to obtain financing, as lenders and investors may view the company as a high risk entity;
- xi. **Internal control issues:** Noncompliance can indicate internal control issues, which can lead to further financial reporting problems and potential fraud;
- xii. **Legal liability of the entity, its management and directors:** In severe cases, non-compliance may expose the entity, its management and directors to litigation by shareholders and other stakeholders, and to personal liability under CAMA 2020 for the directors who approved the financial statements;
- xiii. **Impact on financial analysis:** Noncompliance can make it difficult for analysts and investors to accurately assess a company's financial performance and make informed investment decisions;
- xiv. **Industry-wide consequences:** In some cases, noncompliance by one company can have industry-wide consequences, such as increased regulatory scrutiny or changes to accounting standards;
- xv. **Modified audit opinion:** The external auditor will be unable to give an unmodified opinion. A qualified or in serious cases, an adverse opinion will be issued, which signals to the market that the statements cannot be relied upon;
- xvi. **Poor economic decisions:** Investors, lenders, suppliers and other users make resource- allocation decisions on the basis of distorted information, which leads to mispricing of shares and debt and to misdirected investment. Investors stand to lose money if they have made decisions based on the misleading financial information;

- xvii. **Professional sanctions:** The accountant responsible for the financial statements may face disciplinary action by ICAN, including suspension or withdrawal of membership;
- xviii. **Loss of job:** The Accountants who are responsible for the preparation of financial information where there is noncompliance might lose their job; and
- xix. **Risk of bankruptcy and going-concern problem:** Their action could cause a chain of events that would see the company go bankrupt and the auditors cease business.

b. Consequences of unethical behaviour

The consequences of unethical behaviour of a professional accountant fall on the individual, the employer and the profession, among which are:

- i. **Loss of professional reputation and public trust:** The accountant's personal and professional reputation is damaged, and the trust that the public places in the profession is eroded;
- ii. **Legal consequences:** Unethical conduct that breaks the law may lead to civil litigation, prosecution, fines and imprisonment;
- iii. **Loss of employment:** The accountant may lose the current position and find it difficult to obtain future employment or engagements;
- iv. **Loss of clients:** An employer or firm associated with the conduct may lose clients;
- v. **Financial loss to stakeholders:** Investors, employees, creditors and others may suffer real financial loss as a result of decisions taken on the basis of unethical conduct;
- vi. **Damage to the credibility of the profession:** Each case of misconduct weakens public confidence in accountants generally and undermines the value of the qualification;
- vii. **Personal consequences:** the individual may suffer stress, guilt and lasting reputational harm well beyond any formal sanction;
- viii. **Disciplinary action by ICAN:** The Institute may investigate, leading to: reprimand, fine, suspension or expulsion of the member;
- ix. Penalties include prison sentences or fines;
- x. Repayment of money they had gained from unethical behaviour;
- xi. Severely curtailing the accountant's career such as prohibition of holding a director's position in the future;
- xii. For accountancy firms, there is the prospect of the partners being sentenced to prison sentence;
- xiii. Loss of clients may eventually result in the winding up of the firm;

- xiv. Audit partners may be banned from practicing for years; and
- xv. Payments of huge compensation.

Examiner’s report

Part (a) of the question tests candidates’ knowledge of the potential consequential effects of non-compliance with accounting standards, while part (b) requests candidates to discuss the consequences of unethical behaviour.

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

The common pitfall of the candidates were their inability to distinguish between potential consequences of non-compliance with accounting standards and the consequences of unethical behaviour.

Candidates are advised to familiarise themselves with all aspects of the syllabus and pay special attention to ICAN Code of Ethics for better performance at this level of the Institute examinations.

Marking guide	Marks
(i) Potential consequential effects of non-compliance with standards	
Ten correct points mentioned	10
(ii) Consequences of unethical behaviour	
Five correct points metioned	<u>5</u>
Total	<u>15</u>

Solution 6

a) Distributed Ledger Technology (DLT) and Machine Learning (ML) as means of transforming business reporting process.

The adoption of Distributed Ledger Technology (DLT) and Machine Learning (ML) has the potential to fundamentally reshape Nexus Plc's reporting framework by improving transparency, timeliness, reliability and strategic value.

- i. Enhancing transparency and accountability**

DLT generates a shared, unchangeable record of transactions that cannot be changed without network participants' consent. This would give Nexus Plc an extremely transparent audit trail for transactions pertaining to finances and sustainability. Because records can be independently checked, stakeholders would have more faith in reported information, enhancing corporate accountability and trust.
- ii. Facilitating real-time reporting**

Conventional reporting systems typically rely on periodic reconciliations and manual verification processes. By enabling transactions to be validated and recorded in near real time, Distributed Ledger Technology (DLT) allows Nexus Plc to progress towards continuous reporting. This would provide management, investors and regulators with more up-to-date information, facilitating quicker and more informed decision-making.
- iii. Improving the quality of predictive analysis**

Machine Learning (ML) enables organisations to extend reporting beyond the analysis of historical data by uncovering patterns, trends and relationships within vast amounts of both structured and unstructured information. Nexus Plc could leverage ML models to predict revenues, cash flows, operational risks and sustainability performance. As a result, reporting would become more forward-looking, providing greater strategic value and supporting proactive decision-making.
- iv. Increasing efficiency through intelligent automation**

Machine Learning (ML) can streamline routine accounting and reporting tasks, including transaction classification, variance analysis, anomaly identification and data verification. By automating these processes, Nexus Plc could reduce processing times, minimise the risk of human error and enhance the efficiency of its reporting function. This would enable accounting professionals to devote more time to higher-value analytical and strategic activities.
- v. Strengthening risk management and assurance**

The integration of Distributed Ledger Technology (DLT) and Machine Learning (ML) has the potential to substantially improve internal control frameworks. DLT creates a secure, immutable and auditable record of transactions, while ML enables the continuous monitoring of data flows to detect irregular patterns that could signal fraud, operational weaknesses or regulatory non-compliance. Together, these technologies support a more proactive approach to risk management, strengthening both corporate governance and organisational resilience.

vi. Enhancing sustainability and environmental, social and governance (ESG) reporting

As stakeholders place greater emphasis on transparent environmental, social and governance (ESG) reporting, Distributed Ledger Technology (DLT) can provide trustworthy and verifiable records of sustainability-related activities. At the same time, Machine Learning (ML) can evaluate ESG data to uncover patterns, assess trends, and forecast future performance. This combination would enable Nexus Plc to produce sustainability reports that are both dependable and valuable for informed decision-making.

b) Limitations or risks associated with adoption of DLT and ML

i. High implementation and ongoing maintenance expenditure

The adoption of DLT and ML involves considerable expenditure on technological infrastructure, system integration, cybersecurity frameworks and employee development. For many organisations, these upfront and continuing costs can be substantial, with tangible benefits potentially taking time to materialise.

ii. Security, privacy and ethical risks

While DLT can strengthen the accuracy and reliability of data, organisations may still face risks relating to cyberattacks, unauthorised system access, and breaches of privacy. In addition, machine learning models can generate inaccurate or biased outcomes when developed using incomplete, poor-quality or unrepresentative data.

iii. Skills shortages issues

The effective use of DLT and ML requires employees to possess appropriate technical expertise and analytical skills. However, limited availability of digital talent, together with resistance to new ways of working, can create barriers to implementation and diminish the overall success of these technologies.

c) Quality skills that an accountant must possess in a digital reporting environment

i. Advanced digital and data analytics skills

Accountants will need to acquire strong proficiency in data analytics platforms, artificial intelligence tools and blockchain-based technologies. The ability to interpret, assess and effectively communicate insights derived from data will be vital in a digitally driven reporting environment.

ii. **Critical thinking and professional judgement**

As more routine accounting tasks become automated, accountants will add greatest value through their capacity to evaluate risks, question underlying assumptions, review machine-generated outputs and apply informed professional judgement. Human oversight continues to be essential in ensuring that reporting information is accurate, relevant and ethically sound.

iii. **Strategic communication and business advisory capabilities**

Contemporary accountants are increasingly expected to act as strategic partners within organisations rather than simply maintaining financial records. They must be able to convey complex financial and technological information in a clear manner to both technical and non-technical audiences, influence strategic choices and offer practical recommendations that align with organisational goals.

Conclusion

For Nexus Plc, the integration of Distributed Ledger Technology and Machine Learning would transform business reporting from a predominantly historical and compliance-driven exercise into a transparent, real-time and predictive decision-support system. While challenges relating to cost, cybersecurity and skills development must be addressed, organisations that successfully harness these technologies can achieve stronger governance, enhanced stakeholder confidence and more sustainable long-term value creation. Equally, accountants who cultivate digital expertise, professional judgement and strategic communication skills will remain indispensable in the evolving reporting landscape.

Examiner's report

Part (a) of the question tests candidates' knowledge of how distributed ledger technology and machine learning could transform a business reporting process. Part (b) tests limitations or risks associated with the adoption of such technologies while part (c) is on recommendations of three quality skills an accountant must possess to remain relevant in the evolving digital reporting environment.

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

The common pitfalls of the candidates were their inability to understand the limitations or risks associated with the adoption of distributed ledger technology and machine learning technologies.

Candidates are advised to pay more attention to all aspects of the syllabus especially on beyond the financial reporting issues.

Marking guide	Marks	Marks
(i) Adoption of Distributed Ledger Technology (DLT) and Machine Learning (ML) to transform business reporting process:		
Correct six points listed	3	
Explanation of the six points	<u>3</u>	6
(ii) Limitations or risks associated with the adoption of DLT and ML:		
Correct three points listed	1½	
Explanation of the three points	<u>1½</u>	3
(iii) Qualities of accountants skills relevant in digital reporting environment:		
Correct three points listed	3	
Explanation of the three points	<u>3</u>	
Total		<u>6</u> <u>15</u>

Solution 7

- a) The litigation proceeding is a relevant information in the preparation of the financial statements of Fiwajoye Plc for the year ended 31 December, 2024,

Litigation by a customer

- i) **Facts:** A customer is claiming ₦250m in damages for an injury. Fiwajoye Plc disputed the claim, considering that the injury was caused by the customer's own negligence. The case was undecided at the year-end.
- ii) **Principle:** IAS 37- Provisions, Contingent Liabilities and Contingent Assets requires a provision to be recognised only where there is a present obligation arising from a past event, an outflow of economic benefits is probable and a reliable estimate can be made. If an outflow is possible but not probable, the matter is a contingent liability, which is disclosed but not recognised. If the possibility of an outflow is remote, no disclosure is required.

iii) **Application:** Fiwajoye Plc disputed liability and has an apparently credible defence, namely the customer’s own negligence. The case was unresolved at the year end. On the information available, an outflow of economic benefits is possible but not probable, so the recognition criteria for a provision are not met.

iv) **Conclusion:**

- No provision should be made.
- Fiwajoye Plc should disclose a contingent liability, describing the nature of the claim, an estimate of its financial effect (₦250m), and the uncertainties surrounding the outcome.
- The directors should obtain legal advice on the probability of losing the case; if that advice indicates that an outflow has become probable, a provision for the best estimate would then be required and if the possibility were assessed as remote, disclosure will not be required.

b) Lease agreement on premises

- i) The lease agreement is an onerous contract. An onerous contract is one in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received from it.
- ii) The present obligation under an onerous contract should be recognised and measured as a provision.
- iii) Therefore, the discounted amount of the outstanding lease payments should be fully provided for.
- iv) The provision above will be as follow as at December 31, 2024 as follows:

	Dr.	Cr.
	₦'000	₦'000
Provision for Lease – SOP or L	22,500	
Provision for Lease – SOFP		22,500
Being provision for lease costs		

c) Brand name

The brand name must be evaluated under the recognition criteria of the IASB framework and IAS 38 - Intangible Assets.

- i. **Principle:** IAS 38 - Intangible Assets specifically prohibits the recognition of internally generated brands, mastheads, publishing titles, customer lists and

items similar in substance. The standard takes the view that expenditure on such items cannot be distinguished from the cost of developing the business as a whole, so the recognition criteria cannot be met.

- ii. **Application:** Fiwajoye Plc's brand has been built up internally over time. The fact that a certified consultant has placed a value of ₦250m on it, and that market research and due diligence have been carried out, does not overcome the prohibition by IAS 38 mentioned above; a reliable valuation is not a sufficient reason for an asset to be recognisable.
- iii. In accordance with IAS 38, Internally generated brands and similar intangibles cannot be recognised because it cannot be measured reliably, in spite of certification of the consultant. Reliability of measurement would be determined by an eventual willing buyer who successfully acquired the brand by making full payment as valued.
- iv. **Conclusion:**
 - The internally generated brand cannot be recognised as an intangible asset and the Managing Director's proposal should be rejected;
 - The costs of the valuation and the market research are expensed as incurred; and
 - Only a brand that is acquired, separately or as part of a business combination, may be recognised, because its cost or its fair value at acquisition, can then be measured reliably.

Examiner's report

Part (a) of the question tests candidates' practical understanding of the potential implications of recognition and presentation, of litigation by a customer in the financial statements. Part (b) tests candidates' knowledge of accounting treatment of lease agreement on premises, while part (c) tests candidates' knowledge of the practical application of inclusion of brand name as an asset in the financial statements.

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

Common pitfalls of the candidates was their inadequate knowledge of applications of various International Financial Reporting Standards (IFRS), to real life situations.

Candidates are advised to know the contents and practical application of all the International Financial Reporting Standards (IFRS), that are examinable at this level of the Institute's examination.

Marking guide	Marks	Marks
Recognition and presentation of financial reporting issues in financial statement:		
(a) Litigation by a customer		
Facts of the reporting issue	1	
Identification of applicable accounting standards	1	
Application of the relevant accounting standards	1	
Accounting treatment	1	
Conclusion	<u>1</u>	
		5
(b) Lease agreement on a premises:		
Facts of the reporting issue	1	
Identification of applicable accounting standards	1	
Application of the relevant accounting standards	1	
Accounting treatment	1	
Conclusion	<u>1</u>	
		5
(c) Inclusion of brand name as an asset in the financial statement:		
Facts of the reporting issue	1	
Identification of applicable accounting standards	1	
Application of the relevant accounting standards	1	
Accounting treatment	1	
Conclusion	<u>1</u>	
		5
Total		<u>15</u>

INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

PROFESSIONAL LEVEL EXAMINATION – MAY 2026

ADVANCED TAXATION

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

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

SECTION A: COMPULSORY QUESTION (30 MARKS)

QUESTION 1

ROMO Agro-allied Industries Limited, Port Harcourt, was incorporated and granted a pioneer status to manufacture basic organic chemicals and fertilizers from predominantly Nigerian raw materials, with a production day of July 1, 2018. Agricultural fertilizer, chlorine, and pesticide are the approved products for the company.

The following information was extracted from the company's financial records during the pioneer period:

Year ended	Turnover N'000	Adjusted profit/ (loss) N'000
June 30, 2019	128,250	(41,200)
June 30, 2020	133,630	(37,500)
June 30, 2021	235,400	8,300

For about two years into its pioneer period, the fertilizer brand was not generating sufficient profits for the company, due to customers' preference for cheaper foreign products.

In April 2021, the management of the company at one of its management meetings, decided that the company should take to importation of fertilizers from European countries in order to improve their profitability. These imported products are then repackaged by the company for final sales to its customers.

The officials of the Federal Ministry of Industry, Trade and Investment (FMITI), during one of their routine post-pioneer visits to the company in May 2025, got to know about the importation and sales of fertilizers during pioneer period. This act was considered to be inconsistent with the pioneer certificate granted to the company by the Federal Government. The FMITI subsequently informed the tax authorities of their findings.

The preliminary investigation carried out by the tax authorities in July 2025 on the activities of the company revealed that, between April and June 2021, the company's sales and assessable profit from imported fertilizer were ₦102,280,000 and ₦12,700,000, respectively. While filing its annual returns and reports to the tax authority and FMITI in December 2021, the company reported this transaction as part of its normal operating activities, for the year ended June 30, 2021.

The schedule of qualifying capital expenditure (QCE) during pioneer period revealed the following:

QCE	Date of acquisition	Number of items	Total amount ₦'000
Industrial building	July 2018	1	30,000
Non-industrial building	July 2018	1	25,000
Industrial plant and equipment	July 2018	2	44,000
Motor vehicle	July 2018	1	7,000
Furniture and fittings	July 2018	4	3,000
Motor vehicles	February 2020	2	16,000
Furniture and fittings	December 2020	6	4,800

The company did not apply for extension of its pioneer certificate at the end of its initial three-year period.

The company had the following statements for the first three years post-pioneer period:

Year ended	Turnover ₦'000	Adjusted profit/ (loss) ₦'000
June 30, 2022	150,900	25,100
June 30, 2023	168,800	29,300
June 30, 2024	175,350	36,200

The financial records of the company for the year ended June 30, 2025 showed the following:

	₦'000	₦'000
Gross turnover		262,150
Deduct: Direct cost of production		<u>117,900</u>
		144,250
Add: Other income		<u>12,600</u>
		156,850
Deduct:		
Salaries and other personnel costs	32,700	
Repairs and maintenance	1,500	
Vehicle running expenses	1,700	
Auditors' fees	2,400	
Power cost	4,420	
Depreciation	18,200	
Legal and professional fees	7,900	

Preliminary expenses written off	2,000	
Finance charges	2,080	
Allowance for doubtful debts	13,300	
Administrative expenses	14,250	
Donations and subscriptions	2,500	
Transfer to general reserves	3,400	
Income tax provision	<u>3,600</u>	<u>(109,950)</u>
Net profit		<u>46,900</u>

The following additional information was provided:

(i) **Other incomes:**

	N'000
Dividends received (net)	9,000
Excess on valuation of building	<u>3,600</u>
	<u>12,600</u>

(ii) **Repairs and maintenance:**

	N'000
Improvement to industrial building	1,100
Repairs of plant and equipment	<u>400</u>
	<u>1,500</u>

(iii) **Legal and professional fees:**

	N'000
Acquisition of short lease	1,200
Renewal of long lease	1,300
Retainership of professionals	4,000
Legal cost incurred in respect of tax appeal	<u>1,400</u>
	<u>7,900</u>

(iv) **Allowance for doubtful debts:**

	N'000
Specific provisions	5,100
General provisions	6,700
Bad debt recovered	(2,900)
Bad debt written off	<u>4,400</u>
	<u>13,300</u>

(v) **Administrative and other expenses:**

	N'000
Feasibility study	2,500
Stamp duties on increase in capital	800
Medical expenses	1,700
Insurance	3,200
Rates: Local government	2,750
Transport and travelling	<u>3,300</u>
	<u>14,250</u>

(vi) **Donations and subscriptions:**

	₦'000
Donation- Oreyo Country Club	1,000
Donation of books- National Library	1,100
Subscription-Manufacturers Association of Nigeria	<u>400</u>
	<u>2,500</u>

(vii) **Schedule of qualifying expenditure post-pioneer period:**

QCE	Date of acquisition	Number of items	Total amount ₦'000
Motor vehicles	January 6, 2022	2	16,000
Furniture and fittings	April 15, 2023	2	6,000
Industrial plant and equipment	October 1, 2024	1	28,000

(viii) **Transfer to general reserves**

The decision to transfer a specific amount out of the company's profit was approved by the shareholders at the 2024 annual general meeting.

The company received a letter from the FIRS Integrated Tax Office on the proposed tax audit of the company's activities since inception. The audit visit has been slated for the first week of next month. For a hitch-free exercise, the FIRS, has requested for maximum cooperation from staff and management of the company.

Your firm of chartered accountants has just been appointed by the company to help in the preparation towards the impending visit.

The Managing Partner of your firm has directed you, the Senior Tax Consultant, to take charge of the assignment.

Required:

- a. Draft a report to the Managing Partner for his review, before same is sent to the client. The report should show, for all the relevant assessment years, the company's:
 - i. Adjusted profits (9 Marks)
 - ii. Income tax liabilities (if any) (17 Marks)
- b. Comment on the provisions of the Industrial Development (Income Tax Relief) Act, 2004 (as amended) on factors that can lead to revocation of a pioneer certificate. (4 Marks)

(Total 30 Marks)

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

QUESTION 2

Sustainable development is an approach to growth and human development that balances economic, social, and environmental needs. It ensures meeting the present generation's needs without compromising the ability of future generations to meet their own needs.

Taxation is considered by some tax, fiscal, and economic policy makers as a valuable tool in the achievement of a nation's sustainable development. In the same vein, other notable supra-national organisations are seen to play crucial roles in shaping tax policy globally, thereby assisting member countries to achieve sustainable development.

Required:

- a. Explain **FOUR** roles which taxation can play in the achievement of a country's sustainable development. (4 Marks)
- b. Discuss **THREE** key taxation strategies that can be used to achieve sustainable development. (3 Marks)
- c. Comment on the potential challenges that may affect taxation in achieving sustainable development in Nigeria and how these challenges can be mitigated. (7 Marks)
- d. Identify any **FOUR** supra-national organisations and **explain** their roles in shaping tax policy. (6 Marks)

(Total 20 Marks)

QUESTION 3

Nigeria has established double taxation relief (DTR) mechanisms through laws, treaties, and agreements with other nations. This is to mitigate financial burdens from having to assess the same income twice (in the country where it is earned and again in their country of residence).

Section 44 of the Companies Income Tax Act Cap C21 LFN, 2004 (as amended) provides for the treatment of relief in respect of Commonwealth income tax (that is, when there is no double taxation agreement/arrangement between Nigeria and the other country).

Ajoseh Nigeria Limited, Kaduna, is a manufacturer of indigenous clothing fabrics. The company which was incorporated in 2010, opened a business operation, Hellen Incorp., in Montreal, Canada, five years ago. The Canadian company was established

to respond to the needs of Africans in Canada, the United States, and Caribbean/Latin American countries.

The abridged income statements of Ajoseh Nigeria Limited and Hellen Incorporated for the year ended December 31, 2024 are presented below:

	Ajoseh Nigeria Limited, Nigeria	Hellen Incorp., Canada
	₦'000	CAD \$
Gross turnover	<u>778,500</u>	<u>470,700</u>
Deduct:		
Cost of goods sold	381,400	147,400
Salaries and other emoluments	131,700	94,400
Depreciation	25,300	14,200
Bad debts written off	18,100	9,900
Repairs and maintenance	1,200	900
Vehicle running expenses	1,000	700
Administrative expenses	13,600	8,250
Foreign exchange provision	-	1,750
Foreign tax paid	-	41,400
Share of head office expenses	-	<u>33,500</u>
	<u>572,300</u>	<u>352,400</u>
Net profit	<u>206,200</u>	<u>118,300</u>

The following additional information was provided:

- i. The amount incurred on cost of goods sold was directly related to the business operations.
- ii. The foreign exchange provision arose as a result of fluctuations in the conversion rate of the two currencies.
- iii. The capital allowances as agreed with the Federal Inland Revenue Service were:

Ajoseh Nigeria Limited	₦18,520,000
Hellen Incorp.	₦10,490,000
- iv. Assume that the average exchange rate during the financial year was ₦1,100 to CAD \$1.

Required:

- (a) Compute the double taxation relief (if any) and tax payable by Ajoseh Nigeria Limited for the relevant assessment year. (13 Marks)
- (b) Discuss the relevant information to be considered in respect of Commonwealth income tax relief, as provided for in Section 44 of CITA. (4 Marks)

- (c) Comment on the roles of Vienna Convention in the application and interpretation of international tax treaties. (3 Marks)

(Total 20 Marks)

QUESTION 4

Opobo Petroleum Producing Company Limited had been in oil exploration business for more than thirty years. The company operates in both onshore and shallow water in the Nigerian Western Delta region.

Upon expiration of its oil mining licence (OML) on December 31, 2022, the company automatically converted its OML to petroleum mining lease (PML) on January 1, 2023. This was in line with the provisions of the Petroleum Industry Act (PIA), 2021.

The company has provided the following results in respect of its operations for the year ended December 31, 2024:

(i) **Crude oil sold:**

Type	Quantity (million barrels)	Actual price US \$	Fiscal price US \$
Bonny light	10.8	73	75
Forcados medium	7.5	66	66

(ii) **Condensate from associated gas sold:**

Type	Quantity (MMBTU)	Actual price US \$	Fiscal price US \$
OSO condensate	3 million	32	33
Escravos condensate	2.3 million	30	29.5

(iii) **Natural gas liquid from associated gas sold:**

Type	Quantity (MMBTU)	Actual price US \$	Fiscal price US \$
Penington	2.5 million	33.5	34

(iv) **Other income:**

Ocean going tanker business	N'million
	775,000
Dividends received (net)(from shares in Nigerian listed company)	<u>67,500</u>
	842,500

(v) **Expenses:**

	N'million
Royalty cost paid	357,500
Production cost	834,800
Drilling costs for first 3 appraisal wells	48,900

Terminalling cost	1,200
Repairs of plant, machinery, and fixtures	1,020
Repairs of alteration of production implement utensils	440
Customs duty on essentials	200
Environmental remediation fund	1,750
NDDC charge	300
Stamp duty	150
Host community costs	42,600
Donations to government recognised orphanage home	125
Finance and other bank charges	290
Cost of gas reinjection wells	1,800
Depreciation of plant, machinery and fixtures	1,950
Concession rentals	2,200
Others expenses	1,580

The following additional information was provided:

(vi) The drilling costs for the first 3 appraisal wells consisted of 80% tangible costs and 20% intangible costs.

(vii) **Other expenses comprised:**

	N'million
Acquisition of geophysical and geological data and information expenses	310
Gas flaring penalty	250
State Government ground rent	300
Signature bonus -acquisition of petroleum deposit	500
Head office shared cost	220
	<u>1,580</u>

(viii) **Schedule of qualifying capital expenditure:**

Year of acquisition	Type	Amount (N'million)
2019	Pipeline expenditure	1,800
2020	Drilling expenditure	1,900
2021	Building expenditure	1,700
2022	Plant expenditure	980
2023	Pipeline expenditure	1,200
2024	Drilling expenditure	1,750

(ix) Unrecouped losses and capital allowances from previous assessment years as agreed with the Federal Inland Revenue Service, were ₦1,215million and ₦480million, respectively.

(x) In the immediate preceding assessment year, the excess cost not utilised as a result of cost price ratio (CPR) limit amounted to ₦170million.

(xi) Production allowances after commencement of the PIA 2021, consisted of:

	N'million
Onshore operations	1,200
Shallow water operations	<u>1,100</u>
	<u>2,300</u>

(xii) Assume that ₦1,530 is equivalent to US \$1 and tax dues are to be paid in the local currency (Naira).

The company's management meeting has been scheduled for the next three weeks.

Required:

As the company's Tax Manager, you are to prepare a report to the Managing Director, showing the hydrocarbon tax payable by the company in the relevant assessment year. **(Total 20 Marks)**

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

QUESTION 5

Specific sections of relevant tax statutes were amended by Finance Acts 2019, 2020, 2021, and 2023, in line with the macroeconomic policy reforms of the Federal Government and for efficient financial management of the Federation.

CRD Hotels Limited commenced operations in 2010. It has six branches in each of Nigeria's geo-political zones. In order to add beauty and glamour to their hotel premises, the management of the company in 2021, decided to acquire at a cost of ₦20,000,000, an array of Nigerian traditional and contemporary artefacts and artworks.

In May 2023, all the artworks were disposed of at an all inclusive sales proceeds of ₦19,200,000, thereby making a capital loss of ₦800,000. Another set of artefacts and artworks was acquired at a cost of ₦12,200,000 in October of the same year.

The management observed that these artworks did not attract significant customers as earlier envisaged, hence in August 2025, the company decided to approach a professional auctioneer to help sell all the artefacts and artworks.

The company's accountant presents the following financial details in respect of the disposal of the artefacts and artworks:

Sales proceeds	₦15,100,000
Auctioneer's commission	1.5% of sales proceeds
Newspaper advertisement expenses	₦130,000
Incidental expenses: (painting of artworks)	₦100,000

Required:

- a. Compute the capital gains tax payable in respect of the sales of the artefacts and artworks by the company. (8 Marks)
- b. Comment on the provisions of the relevant Finance Acts as they affect the Capital Gains Tax Act Cap. C1 LFN 2004 on:
 - i. Assets sold or transferred between connected parties (2 Marks)
 - ii. Compensation received for loss of office (2 Marks)
 - iii. Due date for filing capital gains tax returns and penalty for not filing the returns (3 Marks)

(Total 15 Marks)

QUESTION 6

Environmental, Social, and Governance (ESG) considerations have become increasingly important in the business world due to growing concerns about the manner by which most companies treat ESG issues.

For instance, as highlighted in a leading Africa-focused report, a disproportionate large number of companies operating oilfields in Nigeria have essentially ignored the greenhouse gas management guidelines instructed by the country's Upstream Petroleum Regulatory Commission (NUPRC). While some companies have greenhouse gas emission reporting in place, most companies have not complied with this reporting practice.

Social and human right concerns, like labour exploitation, lack of host community support, and corporate governance issues have stressed the need for businesses to behave responsibly.

There are, however, various significant fines, penalties, litigation risks, and loss of operational licences, imposed on any company for failure to comply with the Federal Government's directives on ESG matters. Companies that are alleged to have breached any of these directives are at liberty to seek redress in line with the provisions of the law. One of such provisions is the use of Alternate Dispute Resolution (ADR) mechanism by concerned parties.

Required:

- (a) Discuss the benefits and challenges of sustainable practices for companies in the extractive industry in Nigeria. (8 Marks)
 - (b) Explain the objectives and forms of ADR mechanism in the Nigerian tax system. (7 Marks)
- (Total 15 Marks)**

QUESTION 7

Recent developments in the accounting practice globally have made training and retraining of employees in the profession inevitable. Tax legislation, for instance, is becoming increasingly complex; bringing ever more risk on the professional tax practitioners.

The Principal Partner of a small-sized audit firm is organising a seminar on “Tax Practice Management” for his firm’s newly appointed audit staff next month.

In the letter of invitation sent to you, as a Lead Presenter, the purpose of the seminar, according to the firm’s Principal Partner, is to avail the audit staff (who have just completed their academic programmes in various higher institutions) with current developments in the accounting profession for accountants in tax practice.

You have accepted to present a paper at the seminar titled, “Professional accountants in tax practice, associated risks, benefits and strategies of mitigating the potential risks”.

The organisers of the seminar expects your paper to be forwarded to them.

Required:

As the Lead Presenter, you are to prepare a draft of the paper to be presented at the seminar, covering the under-listed areas:

- (a) Legal requirements for a professional accountant in tax practice. (2 Marks)
 - (b) The risks and benefits of running a professional tax practice (6 Marks)
 - (c) Risk mitigation strategies in professional tax practice (7 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 to August 31, 2023) 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)

SECTION A

SOLUTION 1

ai. **WILCOX & Co (CHARTERED ACCOUNTANTS)**

Date:

The Managing Director
ROMO Agro-allied Industries Limited
Port-Harcourt

Dear Sir,

RE: COMPUTATION OF ADJUSTED PROFIT AND TAX LIABILITIES FOR THE RELEVANT ASSESSMENT YEARS AND OTHER RELATED MATTERS

We refer to your request on computation of adjusted profit for the year ended June 30, 2025 and tax liabilities for 2022, 2023, 2024, 2025, and 2026 assessment years. Our comments are as follows:

ai. **Adjusted profit for the year ended June 30, 2025**

As shown in the attached appendix 1, the adjusted profit of the company for the year ended June 30, 2025 is ₦77,500,000.

aii. **Tax liabilities for 2022- 2026 assessment years**

Appendix 2 presents the report of the companies income tax and tertiary education tax payable for 2022 through 2026 assessment years.

The summary of the result is as follows:

Assessment year	2022	2023	2024	2025	2026
	₦	₦	₦	₦	₦
Companies income tax	3,810,000	-	-	-	18,462
Tertiary education tax	317,500	627,500	879,000	1,086,000	2,325,000

b. **Factors that can lead to revocation of certificate granted to a company include:**

- where the production day is more than one year from the day stated original application;
- value of qualifying capital expenditure (QCE) is less than the threshold of N10 million;
- information provided by the applicant company during application was found to be misleading or false;

- the company did not utilise its tax savings judiciously; there is a clear case of abuse of the incentives;
- the company engages in any tax evasion under the cover of the pioneer status granted it; and
- when the company engages in an activity which is contrary to the pioneer status granted it.

Should you need any further clarifications on this report, we will be glad to address them.

Thank you,

Helen Irobusi

Appendix 1: Adjusted profit for the year ended June 30, 2025

	N'000	N'000
Net profit as per accounts		46,900
Add back:		
Repairs and maintenance:		
- improvement to industrial building	1,100	
Depreciation	18,200	
Legal and professional fee:		
- Acquisition of short lease	1,200	
- Renewal of long lease	1,300	
- Legal cost of tax appeal	1,400	
Preliminary expenses written off	2,000	
Allowance for doubtful debts:		
- General provision	6,700	
Administrative expenses:		
- Feasibility study	2,500	
- Stamp duties	800	
Donations and subscriptions:		
- Donation to OreyoCountry Club	1,000	
Transfer to general reserves	3,400	
Income tax provisions	<u>3,600</u>	<u>43,200</u>
		90,100
Less: Incomes not taxable		
- Dividend received (net)	9,000	
- Excess valuation of building	<u>3,600</u>	<u>12,600</u>
Adjusted profit		<u>77,500</u>

Appendix 2: Computation of tax liabilities for 2022-2026 assessment years

	N'000	N'000
2022 assessment year		
Basis period: 1/7/20 - 30/6/21		
Assessable profit (given)		<u>12,700</u>

Companies income tax @ 30%		<u>3,810</u>
Tertiary education tax @ 2.5% of ₦12,700,000		<u>317.5</u>
2023 assessment year		
Basis period: 1/7/21 - 30/6/22		
Adjusted profit (given)		25,100
Loss b/f from pioneer period (W1)	83,100	
Loss relieved	<u>(25,100)</u>	<u>(25,100)</u>
Unrelieved loss that lapsed (permanently lost)	58,000	
Capital allowance for the year (W2)	72,320	
Capital allowance utilized	<u>(Nil)</u>	Nil
Unutilised capital allowance c/f	<u>72,320</u>	
Total profit		<u>Nil</u>
Companies income tax @ 30%		<u>Nil</u>
Tertiary education tax @ 2.5% of ₦25,100,000		<u>627.5</u>
2024 assessment year		
Basis period: 1/7/22 - 30/6/23		
Adjusted profit (given)		29,300
Capital allowance for the year (W2)	18,620	
Unutilised capital allowance b/f	<u>72,320</u>	
Total capital allowance available for utilisation	90,940	
Capital allowance utilized	<u>(29,300)</u>	<u>(29,300)</u>
Unutilised capital allowances c/f	<u>61,640</u>	
Total profit		<u>Nil</u>
Companies income tax @ 30%		<u>Nil</u>
Tertiary education tax @ 3% of ₦29,300,000		<u>879</u>
2025 assessment year		
Basis period: 1/7/23 - 30/6/24		
Adjusted profit (given)		36,200
Capital allowance for the year (W2)	17,120	
Unutilised capital allowance b/f	<u>61,640</u>	
Total capital allowance available for utilisation	78,760	
Capital allowance utilized	<u>(36,200)</u>	<u>(36,200)</u>
Unutilised capital allowances c/f	<u>42,560</u>	
Total profit		<u>Nil</u>

Companies income tax @ 30%		<u>Nil</u>
Tertiary education tax @ 3% of ₦36,200,000		<u>1,086</u>
2026 assessment year		
Basis period: 1/7/24 - 30/6/25		
Adjusted profit (given)		77,500
Capital allowance for the year (W2)	34,878.46	
Unutilised capital allowance b/f	<u>42,560</u>	
Total capital allowance available for utilisation	77,438.46	
Capital allowance utilized	<u>(77,438.46)</u>	<u>(77,438.46)</u>
Unutilised capital allowances c/f	<u>Nil</u>	
Total profit		<u>61.54</u>
Companies income tax @ 30%		<u>18.462</u>
Tertiary education tax @ 3% of ₦77,500,000		<u>2,325</u>

Workings

1. Determination of total adjusted profit/(loss) made during the pioneer period

Basis period	Assessment year	Profit/(loss) ₦'000
1/7/18 - 30/6/19	2020	(41,200)
1/7/19 - 30/6/20	2021	(37,500)
1/7/20 - 30/6/21	2022	(4,400) see <u>note below</u>
Total		<u>(83,100)</u>

Note: The assessable profit of ₦12,700,000 made from importation and sale of fertilizer (unapproved activity) during the pioneer period is to be deducted from assessable profit reported by the company for the year ended June 30, 2021.

Therefore, the real or actual adjusted loss for the pioneer period = ₦8,300,000 - ₦12,700,000 = (₦4,400,000).

2. Capital allowances schedule

Indust. Building	Non- industrial Building	Industrial Plant & equipment	Motor vehicle	Furniture & fittings	Cap. Allow
IA 15%	IA 15%	IA 50%	IA 50%	IA 25%	
AA 10%	AA 10%	AA 25%	AA 25%	AA 20%	
₦'000	₦'000	₦'000	₦'000	₦'000	₦'000

2023 A/Y						
Cost b/f	30,000	25,000	44,000	23,000	7,800	
Additions	-	-	-	16,000	-	
IA	(4,500)	(3,750)	(22,000)	(19,500)	(1,950)	51,700
AA	(2,550)	(2,125)	(5,500)	(4,875) ₺1	(1,170)	16,220
Investm. allowance	-	-	(4,400)	-	-	<u>4,400</u>
						<u>72,320</u>
2024 A/Y						
TWDV	22,950	19,125	16,500	14,625	4,680	
Additions					6,000	
IA	-	-	-	-	(1,500)	1,500
AA	(2,550)	(2,125)	(5,500)	(4,875) ₺2	(2,070) ₺3	<u>17,120</u>
						<u>18,620</u>
2025 A/Y						
TWDV	20,400	17,000	11,000	9,750	7,110	
AA	(2,550)	(2,125)	(5,500)	(4,875)	(2,070) ₺4	<u>17,120</u>
2026 A/Y						
TWDV	17,850	14,875	5,500	4,875	5,040	
AA						
Additions	1,100	-	28,000	-	-	
IA	(165)	-	(14,000)	-	-	14,165
AA	(2,643.5) ₺5	(2,125)	(8,999.99) ₺6	(4,874.97) ₺7	(2,070)	<u>20,713.46</u>
						<u>34,878.46</u>
TWDV c/f	16,141.5	12,750	10,500.01	0.03	2,970	

Capital allowances (working notes)

~~₺1~~: 2023 assessment year

Motor vehicle (annual allowance)

₺'000

Brought forward from pioneer period = $\frac{23,000 - 11,500}{4} = 2,875$

Addition = $\frac{(\del{₺}16,000 - 8,000)}{4} = 2,000$

4,875

~~₺2~~: 2024 assessment year

Motor vehicle (annual allowance)

Old 2,875

Addition of 2023 = $\frac{\del{₺}16,000 - 8,000}{4} = 2,000$

4,875

**N3: 2024 assessment year
Furniture and fittings (annual allowance)**

New: $\frac{\text{N}6,000 - 1,500}{5}$	900
Old:	<u>1,170</u>
	<u>2,070</u>

**N4: 2025 assessment year
Furniture and fittings (annual allowance)**

Old:	1,170
The one from 2024 assessment year = $\frac{\text{N}6,000 - 1,500}{5}$	<u>900</u>
	<u>2,070</u>

**N5: 2026 assessment year
Industrial building (annual allowance)**

Old:	2,550
New: $\frac{\text{N}1,100 - 165}{10}$	<u>93.5</u>
	<u>2,643.5</u>

**N6: 2026 assessment year
Industrial plant and equipment (annual allowance)**

Old: It has completed its tax useful life and N10 is to be retained in the books.

Therefore AA = N5,500,000 - N10 = N5,499,990

$$\text{New: } \frac{\text{N}28,000 - 14,000}{4} = \frac{3,500,000}{8,999,990}$$

That is, N8,999.99 thousand

**N7: 2026 assessment year
Motor vehicle (annual allowance)**

3 motor vehicles brought from the pioneer period are deemed to have completed their tax useful lives, hence N30 will be retained in the books.

It implies that:

$$\text{AA of vehicles brought from pioneer} = \text{N}4,875,000 - \text{N}30 = \text{N}4,874,970$$

That is N4,874.97 thousand

Examiner's report

The question is divided into two parts. The first part tests the candidates' understanding of the provisions of Companies Income Tax Act Cap C21 LFN (CITA) 2004 (as amended) in respect of computations of adjusted profit and income tax liabilities. The second part tests the candidates' knowledge of the provisions of the Industrial Development (Income Tax Relief) Act, 2004 (as amended) on factors that can lead to revocation of a pioneer certificate.

This being a compulsory question, all the candidates attempted the question. Candidates demonstrated a fair understanding of the question and performance was average.

The commonest pitfall was the inability of some candidates to identify correctly the allowable and disallowable expenses in the computations of adjusted profit and tax liabilities of a company.

Candidates are advised to familiarise themselves with issues concerning computations of companies income tax by reading extensively the Institute's Study Text, other relevant textbooks and the CITA 2004 (as amended) when preparing for future examinations.

Marking guide

	Marks	Marks
ai. Computation of adjusted profit		
Heading	½	
Introduction	½	
Appendix 1:		
Net profit as per accounts	½	
Improvement to industrial building	½	
Depreciation	½	
Acquisition of short lease	½	
Renewal of long lease	½	
Legal cost of tax appeal	½	
Preliminary expenses	½	
General provision for doubtful debts	½	
Feasibility study	½	
Stamp duties	½	
Donations- Oreyo Country Club	½	
Transfer to general reserves	½	
Income tax provisions	½	
Dividend received (net)	½	
Excess on valuation of building	½	
Adjusted profit	½	9

aii. **Computation of income tax liabilities**

Appendix 2

2022 assessment year:

Assessable profit	1/4
Companies income tax	1/4
Tertiary education tax	1/4

2023 assessment year:

Adjusted profit	1/4
Loss b/f	1/4
Loss relieved	1/4
Unrelieved loss that lapse	1/4
Capital allowance utilised	1/4
Total profit	1/4
Companies income tax	1/4
Tertiary education tax	1/4

2024 assessment year:

Adjusted profit	1/4
Total capital allowance available	1/4
Capital allowance utilised	1/4
Unutilised capital allowance c/f	1/4
Total profit	1/4
Companies income tax	1/4
Tertiary education tax	1/4

2025 assessment year:

Adjusted profit	1/4
Total capital allowance available	1/4
Capital allowance utilised	1/4
Unutilised capital allowance c/f	1/4
Total profit	1/4
Companies income tax	1/4
Tertiary education tax	1/4

2026 assessment year:

Total capital allowance available	1/4
Capital allowance utilised	1/4
Unutilised capital allowance c/f	1/4
Total profit	1/4
Companies income tax	1/4
Tertiary education tax	1/4

Workings:

W1: Determination of total adjusted profit/
loss made during the pioneer period:

Loss of ₦41,200,000	1/4
Loss of ₦37,500,000	1/4

Loss of ₹ 4,400,000	1/4
Total	1/4

W2: Capital allowances schedule:

2023 assessment year:

IA (Industrial building)	1/4
IA (Non-industrial building)	1/4
IA (Industrial plant and equipment)	1/4
IA (Motor vehicle)	1/4
IA (Furniture and fittings)	1/4
AA (Industrial building)	1/4
AA (Non-industrial building)	1/4
AA (Industrial plant and equipment)	1/4
AA (Motor vehicle)	1/4
AA (Furniture and fittings)	1/4
Inv. Allow. (Industrial plant and equipment)	1/4
Total capital allowance	1/4

2024 assessment year:

IA (Furniture and fittings)	1/4
AA (Industrial building)	1/4
AA (Non-industrial building)	1/4
AA (Industrial plant and equipment)	1/4
AA (Motor vehicle)	1/4
AA (Furniture and fittings)	1/4
Total capital allowance	1/4

2025 assessment year:

AA (Industrial building)	1/4
AA (Non-industrial building)	1/4
AA (Industrial plant and equipment)	1/4
AA (Motor vehicle)	1/4
AA (Furniture and fittings)	1/4
Total capital allowance	1/4

2026 assessment year:

IA (Industrial building)	1/4
IA (Industrial plant and equipment)	1/4
AA (Industrial building)	1/4
AA (Non-industrial building)	1/4
AA (Industrial plant and equipment)	1/4
AA (Motor vehicle)	1/4
AA (Furniture and fittings)	1/4
Total capital allowance	<u>1/4</u>

17

b. **Factors that can lead to revocation of pioneer certificate**

1 mark for each discussion of factors that can lead to revocation of pioneer certificate, subject to a maximum of 4 factors

Total

4

30

SOLUTION 2

a. **Roles of taxation in the achievement of sustainable development**

Taxation plays the under listed roles in the achievement of sustainable development of a nation:

- i. **Generating revenue:** Taxation provides the government with the necessary funds to invest in sustainable development projects, such as infrastructure, education, and healthcare;
- ii. **Redistributing wealth:** Taxation can help reduce income inequality by redistributing wealth from the rich to the poor through progressive taxation and social welfare programs;
- iii. **Influencing behaviour:** Taxation can influence behaviour by discouraging harmful activities, such as pollution, and encouraging sustainable practices, such as renewable energy production;
- iv. **Promoting economic growth:** Taxation can promote economic growth by providing incentives for investment, innovation, and entrepreneurship; and
- v. **Funding public goods and services:** Taxation helps fund public goods and services, such as healthcare, education, and infrastructure, which are essential for sustainable development.

b. **Key taxation strategies for sustainable development include:**

- i. **Green taxes:** Implementing taxes on activities that harm the environment, such as carbon emissions, to discourage their use;
- ii. **Tax incentives:** Offering tax incentives for investments in sustainable development projects, such as renewable energy or sustainable infrastructure;
- iii. **Progressive taxation:** Implementing progressive taxation to reduce income inequality and redistribute wealth; and
- iv. **Tax transparency:** Promoting tax transparency and accountability to prevent tax evasion and ensure that taxes are used for sustainable development.

c. Potential challenges and how these can be mitigated

Some of the potential tax challenges that impact sustainable development in Nigeria include:

- i. **Limited tax capacity:** Many African countries struggle to formulate tax capacities and mobilise domestic resources, hindering their ability to achieve sustainable development goals;
- ii. **Tax evasion and avoidance:** Weak tax administration and lack of transparency can lead to tax evasion and avoidance, depriving governments of much-needed revenue;
- iii. **Digital economy taxation:** The rise of the digital economy poses new tax challenges, including ensuring that digital businesses contribute fairly to the tax base;
- iv. **Informal economy:** A significant portion of Africa's economy operates in the informal sector, making it difficult to track and tax economic activity; and
- v. **Revenue mobilisation:** African countries need to improve revenue mobilisation to fund public goods and services essential for sustainable development.

Some of the ways of mitigating the challenges that may affect taxation in achieving sustainable development in Nigeria include:

- i. **Strengthening tax administration:** Improving tax administration and increasing transparency can help reduce tax evasion and avoidance;
- ii. **Investing in tax capacity:** Building tax capacity and mobilising domestic resources can help African countries fund public goods and services; and
- iii. **Promoting tax cooperation:** International cooperation and knowledge sharing can help African countries learn from best practices and address common tax challenges.

d. Notable supranational organisations and their roles in shaping tax policy
Supranational organisations include:

- i. Organisation for Economic Co-operation and Development (OECD);
- ii. United Nations (UN);
- iii. International Monetary Fund (IMF);
- iv. World Bank Group (WBG); and
- v. European Union (EU).

Their roles in shaping tax policy include:

- i. **OECD:** Develops guidelines and standards for tax policies, and implements initiatives like the Base Erosion and Profit Shifting (BEPS) project to prevent tax avoidance;
- ii. **United Nations (UN):** Provides a platform for countries to discuss and develop international tax policies, particularly for developing countries;
- iii. **International Monetary Fund (IMF):** Offers guidance on tax policy and administration, helping countries to strengthen their tax systems;
- iv. **World Bank Group (WBG):** Supports countries in building effective tax systems, providing technical assistance, and financing for tax-related projects; and
- v. **European Union (EU):** Develops and implements tax policies for its member States, including regulations on value-added tax (VAT) and corporate taxation.

Examiner's Report

The question is divided into four parts. The first part tests candidates' knowledge of the roles which taxation can play in the achievement of a country's sustainable development. The second part tests candidates' understanding of the the key taxation strategies that can be used to achieve sustainable development. The third part tests candidates' knowledge of the potential challenges that may affect taxation in achieving sustainable development in Nigeria and how these challenges can be mitigated. The last part tests candidates' understanding of supra-national organisations and their roles in shaping tax policy.

About 30% of the candidates attempted the question, and majority of them showed a poor understanding of its requirements, hence their performance was below average.

The commonest pitfall of the candidates was their inability to identify correctly the supra-national organisations and their roles in shaping tax policy.

Candidates are advised to study extensively the Institute's Study Text and other relevant textbooks, for future examinations.

Marking Guide

	Marks	Marks
<p>a. Roles of taxation in the achievement of a country's sustainable development</p> <p>1 mark for each role of taxation in the achievement of a country's sustainable development subject to a maximum of 4 points</p>		4
<p>b. Key taxation strategies that can be used to achieve sustainable development</p> <p>1 mark for each strategy of achieving sustainable development, subject to a maximum of 3 points</p>		3
<p>c. Potential challenges that may affect taxation in achieving Sustainability development and how these can be mitigated</p> <p>1 mark for each challenge of achieving sustainable development, subject to a maximum of 4 points</p>	4	
<p>1 mark for each method of mitigating the challenges, subject to a maximum of 3 points</p>	<u>3</u>	7
<p>d. Identification of supra-national organisations and their roles in shaping tax policy</p> <p>½ mark for identification of each supra-national organisations, subject to a maximum of 4 points</p>	2	
<p>1 mark for each discussion of roles of supra-national organisations, subject to a maximum of 4 points</p>	<u>4</u>	<u>6</u>
Total		<u>20</u>

SOLUTION 3

a. Computation of double taxation relief and tax payable

Ajoseh Nigeria Limited
Computation of double taxation relief and income tax payable
for 2025 assessment year

	N'000	N'000
Net profit as per accounts:		
Nigeria		206,200
Canada (\$118,300 x ₦1,100)		<u>130,130</u>
		336,330
Add back:		
Depreciation- Nigeria	25,300	
- Canada (\$14,200 x ₦1,100)	15,620	
Foreign exchange prov. ((\$1,750 x ₦1,100)	1,925	
Foreign tax paid (\$41,400 x ₦1,100)	<u>45,540</u>	<u>88,385</u>
Assessable/adjusted profit		424,715
Deduct:		
Capital allowances:		
Nigeria	18,520	
Canada	<u>10,490</u>	<u>29,010</u>
Total profit		<u>395,705</u>
Companies income tax @ 30% of ₦395,705,000		118,711.50
Less: Double taxation relief (15% of ₦182,725,000)		<u>27,408.75</u>
Final income tax payable		91,302.75
Tertiary education tax @ 3% of ₦424,715,000		<u>12,741.45</u>
Total tax liabilities		<u>104,044.20</u>

Computation of total profit for Canadian business

	N'000	N'000
Net profit as per accounts		130,130
Add back:		
Depreciation	15,620	
Foreign exchange provision	1,925	
Foreign tax paid (\$41,400 x ₦1,100)	<u>45,540</u>	63,085
Assessable/adjusted profit		193,215
Less: Capital allowance		<u>10,490</u>
Total profit		<u>182,725</u>

$$\text{Commonwealth rate of tax} = \frac{\text{₦}45,540,000}{\text{₦}182,725,000} \times 100 = \underline{\underline{24.92\%}}$$

Nigerian income tax rate = **30%**

$$\frac{1}{2} \text{ of Nigerian income tax rate} = 30\% / 2 = \underline{\underline{15\%}}$$

Since Commonwealth rate of tax is greater than $\frac{1}{2}$ of Nigerian income tax rate, double taxation relief shall be $\frac{1}{2}$ of Nigerian income tax rate (15%).

Hence, double taxation relief = 15% of ₦182,725,000 = **₦27,408,750.**

b. Relevant information that should be considered in respect of Commonwealth income tax relief as provided for in Section 44 of CITA 2004 (as amended)

Section 44 of CITA provides that, if any Nigerian company which has paid, by deduction or otherwise, or is liable to pay, tax under this Act for any year of assessment on any part of its profits as Commonwealth income tax, it shall be entitled to relief from tax paid as follows:

- (i) if the Commonwealth rate does not exceed one half of the rate of tax under this Act, the rate at which relief is to be given shall be the Commonwealth rate; and
- (ii) in any other case the rate at which relief is to be given shall be half the rate of tax under this Act.

However, in case of any company, other than a Nigerian company, which has paid the Commonwealth tax, it shall be entitled to relief from tax paid as follows:

- (i) if the Commonwealth rate does not exceed the rate of tax under this Act, the rate at which relief is to be given shall be one half of the Commonwealth rate; and
- (ii) if the Commonwealth rate exceeds the rate of tax under this Act, the rate at which relief is to be given shall be equal to the amount by which the rate of tax under this Act exceeds one half of the Commonwealth rate of tax.

c. Roles of Vienna Convention in the application and interpretation of international tax treaties

The Vienna Convention plays the following roles in the application and interpretation of tax treaties:

- i. it codifies the rules of treaty interpretation, including tax treaties with its objective to bind the judiciary through a set of rules, it generated a uniform approach to treaty interpretation;

- ii. it establishes comprehensive, operational guidelines, rules, and procedures for how treaties are drafted, defined, amended, and interpreted;
- iii. it establishes that every treaty in force is binding upon the parties to it and must be performed by them in good faith such that a party may not invoke the provisions of its internal law as justification for its failure to perform a treaty;
- iv. it provides a framework for interpreting and applying tax treaties, promoting consistency and predictability in international taxation; and
- v. it follows the Vienna Convention on the Law of Treaties (VCLT's) principles in ensuring that tax treaties are applied fairly and in accordance with their intended purpose.

Examiner's report

The question is divided into three parts. The first part tests candidates' knowledge of computations of double taxation relief and tax payable by the company. The second part tests candidates' understanding of the relevant information to be considered in respect of Commonwealth income tax relief in line with the provisions of Companies Income Tax Act Cap C21 LFN (CITA) 2004 (as amended). The third part tests candidates' knowledge of the roles of Vienna Convention in the application and interpretation of international tax treaties.

About 70% of the candidates attempted the question. Candidates showed a poor understanding of the requirements of the question and their performance was below average.

The commonest pitfall was the inability of some candidates to explain correctly the roles of Vienna Convention in the application and interpretation of international tax treaties.

Candidates are advised to read the Institute's Study Text and other relevant textbooks, as this would go a long way in assisting them to pass future examinations.

Marking Guide

	Marks	Marks
a. Computation of double taxation relief and tax payable		
Net profit (Nigeria)	$\frac{1}{2}$	
Net profit (Canada)	$\frac{1}{2}$	
Depreciation (Nigeria)	$\frac{1}{2}$	

Depreciation (Canada)	$\frac{1}{2}$	
Foreign exchange provision	$\frac{1}{2}$	
Foreign tax paid	$\frac{1}{2}$	
Assessable/adjusted profit	$\frac{1}{2}$	
Capital allowances (Nigeria)	$\frac{1}{2}$	
Capital allowances (Canada)	$\frac{1}{2}$	
Total profit	$\frac{1}{2}$	
Companies income tax	$\frac{1}{2}$	
Less: Double taxation relief	1	
Final income tax payable	1	
Tertiary education tax	$\frac{1}{2}$	
Total tax liabilities	$\frac{1}{2}$	
Adjusted profit for Canadian business:		
Net profit as per accounts	$\frac{1}{2}$	
Depreciation	$\frac{1}{2}$	
Foreign exchange provision	$\frac{1}{2}$	
Foreign tax paid	$\frac{1}{2}$	
Assessable/adjusted profit	$\frac{1}{2}$	
Total profit	$\frac{1}{2}$	
Commonwealth rate of tax	$\frac{1}{2}$	
$\frac{1}{2}$ Nigerian rate of tax	$\frac{1}{2}$	
Relief = $\frac{1}{2}$ Nigerian rate of tax (15%)	<u>$\frac{1}{2}$</u>	13
b. Relevant information to be considered in respect of Commonwealth income tax relief in line with section 44 of CITA		
1 mark per point, subject to a maximum of 4 points		4
c. Roles of Vienna Convention in the application and interpretation of international tax treaties		
1 mark per point, subject to a maximum of 3 points		3
Total		<u>20</u>

SOLUTION 4

(a)

OPOBO PETROLEUM PRODUCING COMPANY LIMITED

INTERNAL MEMO

Date:

From: Tax Manager

To: Managing Director

RE: HYDROCARBON TAX PAYABLE FOR 2024 ASSESSMENT YEAR

I refer to your request on computation of hydrocarbon tax for the 2024 assessment year.

As shown in appendix 1, the hydrocarbon tax payable by the company for the 2024 assessment year is **₦330,335.4 million**.

Thank you.

Ayo Dele

Appendix 1: Computation of hydrocarbon tax for 2024 assessment year

	₦'million	₦'million
Revenue		
Crude oil sold:		
Bonny light (10.8m barrels x \$75 x ₦1,530)		1,239,300
Focardos medium (7.5m barrels x \$66 x ₦1,530)		757,350
Condensates from associated gas sold:		
OSO condensate (3m MMBTu x \$33 x ₦1,530)		151,470
Escravos condensate (2.3m MMBTu x \$30 x ₦1,530)		105,570
Natural gas liquid from associated gas:		
Penington (2.5m MMBTu x \$34 x ₦1,530)		<u>130,050</u>
Gross revenue		2,383,740
Less: allowable deductions (Section 263 of PIA)		
Royalty costpaid	357,500	
Production cost	834,800	

Drilling costs (2/3 x ₦48,900 m)	32,600	
Terminalling cost	1,200	
Repairs of plant, machinery and fixtures	1,020	
Repairs of alteration of production implement utensils	440	
Environmental remediation fund	1,750	
NDDC charge	300	
Stamp duty	150	
Host community costs	42,600	
Cost of gas reinjection wells	1,800	
Concession rentals	2,200	
Others expenses:		
Acquisition of geophysical and geological data and information expenses	310	
State government ground rent	<u>300</u>	
	1,276,970	
Excess cost not utilised (unclaimed allowable deduction b/f)	<u>170</u>	
Total allowable deductions	<u>1,277,140</u>	
Total costs subject to CPR (workings 1)	<u>1,279,107</u>	
Total costs restricted to actual allowable deductions		<u>(1,277,140)</u>
Excess allowable cost c/f	<u>Nil</u>	
Adjusted profit		1,106,600
Less: loss relief		<u>1,215</u>
Assessable profit		1,105,385
Less: Section 266 and 6 th Schedule deductions:		
Capital allowance for the year (workings 2)	1,487	
Unutilised capital allowance b/f	<u>480</u>	<u>1,967</u>
		1,103,418
Less: Production allowance		
Onshore operation	1,200	
Shallow water operation	<u>1,100</u>	<u>2,300</u>
Chargeable profit		<u>1,101,118</u>
Hydrocarbon tax @ 30% of ₦1,101,118m		<u>330,335.4</u>

Workings

	₦'million	₦'million
1. Cost-price-ratio (CPR) limit		
A. Gross revenue		<u>2,383,740</u>
(i) Maximum allowable @ 65% of Gross revenue of ₦2,383,740m		<u>1,549,431</u>
Total operating cost		1,277,140
Capital allowances for the year		1,487
Unutilised capital allowances b/f		<u>480</u>
B. Total eligible costs		1,279,107
Less: Exempted cost incurred [Section 263(1)]:		
Royalties paid	357,500	
Environmental remediation fund	1,750	
NDDC charge	300	
Host community fund	42,600	
Concession rentals	<u>2,200</u>	
C1: Total exempted cost	<u>(404,350)</u>	
(ii) Net total costs to be subject to CPR (B- C1)	874,757	
C2: Maximum allowable cost is the lower of (i) and (ii), which is ₦874,757 million.		
D. Total allowable cost (in line with the practice of FIRS)		
= C1 + C2 (that is, exempted cost + CPR restricted cost)		
= ₦404,350 million + ₦874,757 million		
= <u>₦1,279,107 million</u>		

Note: The total allowable cost will be restricted to actual cost incurred of ₦1,277,140 million.

1. Capital allowances

Year	Type of QCE	Cost	Rate	Capital allowance
		₦'million	%	₦'million
2019	Pipeline	1,800	-	Nil
2020	Drilling	1,900	19	361
2021	Building	1,700	20	340
2022	Plant	980	20	196
2023	Pipeline	1,200	20	240
2024	Drilling	1,750	20	<u>350</u>
	Total			<u>1,487</u>

Examiner's report

The question tests candidates' knowledge of computations of hydrocarbon tax of a company that operates in both onshore and shallow water areas in line with the provisions of Petroleum Industry Act, 2021.

About 80% of the candidates attempted the question, and majority of them showed a good understanding of its requirements, hence their performance was above average.

The commonest pitfall of some candidates was their inability to identify correctly the allowable expenses required for computations of total operating cost.

Candidates are advised to study extensively the relevant sections of the Petroleum Industry Act, 2021 when preparing for future examinations.

Marking guide

	Marks
Computation of hydrocarbon tax	
Crude oil sold:	
Bonny light	½
Forcados	½
Condensate sold:	
OSO	½
Escravos	½
Natural gas sold:	
Penington	½
Allowable deductions:	
Royalty paid	½
Production cost	½
Drilling cost	½
Terminating cost	½
Repairs of plant, machinery, and fixtures	½

Repairs of alteration of production implement utensils	1/2
Environmental remediation fund	1/2
NDDC charge	1/2
Stamp duty	1/2
Host community costs	1/2
Cost of gas reinjection wells	1/2
Concession rentals	1/2
Acquisition of geophysical and geological data and info	1/2
State government ground rent	1/2
Unclaimed allowable deduction	1/2
Total allowable deductions	1/2
Excess allowable cost c/f	1/2
Adjusted profit	1/2
Loss relief	1/2
Assessable profit	1/2
Capital allowances for the year	1/2
Unutilised capital allowances b/f	1/2
Production allowance- onshore operation	1/2
Production allowance- shallow water operation	1/2
Chargable profit	1/2
Hydrocarbon tax	1/2
Workings 1: CPR limit	
Maximum allowable @ 65% of gross income	1/4
Capital allowance for the year	1/4
Unutilised capital allowance b/f	1/4
Total eligible costs	1/4
Royalty	1/4
Environmental remediation fund	1/4
NDDC charge	1/4
Host community costs	1/4
Concession rentals	1/4
Maximum allowable cost	1/4
Total allowable cost in line with FIRS	1/4
Workings 2- Capital allowances	
2019	1/4
2020	1/4
2021	1/4
2022	1/4
2023	1/4
2024	1/4
Total (N1,487m)	1/4
Total	<u>20</u>

SOLUTION 5

a.

CRD Hotels Limited
Computation of capital gains tax
for 2023 assessment year

	₦
Sales proceeds	19,200,000
Deduct:	
Cost of acquisition	<u>20,000,000</u>
Chargeable or Capital loss	<u>(800,000)</u>

CRD Hotels Limited
Computation of capital gains tax
for 2025 assessment year

	₦	₦
Sales proceeds		15,100,000
Deduct:		
Cost of acquisition	12,200,000	
Auctioneer's commission (1.5% of sales)	226,500	
Advertisement	130,000	
Incidental expenses- Painting	<u>100,000</u>	<u>12,656,500</u>
Chargeable gains		2,443,500
Less: Capital loss b/f (see note below)		<u>Nil</u>
Net chargeable gains		<u>2,443,500</u>
Capital gains tax @ 10% of ₦2,443,500		<u>244,350</u>

Note: The Finance Act, 2023 provides that chargeable loss can be carried forward against chargeable gains arising from disposal of another asset of same class. The effective date of the Act was September 2023.

However, the chargeable loss of ₦800,000 was made in May 2023 (before the commencement of the Act), hence the loss cannot be carried forward.

c. **The provisions of the relevant Finance Acts as they affect:**

i. **Assets sold or transferred between connected parties**

- Section 49 of the Finance Act 2019 substituted section 32 e Capital Gains Tax Act, 2004 by providing that assets sold or transferred during business re-organisation by parties that are considered to be related for a period of at least 365 days prior to the date of re-organisation, shall be tax exempted.

- The above concession, however has a proviso. The Act provides that such assets are not sold by the acquiring company within 365 days after the business re-organisation. It implies that if the assets are sold within 365 days of the acquisition, then the company will be liable to pay the appropriate capital gains tax.

ii. **Compensation received for loss of office**

Section 4 of the Finance Act, 2020 amended section 36(2) of the Principal Act. It states that:

- Sums obtained by way of compensation for loss of office, up to a maximum of ₦10 million, shall not be chargeable gains and subject to capital gains tax; and
- Provided that any sum in excess of ₦10 million shall not be so exempt but the excess amount shall be chargeable gains and subject to capital gains tax accordingly. The tax is expected to be paid to the relevant tax authority in accordance with Personal Income Tax Act.

iii. **Due date for filing capital gains tax returns and the penalty for not filing the returns**

- The due date for filing of capital gains tax returns, as provided for in section 2 of the Finance Act 2020, shall not be later than 30 June and 31 December of the year the chargeable assets were disposed.
- Where no returns have been filed and the tax authority discovers that a capital gains tax transaction has taken place, the tax authority will assess the defaulting taxpayer on best of judgment assessment.
- The tax is expected to be paid within 60 days of the notice of assessment, failing which a penalty of 10% and interest at the ruling minimum rediscount rate shall apply.

Examiner's report

The question is divided into two parts. The first part tests candidates' knowledge of computations of capital gains tax. The second part tests candidates' knowledge of the relevant provisions of the Finance Acts in respect of assets sold or transferred between connected parties; compensation received for loss of office; and due date for filing of capital gains tax returns and penalty for not filing the returns.

About 80% of the candidates attempted the question and they exhibited a fair understanding of its requirements. The performance was satisfactory.

The commonest pitfall was the inability of some candidates to explain correctly the provisions of the Finance Act in respect of assets sold or transferred between connected parties .

Candidates are advised to read widely the relevant tax law, the Institute’s Study Text, and other relevant textbooks, when preparing for future examinations.

Marking Guide

	Marks	Marks
a. Computation of capital gains tax payable		
2023 assessment year		
Heading	½	
Sales proceeds	½	
Cost of acquisition	½	
Chargeable loss	1	
2025 assessment year		
Heading	½	
Sales proceeds	½	
Cost of acquisition	½	
Auctioneer commission	½	
Advertisement	½	
Incidental expenses-painting	½	
Chargeable gains	1	
Capital gains tax	1	
Working note	<u>½</u>	8
b. Provisions of the relevant Finance Acts as they affect the Capital Gains Tax Act on:		
i. Assets sold or transferred between connected parties		
1 mark per correct answer, subject to a maximum of 2 points		2
ii. Compensation received for loss of office		
1 mark per correct answer, subject to a maximum of 2 points		2
iii. Due date for filing capital gains tax returns and the penalty for not filing		
1 mark per correct answer, subject to a maximum of 3 points		<u>3</u>
Total		<u>15</u>

SOLUTION 6

a. Benefits and challenges of sustainable practices for companies in the extractive industry in Nigeria

The benefits of sustainable practices for companies include:

- i. Enhanced reputation:** Companies that prioritise sustainability often enjoy a positive public image, attracting customers and investors who value environmental and social responsibility;
- ii. Cost savings:** Sustainable practices can lead to reduced operational costs through energy efficiency, waste reduction, and resource conservation;
- iii. Increased innovation:** Embracing sustainability can drive innovation, leading to the development of new products, services, and business models;
- iv. Risk management:** Companies that proactively address environmental and social issues can mitigate risks related to regulatory compliance, supply chain disruptions, and reputational damage;
- v. Access to capital:** Investors are increasingly considering Environmental, Social, and Governance (ESG) factors in their decisions, making it easier for sustainable companies to access funding; and
- vi. Talent attraction and retention:** Employees are more likely to be attracted to and remain with companies that demonstrate a commitment to sustainability, fostering a motivated and engaged workforce.

The challenges of sustainable practices for companies include:

- i. High initial costs:** Implementing sustainable practices often requires significant upfront investment in technology, infrastructure, and training;
- ii. Complexity of supply chains:** Ensuring sustainability across complex global supply chains can be challenging, particularly in industries with multiple tiers of suppliers;
- iii. Regulatory compliance:** Navigating varying regulations and standards across different regions can be complex and resource-intensive;
- iv. Stakeholder alignment:** Achieving alignment among diverse stakeholders, including investors, customers, employees, and regulators, can be difficult;
- v. Measuring impact:** Accurately measuring and reporting on sustainability initiatives can be complex, requiring robust data collection and analysis systems; and

- vi. **Balancing short-term and long-term goals:** Companies may face pressure to balance short-term financial performance with long-term sustainability objectives.

b. **Objectives and forms of ADR mechanism in the Nigerian tax system**

In Nigeria's tax system, Alternative dispute resolution (ADR) mechanisms are available to resolve tax disputes efficiently and effectively.

The objectives of ADR mechanisms are to:

- i. reduce the burden on the courts;
- ii. provide a faster and more cost-effective way to resolve tax disputes;
- iii. improve taxpayer satisfaction and compliance; and
- iv. enhance the overall efficiency of the tax system.

The ADR mechanisms include:

- i. **The Tax Appeal Tribunal (TAT):** An independent tribunal that hears appeals against tax assessments;
- ii. **Mediation:** A process where a neutral third-party facilitates negotiations between the taxpayer and the tax authority to resolve the dispute.
- iii. **Arbitration:** A process where a neutral third-party makes a binding decision on the dispute.
- iv. **Negotiation:** Direct negotiations between the taxpayer and the tax authority to resolve the dispute; and
- v. **Fast track settlement:** A mechanism that allows taxpayers to settle tax disputes quickly, usually within 30 days.

Examiner's report

The question is divided into two parts. The first part tests candidates' understanding of the benefits and challenges of sustainable practices for companies in the extractive industry in Nigeria. The second part tests candidates' knowledge of the objectives and forms of alternate dispute resolution (ADR) mechanism in the Nigerian tax system.

About 50% of the candidates attempted the question. Candidates showed a poor understanding of the requirements of the question and their performance was below average.

The commonest pitfall was the inability of some candidates to explain correctly the benefits and challenges of sustainable practices for companies in the extractive industry in Nigeria.

Candidates are advised to read the Institute’s Study Text and other relevant textbooks, as this would go a long way in assisting them to pass future examinations.

Marking Guide

	Marks	Marks
a. Benefits and challenges of sustainable Practices for companies in the extractive industry		
1 mark for each benefit of sustainable practices, subject to a maximum of 4 points	4	
1 mark for each challenge of sustainable practices, subject to a maximum of 4 points	<u>4</u>	8
b. The objectives and forms of ADR mechanism in the Nigerian tax system		
1 mark for each objective of ADR, subject to a maximum of 3 points	3	
1 mark for each form of ADR, subject to a maximum of 4 points	<u>4</u>	<u>7</u>
Total		<u>15</u>

SOLUTION 7

a. Legal requirement for professional accountant in practice

In line with the professional code of conduct issued by the Institute of Chartered Accountants of Nigeria, a Chartered Accountant in public practice should not engage in any business, occupation or activity that impairs or might impair integrity, objectivity or the good reputation of the profession and as a result would be incompatible with the rendering of professional services.

b. **The Risks and benefits of running a professional tax practice**

Risks of running a professional tax practice include:

- i. **Lack of expertise:** This may lead to errors due to practitioners advising clients on technical tax matters when they didn't have adequate experience or knowledge. Examples include giving wrong professional opinion on tax matters, advise of tax implications of business arrangement and re-organisation or restructuring, etc.
- ii. **Lack of attention to detail:** This may lead to errors that could have been avoided if there had been procedures and controls in place. This include late filing of tax returns whose penalties is huge for clients.
- iii. **Lack of documentation**
Failing to maintain evidence of client engagement terms or tax filing positions in working paper files. This include failure to detect the client's non-compliance with certain tax laws when it was unclear whether the compliance to such tax laws was part of the tax practitioner's mandate (engagement letters are a key tool for reducing this sort of risk).
- iv. **Unpredictable income for owners**
Owner's income can be unpredictable – Owners are responsible for the financial well-being of their employees and the last one to get paid is the owners. While others can mentally “check out” at the end of the workday, owner's brain is typically plugged into business.

Benefits of running a professional tax practice include:

- i. **Own schedule and rules:** One of the biggest advantages of practice ownership is the ability to make your own schedule working whenever, wherever. Owning your own firm means you are better able to balance work, family and play. To accomplish this, you need to have good procedures in place for your staff, your clients, and, yes, even for yourself.
- ii. **Financial benefits:** While your income can be unpredictable, that's not necessarily a bad thing if you are profitable. As a practice owner, you get to decide what you never would have been able to decide as an employee: how much of the funds to retain in the firm and how much to bonus out. This means more money in your pocket.
- iii. **You pick your own team:** Your success as a practice owner is immensely dependent on your team. As an employee sometimes you can get stuck working with people that are not productive or simply not very nice. With ownership comes the benefit of choosing people that will fit the firm culture and will help it prosper. This is also very important to make possible all of

the above listed benefits. As an owner of your own practice, you get to choose who to hire and what type of environment you want to have at work.

- iv. **Opportunity to pick own clients:** Although many practice owners don't take advantage of this benefit, they really should because they are not limited to just picking specific industries. It is also very important that your clients fit your culture, i.e., if you are a technology driven firm, you don't have to accept clients who loathe technology and handle everything through paper copies. When creating a desired culture, it is advantageous to accept only clients who fit that culture. Detouring from that creates inefficiencies and disadvantages for you, your team and the clients.
- v. **You create your own vision:** As a practice owner, you are also the vision owner. The key to the success of the practice goes back to setting rules, picking the right team, and the right clients. These things are not necessarily easy to achieve, but for a practice owner, unlike for an employee, they are very much possible.

c. **Risk mitigation strategies in tax practice**

Tax practitioners in Nigeria face various risks, including compliance risks, reputational risks, and operational risks. Here are some risk mitigation strategies:

- i. regularly review and update knowledge of Nigerian tax laws, regulations, and guidelines to ensure compliance;
- ii. identify potential tax risks and assess their likelihood and impact on clients or the organisation;
- iii. establish and maintain effective compliance procedures, including record-keeping, reporting, and documentation;
- iv. ensure accurate and complete records of tax-related documents, including returns, payments, and correspondence;
- v. provide regular training and education to staff and clients on tax laws, regulations, and best practices;
- vi. monitor and address interactions with tax authorities, including audits, inspections, and disputes;
- vii. develop and implement tax risk management policies and procedures to guide decision-making and ensure consistency;
- viii. engage with tax professionals and experts to seek guidance and advice on complex tax issues;

- ix. utilise technology and automation to streamline tax processes, improve accuracy, and reduce errors;
- x. regularly review and update tax strategies to ensure they remain effective and compliant with changing tax laws and regulations;
- xi. only take on work within your circle of competence;
- xii. tax practitioners can avoid many of these risks by only accepting work for which they have either adequate experience or the ability to outsource the work to qualified tax specialists;
- xiii. implement quality control systems in professional tax practice;
- xiv. quality control systems can not only help you avoid common pitfalls and manage risk, but they can also help you improve your practice effectiveness;
- xv. use checklists to create general tax preparation and renew checklists for all staff;
- xvi. implementation of a task and deadline tracking system that can help tax practitioner monitor client and meet their due dates;
- xvii. follow client acceptance practices before taken on new clients, as this will enable the practice to determine their (clients) past filing history and any issues encountered with the relevant tax authorities and their past tax advisors;
- xviii. invest in staff education and training so as to cope with the Nigerian tax system, which is becoming complex and constantly changing;
- xix. document all material advice, like client records of filing, positions taken, as well as client correspondence confirming the relevant facts in writing;
- xx. obtain professional valuations when related parties transact with each other in significant transactions, so as to avoid any material risks associated with an unreasonable valuation; and
- xxi. consider professional indemnity insurance to protect against potential claims and liabilities.

Examiner's Report

The question is divided into three parts. The first part tests candidates' knowledge of the legal requirements for a professional accountant in practice. The second part tests candidates' understanding of the risks and benefits of running a professional tax practice. The third part tests candidates' knowledge of the risk mitigation strategies in professional tax practice.

About 60% of the candidates attempted the question and they showed a fair understanding of it, resulting in an average performance.

The commonest pitfall was some candidates' inability to explain correctly the legal requirements for a professional accountant in practice.

Candidates are advised to read the Institute's Study Text and other relevant textbooks when preparing for future examinations.

Marking Guide

	Marks	Marks
a. Legal requirements for a professional accountant in tax practice 2 marks for discussion of legal requirement for a professional accountant in tax practice		2
b. The risks and benefits of running a professional tax practice 1 mark for each discussion of risks of running a professional practice, subject to a maximum of 3 points	3	
1 mark for each discussion of benefits of running a professional practice, subject to a maximum of 3 points	<u>3</u>	6
c. Risk mitigation strategies 1 mark for each discussion of risk mitigation strategies, subject to a maximum of 7 points		<u>7</u>
Total		<u>15</u>

INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

PROFESSIONAL LEVEL EXAMINATION – MAY 2026

STRATEGIC FINANCIAL MANAGEMENT

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

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

SECTION A: COMPULSORY QUESTION (30 MARKS)

QUESTION 1

You should assume that the current date is 30 June, 2025.

Tolade Plc (Tola) is a large clothing retailer. Over the past five years it has built up an internet based division, Kent, which specialises in selling to 16-24 years old female customers.

At a recent board meeting the Chief Executive Officer (CEO) of Tola stated that: “Kent has been successful, but we have not been able to get the value out of it that we initially expected and the management time involved in running Kent is damaging the financial performance of the group as a whole. Because internet-based companies have very high values compared to non-internet companies with similar earnings, I feel that there could be more value in Kent if it operated outside of our group. I think that we should divest ourselves of Kent and appoint a financial advisor to assist us in the process. I wonder whether an Initial Public Offering (IPO), where the shares are brought to the stock market for the first time, is a possibility.”

The board agreed with the CEO and voted in favour of the divestment of Kent. Accountants (AA), a firm of Chartered Accountants, has been appointed to give advice to Tola regarding the value of Kent and the potential IPO. In their valuation AA would like to use net present value analysis and also a multiple of earnings. In addition to general corporate finance work, AA also has a team that specialises in giving investment advice to clients who buy shares in IPOs.

Extracts from Kent’s most recent management accounts are shown below:

Statement of financial position (value of net assets) at 30 June 2025: ₦7,800 million.

Income Statement for the year ended 30 June 2025

	₦m
Sales	28,000
Cost of sales	(11,200)
Gross profit	16,800
Selling and administration costs	(14,400)
Operating profit	2,400

Taxation 20%	<u>(480)</u>
Profit after tax	<u>1,920</u>

Note: Selling and administration costs include depreciation of ₦400 million.

Additional information relating to Kent

- An analyst has estimated that, for the four years to 30 June 2029, the volume of sales will grow by 18% pa and selling prices will increase by 2% pa. Because of volume discounts, the gross profit percentage will increase to 66%.
- Selling and administration costs, excluding depreciation, are estimated to increase by 5% pa for the four years to 30 June, 2029.
- Kent will require an additional investment in working capital on 1 July, 2025 of ₦5,200 million. This will increase at the start of each subsequent year in line with sales volume growth and selling price increases. Working capital will be fully recoverable on 30 June, 2029.
- On 30 June, 2025, Kent will need to invest in a new warehouse management system that will cost ₦2,000 million and will not have any scrap value on 30 June, 2029. The warehouse management system will attract 25% (reducing balance) capital allowances in the year of expenditure and in every subsequent year of ownership by the company, except the final year.
- AA intends to include in the net present value analysis a continuing value at the end of four years that will represent the value of the cash flows after tax beyond the fourth year. This will be calculated by treating the after-tax operating cash flows for the year ended 30 June, 2029, as a growing perpetuity with a growth rate of 1% pa.
- An appropriate money discount rate to reflect the risk of Kent is 10% pa.
- AA would like to assume that the rate of corporate tax will be 20% for the foreseeable future and that tax flows arise in the same year as the cash flows that gave rise to them.
- The average price earnings (P/E) ratio of companies similar to Kent is 55.
- Unless otherwise stated assume that all cash flows arise at the end of the year to which they relate.

Required:

- Using money cash flows, calculate the value of Kent on 30 June 2025 using net present value analysis. (16 Marks)
- Calculate the value of Kent on 30 June 2025 using a multiple of current earnings. (1 Mark)

- c. Summarise the advantages and disadvantages of the two valuation methods used in parts (a) and (b) and identify any concerns you have in respect of using them to value Kent. (4 Marks)
- d. In relation to the potential IPO, explain the difference between an offer for sale and an offer for subscription (also known as a direct offer). (2 Marks)
- e. Outline the advantages and disadvantages of underwriting and advise the board of directors of Tola as to whether the potential IPO should be underwritten. (3 Marks)
- f. Identify any ethical issues that AA may have in relation to the potential Kent IPO and state how they might be resolved. (4 Marks)

(Total 30 Marks)

Note: All calculations to the nearest ₦1million

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

QUESTION 2

- a. The following table is a variance/covariance matrix for Assets A & B and for the market:

	A	B	Market
A	0.150	0.030	0.070
B	X	0.095	0.045
Market	K	Z	0.060

The required return of the market is 20% and the risk free interest rate is 4%. Consider an investor who wants to build a portfolio out of the above two assets with an initial allocation ratio of 60%:40% (60% in A and 40% in B).

Required:

- (i) From the given table, determine the values of X, K and Z. (3 Marks)
 - (ii) Calculate the beta of the assets relative to the market respectively. (2 Marks)
 - (iii) Calculate the beta of the proposed portfolio. (2 Marks)
 - (iv) Calculate the variance of the portfolio. (2 Marks)
 - (v) Calculate the required returns on Assets A and Asset B. Also what should be the required returns of the proposed portfolio based on CAPM theory? (4 Marks)
- b. Identify and discuss the main factors that determine the asset beta of a company. (7 Marks)

(Total 20 Marks)

QUESTION 3

Nabira Industries Plc, a Nigerian construction firm, has secured a contract to supply prefabricated units to a client in Westoria, a fictional country whose currency is the W\$. Payment of W\$50,000,000 will be required in six months' time.

The following market data are available:

- Spot exchange rate: ₦1 = W\$3.10
- Six-month forward rate: ₦1 = W\$3.00
- Six-month Nigerian deposit rate: 12% pa (simple pro-rata)
- Six-month Westorian deposit rate: Unknown

Nabira's treasury department is considering the following three strategies:

- (1) **Forward cover:** Enter into a forward contract today to buy W\$ at the six-month forward rate.
- (2) **Money market hedge:** Convert Naira into W\$ today and invest in Westoria at the prevailing interest rate (to be determined).
- (3) **Speculative position:** Ignore hedging, assume the expected spot rate in six months will be ₦1 = W\$3.05, and arrange to buy W\$ in the market then.

Required:

- a. Derive the Westorian six-month deposit rate that must prevail for covered interest parity (CIP) to hold. Show all workings. (5 Marks)
- b. Calculate the Naira cost today of settlement under each of the three strategies, assuming parity holds, and identify which strategy (if any) appears superior. (6 Marks)
- c. Discuss at least two risks Nabira Industries Plc faces if it pursues the speculative position rather than hedging. (4 Marks)
- d. Critically evaluate the ethical and fiduciary responsibilities of the CFO when deciding whether to hedge, particularly considering the interests of shareholders and other stakeholders. (5 Marks)

(Total 20 Marks)

QUESTION 4

SunSteel Nigeria Plc is a long-established company engaged in the manufacture and distribution of building and roofing materials. The company is listed on the Nigerian Exchange Group (NGX) and has developed a reputation for reliable dividend payments and prudent financial management.

SunSteel owns extensive tangible fixed assets, including modern production plant in Ogun and Delta States and a nationwide network of warehouses and distribution vehicles. These assets have been fully insured and are largely unencumbered.

The company currently has the following capital structure:

Source of capital	Amount (₦ billion)	Cost (%)
Ordinary shares	8.0	—
Retained earnings	2.0	—
10% Debentures (secured)	5.0	10

This structure has remained unchanged for five years, resulting in a debt-to-equity ratio of approximately 45%.

The finance director believes SunSteel could take on additional borrowing to fund future expansion, arguing that the company's gearing is "comfortable." However, the board wishes to review the factors that should be considered in determining an appropriate capital structure before making any policy changes.

Required:

As the company's financial adviser, discuss the main practical factors that should be taken into account when determining or reviewing the company's capital structure, using Sun Steel Nigeria Plc as an example. **(20 Marks)**

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

QUESTION 5

- a. Olowo Plc is financed entirely by equity and its current equilibrium market value is ₦65 million with a cost of capital of 20% per annum.

The company proposed to repurchase ₦10 million of equity and to replace it with 12% irredeemable bond.

Olowo's profit before interest and tax is expected to be constant for the foreseeable future. Income tax rate is 25%. The company has a payout ratio of 100%.

Required:

Using the assumptions of Modigliani and Miller, explain and demonstrate how this change in capital structure will affect:

- (i) the market value;
- (ii) the cost of equity; and
- (iii) the cost of capital of Olowo Plc

(7 Marks)

- b. Explain any weaknesses of both the traditional and Modigliani and Miller theories and discuss how useful they might be in the determination of the appropriate capital structure for a company. (8 Marks)

(Total 15 Marks)

QUESTION 6

- a. You are the Finance Director of a multinational corporation. In the context of mergers and acquisitions (M & A), identify and discuss key ethical dilemmas that may arise and explain how each can be effectively mitigated. (7½ Marks)
- b. Critically discuss the factors that determine a company's capital structure in practice. (7½ Marks)

(Total 15 Marks)

QUESTION 7

- a. The directors of Bola Packaging Ltd (BPL), a well-established manufacturer of cardboard boxes, are currently considering whether to enter the cardboard tube market. Cardboard tubes are purchased by customers whose products are wound around tubes of various sizes ranging from large tubes on which carpets are wound, to small tubes around which films and paper products are wound. The cardboard tubes are usually purchased in very large quantities by customers. On average, the cardboard tubes comprise between 1% and 2% of the total cost of the customers finished product.

The directors have gathered the following information:

- (i) The cardboard tubes are manufactured on machines which vary in size and speed. The lowest cost machine is priced at ₦750,000 and requires only one operator for its operation. A one-day training course is required in order that an unskilled person can then operate such a machine in an efficient and effective manner;
- (ii) The cardboard tubes are made from specially formulated paper which, at times during recent years, has been in short supply;
- (iii) At present, four major manufacturers of cardboard tubes have an aggregate market share of 80%. The current market leader has a 26% market share. The market shares of the other three major manufacturers, one of which is Kola Ltd, are equal in size. The product ranges offered by the four major manufacturers are similar in terms of size and quality. The market has grown by 2% per annum during recent years;
- (iv) A recent report on the activities of a foreign-based multinational company revealed that consideration was being given to expanding operations in their packaging division overseas. The division possesses

- large-scale automated machinery for the manufacture of cardboard tubes of any size; and
- (v) Another company, Pako Tubes Co (PTC) produces a narrow but increasing, range of plastic tubes which are capable of housing small products such as film and paper-based products. At present, these tubes are, on average, 30% more expensive than the equivalent sized cardboard tubes sold in the marketplace.

Required:

Using Porter's five forces model, assess the attractiveness of the option to enter the market for cardboard tubes as a performance improvement strategy for BPL.
(6 Marks)

- b. Discuss the limitations of Porter's five forces model as a technique for assessing how attractive an industry is to enter. (4 Marks)
- c. Kola Ltd was the market leader with a share of 30% three years ago. The managing director of Kola Ltd stated at a recent meeting of the board of directors that: 'our loss of market share during the last three years might lead to the end of Kola as an organisation and, therefore, we must address this issue immediately.'

Required:

Discuss the statement of the managing director of Kola Ltd and discuss six performance indicators, other than decreasing market share, which might indicate that Kola Ltd might fail as a corporate entity.
(5 Marks)

(Total 15 Marks)

Formulae

Modigliani and Miller Proposition 2 (with tax)

$$K_{EG} = K_{EU} + (K_{EU} - K_D) \frac{V_D}{V_{EG}} (1 - t)$$

Asset Beta

$$\beta_A = \left[\frac{V_E}{(V_E + V_D(1 - T))} \beta_E \right] + \left[\frac{V_D(1 - T)}{(V_E + V_D(1 - T))} \beta_D \right]$$

Equity Beta

$$\beta_E = \beta_A + (\beta_A - \beta_D) \left(\frac{V_D}{V_E} \right) (1 - t)$$

Growing Annuity

$$PV = \frac{A_1}{r - g} \left(1 - \left(\frac{1 + g}{1 + r} \right)^n \right)$$

Modified Internal Rate of Return

$$MIRR = \left[\frac{PV_R}{PV_I} \right]^{\frac{1}{n}} (1 + r_e) - 1$$

The Black-Scholes Option Pricing Model

$$C_0 = S_0 N(d_1) - E e^{-rt} N(d_2)$$

$$d_1 = \frac{\ln \left(\frac{S_0}{E} \right) + (r + 0.5\sigma^2)T}{\sigma \sqrt{T}}$$

$$d_2 = d_1 - \sigma \sqrt{T}$$

The Put Call Parity

$$C + E e^{-rt} = S + P$$

Annuity Table

Present value of an annuity of 1 i.e.

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

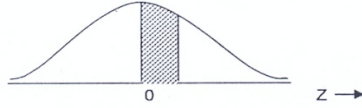
Where r = discount rate
 n = number of periods

Discount rate (r)

<i>Periods</i>											
(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	.1480	.1517
0.4	.1554	.1591	.1628	.1664	.1700	.1736	.1772	.1808	.1844	.1879
0.5	.1915	.1950	.1985	.2019	.2054	.2088	.2123	.2157	.2190	.2224
0.6	.2257	.2291	.2324	.2357	.2389	.2422	.2454	.2486	.2518	.2549
0.7	.2580	.2611	.2642	.2673	.2704	.2734	.2764	.2794	.2823	.2852
0.8	.2881	.2910	.2939	.2967	.2995	.3023	.3051	.3078	.3106	.3133
0.9	.3159	.3186	.3212	.3238	.3264	.3289	.3315	.3340	.3365	.3389
1.0	.3413	.3438	.3461	.3485	.3508	.3531	.3554	.3577	.3599	.3621
1.1	.3643	.3665	.3686	.3708	.3729	.3749	.3770	.3790	.3810	.3830
1.2	.3849	.3869	.3888	.3907	.3925	.3944	.3962	.3980	.3997	.4015
1.3	.4032	.4049	.4066	.4082	.4099	.4115	.4131	.4147	.4162	.4177
1.4	.4192	.4207	.4222	.4236	.4251	.4265	.4279	.4292	.4306	.4319
1.5	.4332	.4345	.4357	.4370	.4382	.4394	.4406	.4418	.4430	.4441
1.6	.4452	.4463	.4474	.4485	.4495	.4505	.4515	.4525	.4535	.4545
1.7	.4554	.4564	.4573	.4582	.4591	.4599	.4608	.4616	.4625	.4633
1.8	.4641	.4649	.4656	.4664	.4671	.4678	.4686	.4693	.4699	.4706
1.9	.4713	.4719	.4726	.4732	.4738	.4744	.4750	.4756	.4762	.4767
2.0	.4772	.4778	.4783	.4788	.4793	.4798	.4803	.4808	.4812	.4817
2.1	.4821	.4826	.4830	.4834	.4838	.4842	.4846	.4850	.4854	.4857
2.2	.4861	.4865	.4868	.4871	.4875	.4878	.4881	.4884	.4887	.4890
2.3	.4893	.4896	.4898	.4901	.4904	.4906	.4909	.4911	.4913	.4916
2.4	.4918	.4920	.4922	.4925	.4927	.4929	.4931	.4932	.4934	.4936
2.5	.4938	.4940	.4941	.4943	.4945	.4946	.4948	.4949	.4951	.4952
2.6	.4953	.4955	.4956	.4957	.4959	.4960	.4961	.4962	.4963	.4964
2.7	.4965	.4966	.4967	.4968	.4969	.4970	.4971	.4972	.4973	.4974
2.8	.4974	.4975	.4976	.4977	.4977	.4978	.4979	.4980	.4980	.4981
2.9	.4981	.4982	.4983	.4983	.4984	.4984	.4985	.4985	.4986	.4986
3.0	.49865	.4987	.4987	.4988	.4988	.4989	.4989	.4989	.4990	.4990
3.1	.49903	.4991	.4991	.4991	.4992	.4992	.4992	.4992	.4993	.4993
3.2	.49931	.4993	.4994	.4994	.4994	.4994	.4994	.4995	.4995	.4995
3.3	.49952	.4995	.4995	.4996	.4996	.4996	.4996	.4996	.4996	.4997
3.4	.49966	.4997	.4997	.4997	.4997	.4997	.4997	.4997	.4997	.4998
3.5	.49977									

SOLUTION ONE

a) Calculation of NPV

Year	0	1	2	3	4
Gross profit (W1)	0	22,243	26,771	32,222	38,782
Selling and admin (W2)	<u>0</u>	<u>(14,700)</u>	<u>(15,435)</u>	<u>(16,207)</u>	<u>(17,017)</u>
Operating cash flow	0	7,543	11,336	16,015	21,765
Tax at 20%	<u>0</u>	<u>(1,509)</u>	<u>(2,267)</u>	<u>(3,203)</u>	<u>(4,353)</u>
After tax operating cash flows	0	6,034	9,069	12,812	17,412
New equipment	(2,000)	-	-	-	-
Tax savings on C.A (W3)	100	75	56	42	127
Working capital (W4)	(5,200)	(1,059)	(1,274)	(1,534)	9,067
Continuing value (W5)	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>195,401</u>
Net cash flows	(7,100)	5,050	7,851	11,320	222,007
PVF at 10%	1	0.909	0.826	0.751	0.683
PV	(7,100)	4,590	6,485	8,501	151,631
NPV =	₦164,107 million				

Working notes

(i) Gross profit

With gross profit margin of 66%, the base case (Year 0) gross profit is:

$$₦28,000 \times 66\% = ₦18,480\text{m}$$

This will grow annually by: $g = (1.18 \times 1.02) - 1 = 20.36\%$

₦m

$$\text{Year 1} \quad 18,480 \times 1.2036 = 22,243$$

$$\text{Year 2} \quad 18,480 \times (1.2036)^2 = 26,771$$

$$\text{Year 3} \quad 18,480 \times (1.2036)^3 = 32,222$$

$$\text{Year 4} \quad 18,480 \times (1.2036)^4 = 38,782$$

(ii) Selling and Admin costs

₦m

$$\text{Given} \quad 14,400$$

$$\text{Less depreciation} \quad \underline{400}$$

$$\underline{14,000}$$

This will grow by 5% p.a.

(iii) **Capital allowances and related tax savings**

Year	0	1	2	3	4
	₦m	₦m	₦m	₦m	₦m
Cost/WDA	2,000	1,500	1,125	844	633
C.A. at 25%	<u>(500)</u>	<u>(375)</u>	<u>(281)</u>	<u>(211)</u>	<u>(633)</u>
WDA	<u>1,500</u>	<u>1,125</u>	<u>844</u>	<u>633</u>	<u>0</u>
Tax = CA × 20%	<u>100</u>	<u>75</u>	<u>56</u>	<u>42</u>	<u>127</u>

(iv) **Working capital (₦m)**

Year	Total*	Incremental
0	(5,200)	(5,200)
1	(6,259)	(1,059)
2	(7,533)	(1,274)
3	(9,067)	(1,534)
4	0	9,067

* The total working capital increases by 18% and 2% every year which is the same as 20.36% (the same as the growth in sales revenue).

(v) **Continuing value**

This is given by:

$$\begin{aligned} &= \frac{\text{After tax operating cashflows in year 5}}{r - g} \\ &= \frac{17,412 (1.01)}{0.10 - 0.01} = \text{₦}195,401 \end{aligned}$$

b) Profits after tax at 30 June 2025 = ₦1,920 million.

The value of Kent based on the mean P/E ratio = ₦105,600 million (1920 × 55).

c) The advantages of the NPV valuation are that it values the future cash flows of the company and takes into account both risk and the time value of money. However, it has the disadvantage that the inputs into the model are critical in arriving at a reliable estimate of the value of Kent.

The major advantage of the multiple valuation is that it values Kent by comparison to its peers, and reflects the future growth potential of the market. However, the disadvantages are that no company is truly comparable with another, and establishing a maintainable earnings figure is problematic.

In relation to Kent, reservations include:

For the NPV valuation: Is 18% growth realistic for the next four years? How has this figure been estimated? Does the 10% discount factor truly reflect the risk of the company? Is it reasonable to calculate the continuing value by treating the fourth year after tax operating cash flow as a growing perpetuity? How has the 1% growth figure been calculated? Is it reasonable to assume that the gross profit percentage will increase by 10%?

For the multiples valuation: The P/E ratio of 55 is the mean of a sample of comparable companies, but what is the spread of P/E ratios, and have outliers been excluded? Is taking historic earnings realistic – should prospective earnings be calculated instead?

- d) With an offer for sale shares in Kent would be sold to an issuing house, which would then offer the shares for sale to the general public. With an offer for subscription (or direct offer) the shares in Kent would be offered directly to the public i.e., not through an issuing house.
- e) Underwriting is a form of insurance, which ensures that all securities are sold and Tola can be certain of obtaining the funds required. The danger for Tola of not using an underwriter for the IPO is that there might be insufficient demand for all the securities to be issued. This is especially important when a fixed issue price is set in advance of the issue date, and the market is volatile. The market appetite for Kent's stocks might be less than expected, especially with the value placed on the company, which depends on high future growth.

The major disadvantage of underwriting is the cost. The cost depends on the characteristic of the company issuing the security and the state of the market. With a company such as Kent, the cost is likely to be at the upper end of the scale. Fees usually range from 1% to 2% of the total finance to be raised.

Another disadvantage of underwriting is that it may signal that the company is not confident in the issue being fully taken up.

Based on the balance of advantages and disadvantages, it might be in the best interest of the company to underwrite the IPO.

- f) For AA there is an issue of confidentiality here, and a potential conflict of interest. This can be resolved by:
- The use of different partners and teams for different clients.

- Taking the necessary steps to prevent the leakage of confidential information between different teams and sections within the firm's "Chinese walls".
- Regular review of the situation by a senior partner or compliance officer not personally involved with either client.
- Advising clients to seek additional independent advice, where it is appropriate.

Examiner's report

This is a standard question on valuation of business. Part (a) tests candidates' knowledge of business valuation using net present value method. Part (b) is still on business valuation using P/E ratio. Part (c) tests the candidates' knowledge on the key advantages and limitations of the above two methods of valuation.

In part (d), candidates are expected to differentiate between offer for sale and offer for subscription. Part (e) tests candidates' knowledge of underwriting. Part (f) asks candidates to discuss key ethical issues involved in a single organisation involves in both the valuation and the IPO. Being a compulsory question, almost all the candidates attempted the question and performance was poor.

A number of them struggled to identify the relevant cash flows to use in computing the net present value thereby losing significant marks. In part (b), most of the candidates correctly value the business using P/E ratio. In part (c), most of the candidates presented the advantages and limitations of the valuation methods and thereby earned very good marks. In part (d), a lot of the candidates could not differentiate between an offer for subscription and offer for sale and lost cheap marks. In part (f), most of the candidates could not produce any meaningful response to the required ethical issues thereby earning little or no marks.

We recommend that future candidates should comprehensively prepare for the examinations by making use of the Institute's study text and pathfinders.

Marking guide

	Marks	Total
(a) Calculate the value of Kent using net present value analysis	16	
(b) Calculate the value of Kent using a multiple of current earnings	1	
(c) Summarise the advantages and disadvantages of the two valuation methods	4	

(d)	Explain the difference between an offer for sale and an offer for subscription	2	
(e)	Outline the advantages and disadvantages of underwriting and advise the board	3	
(f)	Identify any ethical issues that AA may have and state how they might be resolved	<u>4</u>	
		<u>30</u>	<u>30</u>

SOLUTION TWO

a i) **Value of x**

$$R_{B,A} = R_{A,B} = 0.03$$

Value of K

$$R_{M,A} = R_{A,M} = 0.07$$

Value of Z

$$R_{M,B} = R_{B,M} = 0.045$$

ii) The Beta of the assets is given by the following equation:

$$\beta_i = \frac{\text{Cov}(R_i, R_M)}{\text{Var}(R_M)} = \frac{\sigma_{iM}}{\sigma_M^2}, \text{ hence}$$

$$\beta_A = \frac{\sigma_{AM}}{\sigma_M^2} = \frac{0.07}{0.06} = 1.167,$$

$$\beta_B = \frac{\sigma_{BM}}{\sigma_M^2} = \frac{0.045}{0.06} = 0.75$$

iii) $\beta_p = 0.6\beta_A + 0.4\beta_B$

$$= (0.6 \times 1.167) + (0.4 \times 0.75) = 1.0$$

iv) The variance of the proposed portfolio is calculated as:

$$\sigma_p^2 = (0.6)^2 \times (0.15) + (0.4)^2 \times (0.095) + 2(0.6)(0.4)(0.03) = 0.0836$$

v) The required return is computed using CAPM:

$$R_i = R_f + \beta_i(R_m - R_f)$$

$$= 4 + \beta_i(20 - 4)$$

$$= 4 + 16\beta_i$$

$$R_A = 4 + 16(1.167) = 22.67\%$$

$$R_B = 4 + 16(0.75) = 16\%$$

Since the beta of the proposed portfolio is 1, the required return of the proposed portfolio and that of the market portfolio would be the same, that is, 20%. This can also be cross checked using CAPM as below:

$$R_p = 4 + (16)(1) = 20\%$$

b) **Meaning of asset beta**

- Asset beta (β_a) — also called unlevered beta — measures the systematic risk of a company's assets, i.e. the risk of the firm's underlying business activities without the effect of debt (gearing).
- It reflects how sensitive the firm's operating cash flows are to movements in the overall market.

In short: Asset beta shows how risky the business itself is, before considering how it is financed.

Main factors determining a company's asset beta

Below are the key determinants explained with examples:

i) **Nature of the industry / Business risk**

- Firms in cyclical industries (e.g., construction, oil services, automobile) tend to have high asset betas because their performance moves closely with the general economy.
- Firms in non-cyclical industries (e.g., utilities, food, healthcare) have low asset betas because their sales are relatively stable even in economic downturns.

Example: Dangote Cement's cash flows fluctuate with construction activity, so it will likely have a higher asset beta than Nestlé Nigeria, which sells food items consumed throughout the business cycle.

ii) **Operating leverage**

- Operating leverage refers to the proportion of fixed costs in a company's total cost structure.

- The higher the fixed costs (relative to variable costs), the greater the volatility of operating profits, and hence, the higher the asset beta.

Example: A manufacturing company with large investments in machinery (high fixed costs) has higher operating leverage - and thus higher asset beta – than a trading firm with mostly variable costs.

iii) Diversification of products and markets

- Firms operating in many different products or geographical markets face less overall risk, as downturns in one area can be offset by upturns in another.
- Thus, diversified firms have lower asset betas.

Example: MTN Group operates in multiple African countries, reducing exposure to the Nigerian market alone, and therefore likely has a lower asset beta than a telecom firm operating only in Nigeria.

iv) Sensitivity of demand to economic conditions

- If the company's sales depend strongly on disposable income or interest rates, its returns will vary more with market performance — leading to a higher asset beta.

Example: Sales of luxury goods or imported electronics fluctuate more with consumers' income changes (higher beta) than sales of basic household items (lower beta).

v) Regulation and government support

- Firms in regulated industries (e.g., electricity, water, or rail transport) often face less market-related risk because prices and returns may be controlled or guaranteed by government policy.
- Consequently, they have lower asset betas.

Example: A regulated power distribution company in Nigeria (DisCo) will likely have a lower asset beta than a privately run Fintech company like Paystack.

vi) Cost structure flexibility and pricing power

- Firms that can easily adjust prices or costs in response to market changes face less systematic risk.
- Strong brand power or market dominance can stabilise cash flows, thus lowering the asset beta.

Example: Nigerian Breweries can maintain relatively stable margins because of strong brands like Star and Gulder, reducing its asset beta compared to a smaller competitor.

vii) Degree of foreign exposure

- Companies with significant foreign operations or export sales may face additional risks from exchange rate volatility, which can increase the variability of returns — hence, higher asset beta.

Example: An oil exporting firm’s revenues rise and fall with global oil prices and exchange rate movements, leading to a high asset beta.

Summary Table - Optional

Factor	Effect on Asset Beta	Explanation
Industry type	Cyclical - Higher β_a	Earnings tied to economy
Operating leverage	Fixed costs - Higher β_a	Profit volatility increases
Diversification	Diversification - Lower β_a	Risk spread across markets
Demand sensitivity	Income elasticity - Higher β_a	Sales tied to market
Regulation	Regulation - Lower β_a	Government stabilizes returns
Pricing power	Brand/market power - Lower β_a	Stable margins
Foreign exposure	FX risk - Higher β_a	Adds volatility

Examiner’s report

This question tests various aspect of Capital Asset Pricing Model (CAPM). In part (a), the candidates are expected to read and interpret variance/covariance matrix and to calculate a number of statistics like beta, variance, etc. In part (b), candidates are required to identify and discuss the drivers of asset beta.

Less than 50% of the candidates attempted the question with very low level of performance.

There is evidence that large number of the candidates lacked any meaningful knowledge of the topic. They therefore lost a significant amount of marks.

It is recommended that students preparing for this examination should cover every sections of the syllabus to guarantee success.

Marking guide

	Marks	Total
(a) i Determine the values of X, K and Z	3	
ii Calculate the beta of the assets	2	
iii Calculate the beta of the proposed portfolio	2	
iv Calculate the variance of the portfolio	2	

v	Calculate the required returns on Asset A and B and what should be the required returns based on CAPM theory	4	
(b)	Identify and discuss the factors that determine the asset beta of a company	7	
		<u>20</u>	<u>20</u>

SOLUTION THREE

a) **Derive Westorian 6-month deposit rate.**

Interest Rate Parity (IRP) gives the following formula:

$$\frac{F}{S} = \frac{1 + R_D}{1 + R_F}, (DC/FC)$$

F = 6-month forward rate = 1/3

(Rates given are indirect to naira)

S = spot rate = 1/3.10

R_D = 6-month deposit rate in Nigeria = 6/12 × 12% = 6% = 0.06

R_F = 6-month foreign deposit rate which is unknown.

If we let K be the annual foreign rate, then the 6-month rate = 6/12 × K = 0.5k

Thus:

$$\frac{1/3}{1/3.10} = \frac{1 + 0.06}{1 + 0.5K}$$

$$\frac{1}{3}(1 + 0.5K) = \frac{1}{3.10}(1.06) = 0.341935$$

$$1 + 0.5K = 1.025805$$

$$K = 5.161\% \text{ p.a}$$

b) **Naira cost today of each strategy**

We compute the naira cost today of each strategy – (so results are directly comparable).

i) **Forward contract**

If the company enters the 6-month forward to buy W\$ at the forward price, the Naira payment in 6 months is:

$$50,000,000 \times 1/3 = \text{₦}16,666,667$$

$$\text{Present value today at domestic rate is: } 16,666,667/1.06 = \text{₦}15,723,271$$

ii) **Money market cover**

Standard money market hedge for a future foreign payable:

- Compute the foreign amount needed **today** (present value in W\$)
 $= 50,000,000 / (1 + (R_f \times 6/12))$.

From (a) above, $R_f = 5.161\%$ and on pro-rata, $R_f \times 6/12$
 $= 5.161 \times 6/12 = 2.5805\%$.

Thus: $PV (W\$) = 50,000,000 / 1.025805 = W\$48,742,207$

- Convert that W\$ amount to Naira at the spot (Naira per W\$) to obtain Naira required today:
 $48,742,207 / 3.10 = \text{₦}15,723,293$

Note: Because of algebraic CIP equality, the money-market PV and forward PV are theoretically equal, the small difference above is due to rounding. (They are effectively identical when computed without rounding – this is the content of CIP.)

iii) **Speculative (no hedge) – using management’s expected spot**

Management expects spot in 6 months: $\text{₦}1 = W\$3.05$, so expected ₦ per W\$
 $= 1/3.05$.

Expected Naira payment in 6 months $= 50,000,000 \times 1/3.05 =$
 $\text{₦}16,393,442$

PV at domestic rate:

$$= \frac{\text{₦}16,393,442}{1.06} = \text{₦}15,465,511$$

Conclusion: On the basis of expected value alone, the speculative strategy looks cheaper. However, the speculative strategy exposes the firm to downside risk (adverse FX moves). The two hedged strategies (forward and money market) are economically equivalent under CIP and represent the prudent way to lock in a known Naira cost.

c) **At least two risks if Nabira pursues the speculative position**

(i) **Exchange-rate risk/adverse movements**

If the W\$ strengthens (i.e., the Naira weakens more than expected), the actual Naira amount required could be much larger than expected. The expected PV advantage can be wiped out – and losses can be materially larger than the small expected saving. Example: If the actual spot in 6 months were $1 = W\$2.90$ (instead of 3.05), the Naira payable would be $50,000,000 / 2.90 \approx 17.241\text{M}$ Naira (much worse).

- (ii) **Forecast risk/model error and volatility**
The forecast (3.05) may be biased or based on weak information. FX markets are volatile, political, macro, or market shocks in Westoria or Nigeria may invalidate the forecast quickly.
 - (iii) **Liquidity/Funding risk (additional)**
If Naira funding becomes constrained at the settlement date (or interest rates rise), even if the spot is favourable, the firm may struggle to raise cash at a reasonable cost.
 - (iv) **Reputational and counterparty risk (additional)**
Failing to pay on time (if FX moves and the firm is under-hedged) can harm supplier relationships and future contracting ability.
- d) **Ethical and fiduciary responsibilities of the CFO when deciding whether to hedge**
- A strong exam answer should cover legal duties, prudence, stakeholders and accountability. Key points:
- (i) **Fiduciary duty to shareholders: duty of care and prudence**
The CFO must act in the economic interest of the company's owners by protecting enterprise value. Deliberately choosing an unhedged speculative position to chase small expected gains (e.g., ₦0.26m) amounts to gambling with shareholder funds and may breach prudence unless clearly justified and disclosed.
 - (ii) **Risk-return tradeoff must be explicit and documented**
If management accepts a speculative policy, the CFO must quantify the upside and downside (scenario analysis, VaR/stress tests), obtain board approval, and set explicit limits (maximum loss tolerances). Transparency reduces agency problems.
 - (iii) **Duty to other stakeholders**
Suppliers, lenders and employees can be adversely affected by poor FX management (e.g., default risk or disrupted supply). Ethical stewardship requires balancing shareholder returns with contractual and social obligations.
 - (iv) **Governance and disclosure**
The CFO should disclose hedging policy and rationale to audit/board risk committee; use independent advisers or internal controls; ensure segregation of duties (no personal speculative positions).

- (v) **Avoid conflicts of interest and moral hazard**
The CFO must avoid incentives that reward short-term gains at the expense of long-term stability. Compensation design should not encourage speculative currency bets.
- (vi) **Reasoned exceptions**
If speculative view is supported by strong information advantage, low risk appetite of the company, or explicit approval from the board, limited speculative positions may be acceptable - but only with rigorous documentation, size limits, and contingency plans.

Examiner's report

This question tests candidates' knowledge of foreign currency risk management. Part (a), asks the candidate to calculate the foreign interest rate, using Interest Rate Parity Theory (IRPT). Part (b) asks the candidates to evaluate various hedging techniques, including the use of speculation. In part (c), candidates are to identify and discuss risks involved in the use of speculation. Finally, in part (d), candidates are expected to evaluate key ethical issues involved in the scenario.

Less than 25% of the candidates attempted the question and with very poor level of performance. There is evidence that most of the candidates do not have any idea of this section of the syllabus despite the fact that this section of the syllabus is tested almost every diet.

International finance and the related risks is an important aspect of the subject and students should be prepared to face similar questions in future examinations.

Marking guide

	Marks	Total
(a) Derive the Westorian six-month deposit rate	5	
(b) Calculate the Naira cost today of settlement under each of the three strategies assuming parity holds	6	
(c) Discuss at least two risks Nabiru faces if it pursues the speculative position rather than hedging	4	
(d) Critically evaluate the ethical and fiduciary responsibilities of the CFO when deciding whether to hedge	<u>5</u>	
	<u>20</u>	<u>20</u>

SOLUTION FOUR

The following are the key practical factors that should influence SunSteel's capital structure decision in practice.

(i) **Existing level of gearing**

- The company's current debt-to-equity ratio of about 45% represents moderate gearing.
- Increasing debt could enhance returns to equity holders through financial leverage, if the return on investment exceeds the after-tax cost of debt.
- However, further borrowing may increase financial risk, especially during periods of economic slowdown in the construction sector.
- SunSteel must therefore, assess whether its present level of gearing still lies within its optimal range.

(ii) **Stability of earnings and cash flow**

- SunSteel manufactures essential building and roofing materials, products with consistent demand in Nigeria's housing and infrastructure sectors.
- SunSteel's relatively stable earnings support moderate to high levels of debt since the firm can meet fixed interest obligations.
- A company with volatile or seasonal income would instead favour equity financing to avoid distress during downturns.

(iii) **Asset structure**

- SunSteel possesses extensive tangible assets – plants, machinery, warehouses, and distribution vehicles – which are largely unencumbered.
- These assets can serve as security for additional borrowing, allowing the company to obtain long-term loans at favourable rates.
- Firms with predominantly intangible assets would not enjoy this advantage, highlighting why SunSteel's tangible asset base supports prudent use of debt.

(iv) **Cost of debt vs. cost of equity**

- Debt financing is typically cheaper than equity because interest is a fixed, tax-deductible expense.
- However, with Nigerian interest rates around 18–20%, the effective cost of borrowing could be high.
- The company should compare the after-tax cost of debt with the expected return required by shareholders to determine whether additional borrowing reduces or increases its weighted average cost of capital (WACC).

(v) **Taxation**

- Since interest on debt is tax-deductible, SunSteel benefits from a tax shield that reduces overall tax liability.
- The firm's consistent profitability ensures that this advantage is fully realised.
- However, excessive gearing would raise the risk of insolvency and could eliminate the benefit if profits fall and tax relief cannot be utilised.

(vi) **Business risk (operating risk)**

- Manufacturing is capital-intensive and subject to fluctuations in energy and raw-material costs.
- SunSteel's high fixed operating costs already expose it to operating leverage; adding too much financial leverage could make total risk unacceptably high.
- A balanced mix is therefore advisable to maintain stable earnings per share.

(vii) **Control considerations**

- Issuing additional equity may dilute the ownership and control of existing shareholders.
- The board's preference for maintaining control may incline it towards debt financing, provided that interest obligations remain manageable.
- This is particularly relevant in a publicly listed company where new share issues could shift voting power.

(viii) **Growth and financial flexibility**

- Although SunSteel is mature, the Nigerian building materials market still offers growth potential through real-estate development and government infrastructure projects.
- The firm should maintain sufficient financial flexibility to future opportunities.
- Over-reliance on debt now may restrict access to finance later if conditions become less favourable.

(ix) **Market conditions and investor sentiment**

- When interest rates are high and credit is tight, new borrowing becomes expensive.
- Conversely, if the Nigerian capital market remains buoyant, SunSteel might issue additional shares at attractive prices.
- Management should therefore, consider current macroeconomic and market conditions before deciding between debt and equity options.

(x) **Management's attitude to risk**

- The company's history of steady dividends and prudent financial policy suggests a conservative management culture.
- Such management is likely to favour a moderate gearing level that balances tax advantages with long-term financial stability.
- Aggressive use of leverage may conflict with the company's established risk profile.

(xi) **Size and reputation of the company**

- As a large, listed, and reputable firm, SunSteel enjoys easier access to capital markets and can negotiate favourable terms with lenders.
- This status supports the availability of debt, but it also increases scrutiny from investors and credit-rating agencies, who expect disciplined capital management.

Conclusion

SunSteel Nigeria Plc's present capital structure appears broadly appropriate and its moderate gearing supported by tangible assets, steady earnings, and prudent management; and

Any decision to raise additional debt should be based on a careful review of current interest rates, future cash-flow forecasts, and the company's tolerance for risk.

In practice, an optimal capital structure is dynamic - it must evolve with changes in the company's profitability, tax position, market conditions, and strategic objectives.

Examiner's report

This question tests candidates' knowledge of capital structure. Almost all the candidates attempted the question with average level of performance.

Almost all the candidates that attempted the question lost valuable marks because they produced generic answers rather than relating their solutions to the given scenario.

At this level of the examination, candidates are expected to demonstrate maturity in their solutions rather than reproducing text book solutions.

Marking guide

Discuss factors to be considered when determining company's capital structure

Total

20

SOLUTION FIVE

a) Application of Modigliani and Miller

Given:

- Current equity-financed value = ₦65m
- Current cost of equity (K_E) = 20%
- EBIT = 65m × 20% = ₦13m(constant perpetuity)
- Proposed capital structure:
- Issue ₦10m debt (12% irredeemable bond)
- Repurchase ₦10m equity
- Tax rate = 25%
- Payout ratio = 100% (no retained earnings)

Step 1: Market value after capital restructuring (MM with tax)

Under MM with corporate tax:

$$V_L = V_U + (T \times D)$$

$$V_U = 65\text{m}$$

$$D = 10\text{m}$$

$$T = 25\%$$

$$V_L = 65 + (0.25 \times 10) = 65 + 2.5 = \text{₦}67.5\text{m}$$

The market value increases by ₦2.5m due to the tax shield.

Step 2: Cost of equity after leverage

Formula (MM with tax):

$$k_e = k_u + (k_u - k_d)(1 - T) \frac{D}{E}$$

- $K_u = 20\%$
- $K_d = 12\%$
- $T = 25\%$
- After restructuring: $E = V_L - D = 67.5 - 10 = \text{₦}57.5\text{m}$

$$\text{Debt-equity ratio} = \frac{10}{57.5} = 0.174$$

$$K_e = 0.20 + (0.20 - 0.12)(1 - 0.25)(0.174) = 21.04\%$$

The cost of equity rises from 20% to 21.04% due to higher financial risk.

Step 3: Weighted average cost of capital (WACC)

$$k_0 = \frac{E}{V_L} k_e + \frac{D}{V_L} k_d (1 - T)$$

$$E/V_L = 57.5/67.5 = 0.8519$$

$$D/V_L = 10/67.5 = 0.1481$$

$$k_0 = (0.8519 \times 0.2104) + (0.1481 \times 0.12 \times 0.75) = 19.2\%$$

The WACC falls from 20% to 19.2%, reflecting the benefit of the debt tax shield.

Summary of results

Item	Before (all equity)	After restructuring
Market value	₦65m	₦67.5m
Cost of equity (k_e)	20%	21.04%
WACC (k_0)	20%	19.2%

Interpretation:

- The value of Olowo Plc rises because of the tax shield.
- Equity holders demand a higher return because of higher financial risk.
- Overall WACC falls slightly, showing benefit of moderate gearing.

b) Weaknesses of the Traditional and MM Theories

(i) Traditional view (Pre-MM)

Weaknesses

- Relies on the idea of an optimal capital structure where WACC first falls and then rises with leverage.
- Lacks strong theoretical proof-based more on intuition than rigorous finance principle.
- Does not specify exactly where the optimal point lies.

Usefulness

- Recognises that excessive debt increases bankruptcy risk.
- Matches practical observation that firms avoid 100% debt financing.

(ii) MM proposition (without taxes)

Weaknesses

- Unrealistic assumptions: No taxes, no transaction costs, perfect capital markets, identical borrowing costs for firms and individual

- Ignores bankruptcy risk and agency problems.
- In practice, investors cannot borrow at the same rate as firms.

Usefulness

- Provides a rigorous benchmark: financing choice is irrelevant in a frictionless world.
- Highlights that value creation depends more on operating performance and investment policy than on financing mix.
- Foundation for later theories incorporating taxes, bankruptcy, and agency costs.

(iii) MM with taxes

Weaknesses

- Overstates the benefits of debt since it assumes perpetual tax shields without considering bankruptcy risk or limits to debt capacity.
- Ignores costs of financial distress, agency costs, and market imperfections.

Usefulness

- Shows the importance of the tax shield.
- Practical in explaining why moderate debt is valuable.
- Serves as a stepping stone to the trade-off theory of capital structure.

Examiner's report

This question tests candidates' knowledge of capital structure – both computational and theoretical.

In part(a), students are expected to make use of Modigliani and Miller, to calculate:

- the market value of a company;
- the cost of equity; and
- the WACC.

In part (b), they are expect to provide a practical assessment of the theory. Almost all the candidates attempted the question with average level of performance.

In part (a), candidates lost valuable marks because most of them made use of wrong formulae. The others could not interpret the question. In part (b), a good number of the candidates earned some good marks.

We emphasise once again that students preparing for this examination should read widely and cover the entire syllabus.

Marking guide

	Marks	Total
a. (i) Using M&M explain and demonstrate how change in capital structure will affect the market value	2	
(ii) Using M&M, explain and demonstrate how change in capital structure will affect the cost of equity	2	
(iii) Using M&M, explain and demonstrate how change in capital structure will affect the cost of capital	3	
b. Explain any weakness and usefulness of both the traditional and M&M theories	<u>8</u>	
	<u>15</u>	<u>15</u>

SOLUTION SIX

a) A Finance Director of a multinational company, overseeing mergers and acquisitions (M&A) can involve navigating a number of ethical dilemmas. These dilemmas often arise because of competing interests between stakeholders, differing corporate cultures, and the pressure to maximise financial gain. Below are some key examples of ethical dilemmas in M&A, along with a discussion of their implications:

(i) **Conflict of interest**

Scenario: During an acquisition process, a senior executive or finance professional may have personal or financial ties with individuals in the target company. For example, the Finance Director might have personal friendships with key stakeholders in the acquired company or be offered a future role in the new, merged entity.

Ethical dilemma: The conflict of interest may cause the executive to make biased decisions that benefit the target company or themselves at the expense of their current organisation. Even the appearance of such a conflict can erode trust among shareholders and other stakeholders.

Management: To avoid this, transparency is key. The executive must disclose any personal relationships or potential conflicts to the board of directors and recuse themselves from decision-making, if necessary. Companies should also implement clear conflict of interest policies to mitigate such risks.

(ii) **Misrepresentation of financial information**

Scenario: In M&A transactions, the target company may present financial statements that are overly optimistic or fail to disclose liabilities, such as pending lawsuits, environmental risks, or debt. Alternatively, the acquiring company might pressure its finance team to manipulate projections to justify a higher acquisition price.

Ethical Dilemma: Misrepresenting financial information to make the deal more attractive violates principles of transparency and can result in significant financial losses or legal consequences once hidden liabilities come to light.

Management: Conducting thorough due diligence is essential. The acquiring company should ensure independent third-party audits of the target's financials, and any discrepancies or red flags must be disclosed and addressed transparently. Misrepresentation of information could also violate regulatory requirements, resulting in fines or litigation.

(iii) **Pressure to inflate the valuation**

Scenario: In some mergers, the leadership or shareholders of the acquiring company may pressure the Finance Director to inflate the valuation of the target company to convince stakeholders that the deal is beneficial. This pressure could come from the board or external consultants looking to maximise their commissions from the deal.

Ethical dilemma: Inflating the valuation might lead to paying more than the company is worth, which harms the acquiring company's shareholders and can damage its long-term financial health. It also sets unrealistic expectations for the performance of the combined entity post-merger.

Management: The Finance Director should resist this pressure and provide a fair, independent, and objective assessment of the value of the target company. It is also essential to document all aspects of the valuation process to ensure transparency and accountability.

(iv) **Employee layoffs and restructuring**

Scenario: After a merger, there may be redundancies between the two companies, leading to layoffs, particularly in overlapping departments. Management might face pressure to downplay the scale of these layoffs during negotiations to avoid resistance from employees or labour unions.

Ethical dilemma: While job cuts are often necessary to achieve cost synergies, misrepresenting the likelihood of layoffs during the acquisition process can harm employee trust and damage the corporate culture. Ethical concerns arise when employees are misled about the stability of their jobs.

Management: The Finance Director and senior management should approach the issue with honesty, ensuring that decisions on layoffs or restructuring are communicated clearly and transparently. Affected employees should be treated with respect, offered fair severance packages, and given adequate support for transitioning to new roles.

(v) **Data privacy and confidentiality**

Scenario: During the due diligence phase of an acquisition, both parties share sensitive financial, operational, and personal data. There might be pressure to share or misuse confidential data obtained during negotiations, particularly if the deal falls through.

Ethical dilemma: The improper use or disclosure of sensitive data, such as trade secrets, client lists, or employee information, is an ethical breach. It could also lead to violations of data privacy laws, such as the General Data Protection Regulation (GDPR) or other data protection laws.

Management: The Finance Director should ensure that strict confidentiality agreements are in place, and all employees and advisors involved in the deal adhere to them. Any data shared should be used only for the purpose of the transaction, and appropriate safeguards should be implemented to protect sensitive information.

(vi) **Cultural integration and ethical misalignment**

Scenario: A multinational company acquires a smaller firm in a different country, where ethical standards and business practices may differ. For example, the target company may operate in an industry where bribery is common practice or environmental standards are less stringent than those of the acquiring company.

Ethical dilemma: Ethical misalignment can create a conflict when integrating the two companies. The acquiring company may be tempted to overlook unethical practices in order to maintain profitability or ease the transition.

Management: The Finance Director should ensure that ethical alignment is a key consideration in the merger. Post-merger, the acquired company must adopt the ethical standards of the parent company, with policies in place to ensure compliance with corporate governance, anti-bribery laws, and environmental regulations.

(vii) **Insider trading**

Scenario: During the acquisition process, certain individuals within the company might have access to non-public information about the deal. They may be tempted to engage in insider trading, either by trading shares themselves or by passing on information to external parties who trade on it.

Ethical dilemma: Insider trading is illegal and unethical, violating principles of fairness and market transparency. It can lead to significant legal penalties and damage the company's reputation.

Management: The Finance Director should enforce strict insider trading policies, ensuring that all employees and directors involved in the merger are aware of their legal obligations. Trading in the company's stock should be restricted for individuals with insider knowledge during the M&A process.

(viii) **Shareholder vs. stakeholder interests**

Scenario: In some mergers, the deal may disproportionately benefit certain shareholders (e.g., major institutional investors) at the expense of minority shareholders or other stakeholders, such as employees, customers, or local communities.

Ethical dilemma: Focusing solely on shareholder value can lead to decisions that harm other stakeholders, such as closing plants and affecting local economies or reducing product quality due to cost-cutting measures.

Management: The Finance Director should advocate for a balanced approach that considers the impact of the merger on all stakeholders, not just shareholders. This includes a commitment to corporate social responsibility (CSR) and ensuring that the long-term sustainability of the company is prioritised.

Conclusion

Ethical dilemmas in mergers and acquisitions can be complex and multifaceted, involving conflicts of interest, transparency issues, and the competing interests of various stakeholders. As Finance Director, it is essential to navigate these dilemmas with integrity, transparency, and a commitment to ethical principles. Ensuring robust governance structures,

clear conflict of interest policies, and transparency in communication are critical to managing these challenges effectively.

b) Factors determining a company's capital structure in practice

Capital structure refers to the mix of long-term financing used by a company, particularly:

- equity,
- retained earnings,
- preference shares,
- long-term debt.

In theory, firms seek an optimal capital structure that minimises the weighted average cost of capital (WACC) and maximises shareholder wealth. In practice, however, many factors influence financing decisions.

Factors determining capital structure

(i) Business risk

Business risk refers to the variability of operating profits due to the nature of the company's operations.

Companies with:

- stable earnings; and
- predictable cash flows, can safely use more debt.

Examples:

- utility companies; and
- telecommunications firms.

However, firms with highly volatile earnings generally avoid excessive debt because fixed interest obligations increase financial distress risk.

(ii) Financial risk

Financial risk arises from the use of debt financing.

As debt increases:

- interest obligations rise;
- bankruptcy risk increases; and
- earnings volatility to shareholders increases.

Companies therefore balance:

- benefits of debt, against; and
- risk of financial distress.

(iii) **Cost of capital**

Firms attempt to choose financing sources that minimise overall financing costs.

Debt is often cheaper because:

- interest is tax deductible; and
- lenders take lower risk than shareholders.

However, excessive debt increases:

- borrowing costs; and
- required returns by shareholders.

Therefore, firms seek an appropriate balance.

(iv) **Tax considerations**

Interest payments on debt are tax allowable in many countries, creating a tax shield benefit.

As a result:

- profitable firms often prefer debt financing.

However, where tax rates are low or firms already enjoy tax allowances, the benefit of debt may be less significant.

(v) **Control considerations**

Managers and existing shareholders may avoid issuing new equity because it dilutes ownership and voting power.

Consequently:

- family-owned businesses often prefer debt financing; and
- management may retain control by avoiding external equity.

(vi) **Flexibility**

Financial flexibility refers to the ability to raise funds easily in the future.

Companies may avoid excessive borrowing in order to preserve future borrowing capacity, especially during uncertain economic conditions.

(vii) **Profitability and internal funds**

According to the pecking order theory:

- firms prefer retained earnings;
- then debt; and
- and issue new equity only as a last resort.

Highly profitable firms therefore often rely more on internally generated funds rather than debt.

(viii) **Nature and quality of assets**

Companies with substantial tangible assets can borrow more easily because assets can serve as collateral.

Examples:

- manufacturing firms; and
- real estate companies.

In contrast, technology or service firms with fewer tangible assets may rely more heavily on equity financing.

(ix) **Growth opportunities**

Rapidly growing companies require substantial financing.

However:

- growth firms may avoid excessive debt because future earnings are uncertain; and
- lenders may consider them risky.

As a result, such firms may depend more on equity financing.

(x) **Market conditions**

Capital structure decisions are influenced by conditions in:

- stock markets;
- interest rate markets; and
- investor sentiment.

For example:

- companies may issue equity when share prices are high;
- firms may borrow when interest rates are low.

(xi) **Economic conditions**

During economic recessions:

- firms may reduce debt levels because of uncertainty.

During periods of economic stability:

- firms may increase leverage confidently.

Macroeconomic conditions therefore significantly influence financing choices.

(xii) **Industry norms**

Companies often compare themselves with competitors within the same industry.

Certain industries traditionally operate with high gearing, while others maintain conservative structures.

Industry practice therefore influences financing decisions.

(xiii) **Legal and regulatory environment**

Government regulations may influence financing decisions through:

- tax laws;
- bankruptcy laws;
- stock exchange regulations; and
- lending restrictions.

For multinational corporations, differences in international regulations also matter.

(xiv) **Attitude of management**

Management's attitude toward risk strongly affects capital structure.

Conservative managers may prefer low debt levels, while aggressive managers may favour higher leverage to enhance shareholder returns.

Examiner's report

Part (a) of the question tests candidates' knowledge of possible ethical dilemmas associated with mergers and acquisitions. Part (b) deals with factors affecting capital structures in practice. Almost all the candidates attempted the question with a good level performance.

However, a number of the candidates did not produce good solutions to part (a) and therefore lost some cheap marks.

Students need to pay good attention to ethical issues in all aspects of the syllabus when preparing for future examinations.

Marking guide

		Marks	Total
(a)	Identify and discuss key ethical dilemmas that may arise and explain how each can be effectively mitigated	7½	
(b)	Critically discuss the factors that determine a company's capital structure	<u>7½</u>	
		<u>15</u>	<u>15</u>

SOLUTION SEVEN

a) Using Porter's Five Forces Model

Porter's five forces can help assess how attractive the cardboard tube industry is for BPL.

(i) Threat of new entrants – moderate to high

- Entry cost is relatively low (₦750,000 machine, one operator, simple training).
- No significant technical barriers – tubes are fairly standardised product
- However, supply of the key raw material (special paper) can be a constraint.
- Established firms already dominate 80% of the market, so reputation and customer relationships are barriers.

Assessment: Entry is possible but not easy to build/scale quickly.

(ii) Bargaining power of suppliers – high

- Key input is specially formulated paper, which has been in short supply in recent years.
- Few suppliers likely control the market, they can increase prices or limit supply.
- If BPL cannot secure reliable supply, production may be disrupted.

Assessment: This is a serious threat.

(iii) Bargaining power of buyers – high

- Buyers purchase in very large quantities.
- Tubes make up only 1–2% of their product cost, but are essential for packaging.
- Since cardboard tubes are largely standardised and quality is similar, customers can switch suppliers easily to get better prices.

Assessment: High buyer power exerts downward pressure on margins.

(iv) Threat of substitutes – increasing

- Plastic tubes (PTC) are a substitute, currently 30% more expensive but gaining acceptance in niche segments.
- If plastic costs fall, or if customers value plastic properties (durability, moisture resistance), threat of substitution could rise sharply.
- Multinational firm entry with more advanced products could also act as a substitute.

Assessment: Moderate but rising threat.

(v) **Industry Rivalry – very high**

- Four main firms control 80% of the market - oligopolistic structure.
- Market growth is slow (only 2% annually) - competition is largely for market share rather than new demand.
- Multinational interest suggests rivalry could intensify further.

Assessment: Rivalry is already intense and likely to increase.

b) Limitations of Porter's Five Forces Model

- Static nature:** The model assumes industry structure is stable, but in reality industries evolve (e.g., plastic tubes emerging, multinational entry).
- Ignores internal capabilities:** The framework does not consider BPL's strengths, resources, or brand equity.
- Overemphasis on structure:** It assumes industry structure determines profitability, neglecting firm-specific strategies (e.g., cost leadership, innovation).
- Narrow focus:** Concentrates on competition, ignoring collaboration, alliances, or government policies.
- Excludes external factors:** Broader PESTEL factors (technological change, environmental concerns, regulation) are overlooked.
- Short-term perspective:** It may not capture dynamic trends such as disruption, digitalisation, or sudden material shortages.

c) Kola Ltd's market share decline

The managing director's alarm is partly justified, but the statement may be too pessimistic.

- A fall from 30% to 18% (since the other three now share equally in the 54% remaining after the leader's 26%) is significant.
- However, market share loss alone does not automatically mean failure. The firm could restructure, innovate, or enter niches.

Six performance indicators (other than market share) suggesting possible corporate failure

- Declining profitability** – Persistent fall in profit margins due to high cost or inability to raise prices.
- Liquidity problems** – Inability to meet short-term obligations, poor cash flow, reliance on overdrafts.
- High gearing/leverage** – Excessive debt compared to equity, leading to high interest burdens.
- Falling sales revenue** – Absolute decline in turnover, not just relative to competitors.

- (v) **Declining productivity/efficiency** – Rising costs per unit, machine under-utilisation, labour inefficiency.
- (vi) **Customer and supplier losses** – Key customers switching suppliers, or difficulty in securing raw material supply.
- (vii) **Weak innovation pipeline** – Inability to introduce new products (e.g., no response to plastic tube trend).
- (viii) **Employee morale and staff turnover** – High staff turnover, loss of key talent, industrial disputes.

If several of these indicators occur alongside declining market share, then corporate failure risk is high.

Examiner's report

In parts (a) and (b), candidates are expected to apply their knowledge of Porter's five forces model to a given scenario and to discuss the key limitations of the model. In part (c), they are expected to apply their knowledge to key performance indicators to a given scenario.

Almost all the candidates attempted the question with average level of performance. There is good evidence that a number of the student do not have a good knowledge of this part of the syllabus.

We recommend again that students should not ignore any part of the syllabus when preparing for this examination.

Marking guide

	Marks	Total
(a) Using Porter's five forces model, assess the attractiveness of the option to enter the market	6	
(b) Discuss the limitations of Porter's five force model technique	4	
(c) Discuss six performance indicators, other than decreasing market share, which might indicate that Kola Ltd might fail as a corporate entity	<u>5</u>	<u>15</u>
	<u>15</u>	<u>15</u>

INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

PROFESSIONAL LEVEL EXAMINATION – MAY 2026

ADVANCED AUDIT, ASSURANCE AND FORENSICS

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

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

SECTION A: COMPULSORY QUESTION (30 MARKS)

QUESTION 1

David Copeland and Partners International is a group of professionals that are into accounting and advisory services across audit, tax, regulatory compliance, outsourcing, human resources, and corporate governance. The firm has a team that confronts daily challenges in a highly competitive and fast moving environment by assisting national and international clients to excel in their businesses. The firm has its footprints in major cities worldwide. The geographical network allows the partners to meet international needs of clients. The set-up of the firm allows each member firm to serve its local market independently and effectively.

Due to global competition, the partnership is committed to attracting and developing talents in other locations in Africa with diverse workforce that brings innovation and foresight to clients. The firm decided to include in its business operations across the geographical network, insolvency and business recovery services, and have a practice office in Nigeria. Aside from having competent professionals, a major condition for firms in any country that wants to join the global network is the need to ensure a robust quality control review that supports International Standards on Quality Management (ISQM).

Your firm, FFO & Co (Chartered Accountants), is interested in joining the global network and with a view to expanding its audit portfolio with multinational clients. You are part of a team saddled with the responsibility of developing a framework to ensure a seamless onboarding with the international firm.

Required:

- a. Evaluate the purposes of quality management that are expected in your firm's quality control system. (3 Marks)

- b. Discuss the principles of quality management for audit and assurance engagements. (5 Marks)
- c. Discuss the components of a system of quality management that are relevant to a given firm. (6 Marks)
- d. Identify what should be the responsibilities of your firm's Engagement Partner regarding quality management. (4 Marks)
- e. Discuss what you would include in the framework to demonstrate that your firm, FFO & Co.:
 - i. conducts its audits in a professional and ethical manner. In this regard, explain scenarios that may impact or threaten integrity, objectivity and independence and how these are managed in your firm. (6 Marks)
 - ii. has the capacity to participate in group audits and support the group auditor. In this regard, discuss typical reports issued by component auditors, considering communication of audit referral instructions – contents, purposes and importance. (6 Marks)

(Total 30 Marks)

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

QUESTION 2

Your firm has recently been appointed as external auditors to the Velvet Bank Limited (VBL) and you are one of the staff saddled with the responsibility to prepare for the engagement.

VBL was incorporated under the Companies and Allied Matters Act on August 20, 2007. It obtained a licence from the Central Bank of Nigeria to operate as a commercial bank on December 14, 2007 and commenced business, effective January 1, 2008. The bank is not listed on the Nigerian Exchange Limited.

The following have been identified as some of those who have interest in the bank and its financial statements:

Shareholders

The shareholders' focus is on the profit before tax, revenue and net assets of the bank, when using the financial statements.

Shareholders, in making their decision as to the performance of the bank would generally review the operating income of the bank to ascertain its growth and reduction in costs, while achieving its set objectives (maintaining the profitability of the bank). They will also check the relevant investment ratios that exhibit the profitability of the bank.

Regulators

The regulators such as Central Bank of Nigeria and Nigerian Deposit Insurance Corporation are interested in protecting customers' deposits and ensuring that the bank meets regulatory requirements as well as growing its revenue from the disbursement of loans to customers.

Other relevant statutory authorities, including Nigeria Revenue Services (NRS), Financial Reporting Council of Nigeria (FRC), Nigeria Deposit Insurance Cooperation (NDIC), the tax authorities are interested in the banks revenue growth as it translates to increased value added tax. They are also interested in improved profitability which translates to increased companies income tax and other tax responsibilities. Key ratios in the regulatory returns were identified to be the loan to deposit ratio, capital adequacy ratio and liquidity ratio.

Highlights of performance

	December 31, 2024	December 31, 2023
	N	N
Profit before tax	870,109,115	108,249,465
Revenue	18,442,124,018	11,131,048,112
Net assets	99,010,444,232	42,104,122,068
Loans	110,022,112,044	85,022,444,000

Required:

- a. Discuss the areas the audit planning memorandum for the audit of this bank should cover. (5 Marks)
- b. Identify the issues you need to consider when assessing the objectivity of the expert to be engaged on the audit of the bank. (5 Marks)
- c. Describe the main procedures, with examples, that relate to gathering audit evidence for this engagement. (6 Marks)
- d. Discuss the factors that may affect the identification of an appropriate materiality benchmark for the audit. (4 Marks)

(Total 20 Marks)

QUESTION 3

ABC Manufacturing Plc. is a large Nigerian company listed on the Nigerian Exchange Limited (NGX). In line with the provisions of the Companies and Allied Matters Act (CAMA) 2020, the company appointed Obed Ijahdulah & Co. (Chartered Accountants), as its statutory auditor.

During the planning stage of the audit, the Audit Manager noted that:

- (i) some members of the management were reluctant to provide certain internal control documentation;
- (ii) the internal audit department exists but seems under-resourced, performing mainly compliance checks without focusing on risk management;
- (iii) the company recently faced shareholders' complaints regarding late and unreliable financial reporting; and
- (iv) during testing, the auditors discovered evidence of inventory obsolescence that management had not disclosed.

Required:

- a. Discuss the factors to be considered when the entity wants to outsource its internal audit functions. (5 Marks)
- b. Discuss the importance of the internal audit functions to the organisation. (7½ Marks)
- c. Evaluate the disadvantages of outsourcing the internal audit function to an external accounting firm. (7½ Marks)

(Total 20 Marks)

QUESTION 4

Omuoru Bottling Company Limited has been producing carbonated water and other soft drinks since 2019. The company produces high-quality drinks and markets the products aggressively to make enough profit to sustain the business and meet the needs of various stakeholders. The company has about three hundred staff and an impressive market share. The products have various brands and flavours including carbonated water, juice, banana, pineapple and other carbonated drinks.

The annual sales of the company have been within the range of ₦380million and ₦790million. The profit after tax moved from ₦150million in 2019 to ₦367million in 2024. The company pays tax and other levies as and when due.

The details of the contributions made by the company to the community during the year 2024 are as follows:

	Details of donation	Nature	Amount N'000
i.	Renovation of secondary school	Corporate social responsibility	48,000
ii.	Purchase of computers	Corporate social responsibility	10,000
iii.	Scholarship	Sponsorship	25,000
iv.	Solar inverter	Corporate social responsibility	16,000
v.	Contribution to community flood fund	Corporate social responsibility	12,000
vi.	Stomach infrastructure	Corporate social responsibility	8,000
vii.	Donation of drugs to hospital	Corporate social responsibility	13,000
viii.	Women empowerment	Sponsorship	<u>13,000</u>
	Total		<u>145,000</u>

The directors of the company have not been making a disclosure of the various corporate social responsibilities in the financial statements. The Managing Director has intimated your firm of the threat of the pressure group during the pre-audit meeting for the current audit due to non-discussion of the company's special responsibility in the financial statements. As a result of the foregoing, your firm has decided to intimate your firm's expert to conduct sustainability assurance for reporting in the financial statements.

Required:

- a. Evaluate the issues to be considered before accepting sustainability assurance, including ethical and professional considerations. (5 Marks)
- b. Discuss the process for sustainability reporting and assurance. (6 Marks)
- c. Justify the need for sustainability reporting and assurance. (4 Marks)
- d. Discuss the ethical concerns on the use of Artificial Intelligence (AI) in sustainability reporting. (5 Marks)

(Total 20 Marks)

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

QUESTION 5

Clement Nigeria Limited was incorporated as a private limited liability company on October 4, 2020 under the Companies and Allied Matters Act. The company commenced commercial production on January 20, 2021, and currently engages in the manufacturing, distribution, and selling of foods and related products.

In 2023, the entity recognised a revenue of ₦3,128,444,186 (2022: ₦2,544,182,062), and a loss of ₦3,555,104,123 (2022: ₦2,722,942,805.14). The entity has, however, continued to make recurring losses in the years, which has led to an increase in the accumulated losses and the erosion of its equity.

The entity's current working capital position is a net liability position of ₦19.660 billion (2022: net liability of ₦16.105 billion); and positive cashflows of ₦0.333 billion (2022: 0.201billion). Also, the entity's shareholder's equity has been eroded in the current year to ₦1.102 billion (2022: ₦894 million).

The direct parent company, Wagge Limited, is also not in a financially viable position to provide support to Clement Nigeria Limited. However, the parent company and beneficial shareholders have provided letters of comfort explaining that they would support Clement Nigeria Limited for a period of 12 months from the date of the financial statements for the year ended December 31, 2024. They expect that this would enable the company to continue as a going concern and meet their obligations as and when they fall due, for at least 12 months from that date. The letter is irrevocable and would remain in force for 12 months from the date of the audited financial statements.

The comfort letter was signed by a director (Stephen Konibaje), on the strength of which management believes that there is no further threat to the going concern assumption of the company.

You are the partner in charge of the audit of Clement Nigeria Limited in your firm.

Required:

- a. Discuss the factors that raise questions about the going concern assumptions from the above scenario. (6 Marks)
- b. Develop the audit procedures to be carried out where events or conditions have been identified that may cast significant doubts on the entity's ability to continue as a going concern. (9 Marks)

(Total 15 Marks)

QUESTION 6

Gubico Limited was incorporated to carry on haulage business, chartering of trawlers, trawling, and fishing. It commenced business in the same month. The company acquired another entity as its subsidiary which is into the business of hospitality, indoor and outdoor catering services in 2022. Both the parent and subsidiary have December 31, as the year-end for the preparation of their financial statements.

The company, in 2022, decided to embark on a large scale fish production. It, therefore, acquired a piece of land for fish and shrimps farming. The farm is located on a vast expanse of 250 hectares of land around the beach and utilises 150 hectares of the land for production. The subsidiary in hospitality and catering business also patronise Gubico Limited on normal business terms instead of patronising third party companies which might largely charge heavily for same products (mainly fish and shrimps).

The company's tropical fish and shrimps are distributed worldwide in over 20 countries. The company aims to substantially increase her export volumes overtime.

FIK Professional Services has completed six years as Gubico's auditors and in line with good practice, the company is, therefore, opening doors of opportunity to another firm to be appointed auditors for the group, but this time as a joint auditor. The subsidiary has a separate audit firm. The current auditors are also formally invited to submit their proposal for the audit. The successful external auditors will express opinion on the group financial statements, which shall be prepared in accordance with International Financial Reporting Standards (IFRS).

Eligible audit firms should meet the following criteria:

- i. compliance with relevant legal and regulatory requirements for external audit firms;
- ii. experience with audit reporting under International Financial Reporting Standards and International Standards on Auditing ("ISA");
- iii. evidence of having performed similar audits within the last five years; and
- iv. the curriculum vitae for the partner, manager and key staff proposed for the audit team.

Your firm has received the request for proposal and has indicated interest in the audit. You are the proposed engagement partner for the audit.

Required:

- a. As the proposed group auditor, develop the schedule of work which your firm expects the component auditors to perform and include in their report. (5 Marks)
 - b. Discuss the factors an audit firm needs to consider before participating in this type of joint audit. (5 Marks)
 - c. Assess the benefits the client might likely get from a joint audit. (5 Marks)
- (Total 15 Marks)**

QUESTION 7

Jovial Limited was incorporated on November 10, 2022 to carry on the business of investment in real estate. The company's set up enables it to acquire by purchase, exchange or otherwise, any interest in land and buildings and any form of real estate. The company has a large expanse of land which it currently carries at cost value and in the event of winding up, the value of the land is sufficient to settle the company's liabilities (if any). The trade and other payables mainly comprise of the Directors' Current Accounts, which were incurred at incorporation of the company.

Due to pressing demand from customers for short-let apartments, especially during festive periods, the company has some properties on lease. In the prior period, the lease arrangement had always been treated as an operating lease, whereby periodic lease payments are treated as operating expenses and are expensed on the income statements, and the amounts not paid are treated as payable.

In the current year, as part of the risk assessment, the lease payable was reassessed to verify whether it qualifies as an operating or a finance lease. The result of this assessment had an impact on prior year balances, as the standard requires a right-of-use asset and lease liability to be recognised via amortisation and interest expense.

The directors of the company have shortlisted some external audit firms for the audit, of which your firm is one. As part of the preparation for presentation to those charged with governance on the audit proposal, some questions that might likely come up have been structured out and your team has been requested to come up with responses.

Required:

- a. Discuss the risk management practices to consider in response to the risks identified during the client acceptance evaluation. (6 Marks)

- b. Identify the quantitative methods, automated tools and techniques your firm is likely to use on the audit engagements.

(9 Marks)

(Total 15 Marks)

Solution 1

- (a) **In accordance with ISQM 1 (*Quality Management for Firms that Perform Audits or Reviews of Financial Statements*)**, a firm must design, implement, and operate an ISQM to provide it with reasonable assurance that:
- i. it has a road map for quality that will create awareness for value and uphold quality in the way the firm discharges its duties. This will increase the revenue of the firm and help to reduce waste or cost;
 - ii. it will help to ensure compliance with standards, build trust, make for consistency and transparency with clients and other stakeholders. This will help to build the image of the firm;
 - iii. it will help to identify areas requiring improvement to make the firm relevant as business operations change. This will add value and provide a proactive approach to responding to challenges, and will enable the firm to align operations with emerging issues and challenges;
 - iv. it will help to provide the firm with an objective evaluation of business processes and enlighten clients on what they need to do to enhance their business operations. It provides strong evidence that reports are based on thorough analysis. The clients will take the firm's report seriously and may encourage the firm to get more referrals from the clients;
 - v. when personnel understand the process, they are motivated to achieve greatly, build team spirit, productivity and improve the learning curve. This may eventually improve the turnaround time;
 - vi. early identification, assessment and effective management of the problem will help to reduce risk and prevent avoidable mistakes. It will also help to prevent customer dissatisfaction and reputational damage as the quality work will reveal whether the control environment is robust and working as expected; and
 - vii. having a robust quality process will lead to quality service delivery. This will be a selling point in positioning the firm for competition.

(b) Principles of quality management for audit and assurance engagements

- i. **Meeting and exceeding the expectations of clients:** The firm should be client-focused by identifying their needs and striving to always provide exceptional service, working with them as business partners.
- ii. Ensuring the existence of leadership skills that guide and motivate others.
- iii. Providing vision to invest in the growth of personnel and their work with a collaborative mind.
- iv. Encouraging every member to have a good sense of belonging and a committed mind: Having an environment that drives staff commitment and improvement that gives opportunity for career progression, recognises individual differences and rewards excellent performance.
- v. Ensuring a proactive organisation where all work towards stipulated goals that will produce consistent and outstanding results: Have an environment that allows for creativity and allows for constant update and improvement for outstanding results.
- vi. Having an organisation that always strives for continuous improvement: The organisation should perform root cause analysis and work on issues that will lead to robust performance.
- vii. The organisation should have a robust database for effective decision-making: There should be reliable information which should form the bedrock of developing a sustainable plan. Having convincing evidence to understand the cause will help to reduce uncertainty and allow understanding of the effect.
- viii. There should be good relationship management with all stakeholders: The goal of the firm and the clients should be harmonised, and the line of communication should be kept open for an effective relationship.

(c) The components of a system of quality management in a firm

- i. The risk assessment process: The firm shall gain an understanding of issues that can militate against performing quality engagements and take into account how action or inaction may affect the achievement of the objectives of the firm. The firm shall institutionalise policies and procedures that can lead to additional quality objectives and consider such when necessary.

- ii. **Tone at the top:** There should be leadership responsibilities for the system of quality control. Leadership should be accountable and committed to quality by providing structure and support for the internal culture of compliance with global requirements of quality. The tone at the top should promote a quality-oriented internal culture based on clear, consistent and frequent actions and messages from all levels of management, emphasising quality control policies and procedures.
- iii. **Ethical requirements:** The firm and its network should ensure a proper understanding of relevant ethical requirements and how they are applied to all its engagements. It should show responsiveness to the identification of what constitutes threats to ethical requirements and independence. It should also ensure that staff who work on engagements complete a form indicating compliance with independence issues. The firm should assign relevant partners and staff to engagements in line with International Standards and applicable legal and regulatory requirements.
- iv. **Inquiries** should be made to ascertain that individuals participating in an engagement have no issues of personal conflicts. Conflict checks should be performed on all prospective engagements to identify potential conflicts of interest. Once the relationship is identified, such a relationship should be assessed.
- v. **Acceptance and continuance of client relationships on engagements:** There should be guidelines for acceptance and continuance of engagement through assessment of the credibility of those charged with governance and the ability of the firm to deliver on the engagement, according to high levels of professional standards.
- vi. **Fee** should not be a primary consideration for engagement acceptance and continuance, especially when quality is likely to be compromised.
- vii. **Engagement performance:** The firm should ensure that the partner takes responsibility for assigned tasks by his involvement and commitment to the engagement. He should ensure adequate resources are available. There should be prompt direction, supervision and review, so that issues can be resolved timely. The engagement assigned partner should ensure that the engagement team maintains professional scepticism throughout the audit. Consultation on grey areas and issues of differences of opinion should be promptly addressed. Currently the engagement partner acknowledges responsibility in the audit report.

- viii. The engagement team should ensure gathering and documentation of sufficient appropriate evidence, which should be maintained in compliance with the firm's ethical requirements, professional standards, relevant laws and regulations.
- ix. Resources: The firm should ensure that appropriate resources are available for the engagement, and they are well-maintained to prevent service disruption. They should ensure any partner or staff assigned responsibility has sufficient knowledge and experience to perform the assigned task. The engagement team members should be well-trained and kept abreast of quality control issues and procedures. The staff members should have the necessary authority to implement the policies and procedures given for the assigned task. The staff should be well compensated.
- x. Information and communication: The firm should institute a culture of maintenance of relevant and reliable information channel that supports the system of quality management, and to be shared within the firm and with other identified stakeholders. There should be procedures in place where there is a need to share information with third parties, whether required by law or legislation.
- xi. The monitoring and remediation process: There should be monitoring activities for the purpose of identifying areas of weakness. There should also be a culture of procedures for remediation on files with deficiencies from practice review results within a time frame. Partners who have practice review deficiencies on their engagements should be prevented from supervising Public Interest Entities (PIE) and from acting as Engagement Quality Reviewers on big engagements, pending the remediation of the deficiencies. The firm should ensure the performance of root cause analysis and develop actions to address the identified deficiencies.

(d) The responsibilities of the Engagement Partner regarding quality management

- i. He should consider all sensitive information gathered during the acceptance and continuance process of the audit, during the planning and implementation of the audit.
- ii. He is responsible for the overall direction, supervision and review of the audit. It is his duty to set and ensure adherence to the nature, timing and extent of audit work done.

- iii. He should ensure the competence and capabilities of the team members, as well as the specialists. He should allow sufficient time to be allocated to the engagement team for execution of assigned tasks. He should communicate with the appropriate team or firm resource personnel for additional hands, if the resources assigned or made available are insufficient or inappropriate in the circumstances of the engagement.
- iv. He has the responsibility to delegate and ensure more experienced members on his team, direct, supervise and review the work of less experienced members of the engagement team. Regardless of this, he should constantly monitor and ensure proper management of the audit for the achievement of quality on the engagement, as he has the overall responsibility for the work.
- v. The Engagement Partner is responsible for accountability for the engagement as well as ensuring compliance with provisions of ISQMI and Quality Control for an Audit of Financial Statements (ISA 220).
- vi. He has the responsibility for ensuring proper review of all audit documentation, as well as the financial statements, the auditor's report, the management letter, and reports to those charged with governance or regulatory authorities. He should ensure that there is sufficient appropriate evidence to support the audit work conducted.
- vii. In case there is an issue with the audit work done and remediation has to be made on the working paper file, he should anchor the remediation process as instituted by the firm. He should be abreast of all necessary information required for the monitoring and remediation process on the file.
- viii. There should also be appropriate documentation of his involvement in the engagement by:
 - ensuring progress meetings between the engagement team, specialists and the client. This will ensure that all significant and judgmental areas are satisfactorily resolved; and
 - conduct periodic visits on the field and engage with the audit team and the client to resolve key audit issues.

- ix. If an Engagement Quality Reviewer is appointed on the engagement, he should work closely with the reviewer to ensure he performs his duties to enhance the quality of the file. He should schedule meetings and ensure all issues raised are attended to by the engagement team.
- e. (i) **Scenarios that can impact the integrity, objectivity, independence professional competence and due care, confidence and professional behaviour of FFO & CO.**
- Self-interest threat: This arises when the audit firm has a financial interest or other interest in a matter. Typically, this means that the firm's decisions might be influenced by self-interest, and the firm will, therefore, not act with objectivity and independence.
 - Self-review threat: This occurs when a firm is required to review or re-evaluate (for a different purpose) a previous judgment it has made or action that it has taken. Self-review threats can also apply to audit firms, for example; if an audit firm prepared the financial statements for a client company and then acted as auditor, it would be reviewing its own work and would be reluctant to criticise or question it. This would be a threat to objectivity and independence.
 - Advocacy threat: This occurs when the firm is in a position where it is expected to defend or justify the position of the client, and act as an 'advocate' for the client's position or point of view. This would be a threat to objectivity and independence.
 - Intimidation threat: This occurs when the firm is deterred from acting with objectivity due to threats against this firm, for example, the client may threaten that it will take the engagement away from the firm unless it agrees with the point of view of the client's management.
 - Familiarity threat: This occurs when the firm becomes too sympathetic with the client's position due to close relationships.

Examples of this type of threat include:

- long association – when this audit firm is engaged over many years in carrying out the annual audit and becomes overly trusting of the client;

- when a member of the engagement team has a family or personal relationship with someone at the client's office who can exercise significant influence on the financial statements; and
- where there is an interchange of employees between the firm and the client.

Procedures that can be put in place to manage these ethical threats

- Rotation of the engagement partner and of senior staff. Rotation means that an individual should not be involved in the annual audit of the same client company for more than a maximum number of years as specified by relevant laws and regulations.
- Appropriate training. This includes training in how to maintain an independent opinion during audit work.
- Quality control procedures. A firm shall have procedures for quality control to ensure that independence is considered in respect of all work undertaken by the audit firm.
- Consultation procedures. A firm shall have internal procedures for consultation, whereby questions arising in relation to independence can be discussed.

(ii) **As a component auditor, FFO & CO., would be required to submit a Report of work performed that would include:**

- a statement of compliance with ethical and group auditor requirements;
- identification of the financial information on which the component auditor is reporting;
- any instances of non-compliance with laws and/or regulations which could lead to a material misstatement of the group financial statements;
- a list of uncorrected misstatements of the financial information of the component auditors;
- indicators of possible management bias;
- any identified material weaknesses in internal control;
- any other significant matters the component auditor expects to communicate to those charged with governance of the component;

- any other matters that may be relevant to the group audit; and
- the component auditor's overall findings, conclusions and opinion.

Examiner's Report

The question tests candidates' knowledge of quality management of an audit engagement. This being a compulsory question, all the candidates attempted it and the overall performance was above average.

The commonest pitfall of the candidates was their display of poor understanding of various aspects of the quality management practices expected on an engagement and the firm in general.

Candidates are advised to acquaint themselves with quality management practices relating to engagements and also read the Institute's Study Text and Pathfinders which are freely available on the Institute's website.

Marking Guide

	Marks	Marks
a. Evaluation of the purposes of quality management that are expected in your firm's quality control system (1 mark each, subject to a maximum of 3 points)		3
b. Identification and discussion of the principles of quality management of audit and assurance (1 mark each, subject to a maximum of 5 points)		5
c. Discussion on the component of a system of quality management (1 mark each, subject to a maximum of 6 points)		<u>6</u>
d. Identification of what should be the responsibilities of your firm's engagement partner regarding quality management (1 mark each, subject to a maximum of 4 points)		4
e. i. Discussion on what you would include in the framework to demonstrate that the firm, FFO & Co. has the capacity to conduct its activities in a matter that can impact integrity, objectives and independence (1 mark each for any 3 threats and 3 safeguards mentioned)	6	

ii. **Typical reports issued by component auditors, considering communication**

(1 mark each, subject to a maximum of 6 points)

6

Total

12

30

SOLUTION TWO

a. The areas to be covered by the audit planning memorandum for the audit of the bank

- i. **Risk assessment:** The engagement should be risk-based. The efforts of the auditors should be geared towards ensuring that what may lead to material misstatements in the report or may mislead the users of the financial statements are in focus and well addressed during the exercise. It is to be noted that risk assessment is iterative or continuous as the engagement progresses.
- ii. **Objectives:** The objectives of the engagement will show the areas to be covered, that is, whether statutory, compliance, internal control review and value for money. The efforts should meet the requirements of the stipulated objectives.
- iii. **Users of the financial statements:** The engagement should meet the needs of the board of directors, audit committee, management and regulators. There could be areas of attention that the board of directors expects the engagement to focus on. The laws and regulations expect certain disclosures, which may lead to sanctions if not well addressed. There is a need to establish focus areas based on these parameters.
- iv. **Available resources:** The audit firm should consider the expected audit time set, the budget, the competence of the engagement team, and their specialists. No engagement should be embarked upon without considering the efficient use of the resources to be deployed on the assignment. There is the need to ensure that no unrealistic expectations are set.
- v. **Materiality and significance:** The engagement to be carried out should not lose focus on areas with material account balances, both qualitatively and quantitatively. The engagement team should focus on areas that are

significant enough to influence the decisions of the users of the financial statements. The auditor makes use of a materiality threshold, which helps to guide his/her work to prevent material misstatement.

- vi. **Compliance with applicable standards:** The engagement team should ensure that requirements of enabling laws, regulations and standards are complied with. To ensure quality, uniformity and comparability, the standards expect that all organisations should conduct their businesses by ensuring compliance with laws and regulations to avoid sanctions, security breaches, penalties and reputational damage. Omission of the requirements of the standards may render the audit report misleading and not fit for use.
- vii. **Previous findings:** The engagement team should bring into focus prior-year findings which have not been addressed and which require follow-up. For audit or other engagements, regulatory, internal audit and other identified findings could give useful information that calls for focus to ensure presenting a report that is not misleading. Some sensitive findings earlier identified need to be critically reviewed and followed up to ensure that the organisation works towards addressing the issues to prevent a negative effect on the bank.
- viii. The audit timetable is to meet the required reporting deadlines for the auditor's report.
- ix. Changes in the client's organisation or business, or external (environmental) changes affecting the client's business, since the previous audit.
- x. A summary of key financial ratios and other ratios from previous years.
- xi. Planning decisions for the audit.
- xii. The use that will be made of the client's staff in the audit (for example, internal auditors) and the external experts.

- xiii. Possible problem areas in the audit and the approach to be adopted to deal with them.
 - xiv. Proposed methods of communication with the client (for example, meetings/reports).
- (b) **The issues for the auditors to consider when assessing the objectivity of an expert includes whether:**
- i. the expert has a financial interest in the audit client, for example, a shareholding;
 - ii. the expert has a personal relationship with a senior manager in the audit client;
 - iii. the fee paid for the expert's services was a fair commercial price;
 - iv. the work of the expert provides sufficient and appropriate evidence for the audit purposes;
 - v. the auditor should review the terms on which the expert was engaged by the audit client, such as the objective and scope of the expert's work and whether the expert was notified that his work may be relied on by the auditors;
 - vi. the auditor should obviously study the content of the expert's report and the conclusions that the expert reached. Any assumptions used by the expert may be significant (for example, in making an asset valuation), and the auditor should compare those assumptions with their own understanding of the audit client's business;
 - vii. the auditor may also need to check the methods used by the expert. For example, for the valuation of investment property, the method of valuation used should be consistent with the requirements of (International Accounting Standards) IAS 40;

- viii. the expert has been used to provide a valuation, the date of the valuation should be close to the end of the financial year of the audit client (so that it is up-to-date and current).

c. Procedures for gathering audit evidence

- i. **Inspection:** Physically examining an asset, like a vehicle, provide strong evidence for its existence, though not its value or ownership. Inspection of entries in accounting records of documents (for example, invoices).
- ii. **Observation:** Watching a procedure (for example, physical inventory and cash counts, distribution of wages, opening of mail). This is limited to the point in time when the observation takes place. This allows the auditor to directly see how the count is being performed and assess the reliability of the company's procedures.
- iii. **Inquiry:** Seeking information from knowledgeable persons inside or outside the entity, evaluating responses to those inquiries, and corroborating those responses with other audit evidence.
- iv. **External confirmation:** A specific type of inquiry – seeking confirmation from a third party (for example, a bank or loan customer, trade payable or trade receivable). It is the process of obtaining evidence directly from a third party in written form. A common example is when an auditor sends a request to a company's bank to confirm its account balances and loan details. Confirmations are also used to verify accounts receivable balances with customers.
- v. **Recalculation:** An auditor might recalculate the depreciation expense for a sample of assets to ensure it aligns with the company's stated policy. This procedure provides strong evidence regarding the accuracy assertion. Checking the mathematical accuracy of documents or records (For example, adding up the list of year-end loan portfolio or trade receivables)
- vi. **Reperformance:** Independently carrying out procedures or controls which were originally performed by the client (for example, reperforming the ageing of year-end loan balances or trade receivables).

- vii. **Analytical procedures:** Evaluating and comparing financial and/or non-financial data for plausible relationships and investigating unexpected fluctuations, for example, comparing last year's gross profit percentage to this year's and ensuring any change is in line with expectations.
- d. **Factors that may affect the identification of an appropriate materiality benchmark include the following:**
- i. the elements of the financial statements (for example, assets, liabilities, equity, revenue, expenses);
 - ii. whether there are items on which the attention of the users of the entity's financial statements tends to be focused (for example, for the purpose of evaluating financial performance, users may tend to focus on profit, revenue or net assets);
 - iii. the nature of the entity. Where the entity is in its life cycle, and the industry as well as the economic environment in which the entity operates;
 - iv. the entity's ownership structure and the way it is financed (for example, if an entity is financed solely by debt rather than equity, users may put more emphasis on assets, and claims on them, than on the entity's earnings); and
 - v. the relative volatility of the benchmark.

Examiner's Report

The question tests candidates' knowledge of audit planning memorandum, identification of issues to consider when assessing the objectivity of an expert, the procedures for gathering audit evidence and the factors that may affect the materiality benchmark for an audit. The question was attempted by about 80% of the candidates but performance was just average.

The commonest pitfall was the poor understanding of engagement procedures for both the client's engagement and the use of an expert for aspects of the engagement.

Candidates are advised to pay close attention to the requirements of the question and ensure adequate preparation in order to identify the relevant features of the question. They are also advised to study properly the Institute's Study Text and Pathfinders for future examinations.

Marking Guide

	Marks	Marks
a. Discussion on the areas the audit planning memorandum should cover ($\frac{1}{2}$ mark for each subject to a maximum of 10 points)		5
b. Identification of the issues needed to be considered when assessing the objectivity of expert (1 mark for each point, subject to a maximum of 5 points)		5
c. Description of the main procedures with examples, that relate to gathering audit evidence ($\frac{1}{2}$ mark for each point, subject to a maximum of 4 points) (1 mark for each explanation subject to a maximum of 4 points)	2 4	6
d. Discussion on the factors that may affect the Identification of an appropriate materiality benchmark (1 mark each for each points, subject to a maximum of 4 points)		4
Total		<u>20</u>

SOLUTION 3

- (a) **Factors the board of directors need to consider when the entity wants to outsource its internal audit function.**
- i. The outsourced accounting firm must have a greater level of independence than the entity's own internal audit staff. If the firm handling the outsourcing function is not properly independent from the executive management of the entity, it should not be given any internal audit work.

- ii. The outsourced accounting firm should have access to more highly trained, specialist employees.
- iii. The outsourced accounting firm should have more employees available for any urgent internal audit assignments.
- iv. The professional code of conduct and standards of behaviour should regulate outsourced the accounting firm. This might not be the case with an in-house internal audit department.
- v. The outsourced firm should have professional indemnity insurance to meet claims for losses due to negligent work as if may be sued for breach of contract or for negligent work.

(b) The importance of the internal audit function to the organisation:

- i. Internal audit helps management to monitor the controls within their entity. As entities increase in size and complexity and become global in nature the task of monitoring controls becomes more difficult. An internal audit function helps management to monitor these controls.
- ii. Similarly, as markets become increasingly competitive, it is important that entities should be very competitive themselves. This means using resources efficiently and effectively. An internal audit function can be used to monitor the efficiency of operations.
- iii. In many countries, there is a large amount of statutory and accounting regulations, including corporate governance regulations. An internal audit function can be used by management to check on compliance with laws and regulations.
- iv. Many entities use complex IT systems. Specialist internal auditors can help management to review the effectiveness of controls within information technology (IT) systems (by means of IT audits).
- v. The increasing cost of the external auditor's services means that it may be cheaper to use internal auditors to perform routine audit tasks whenever possible.
- vi. Work not related to the external audit that might otherwise be given to an external firm of accountants as non-audit work could be given to the internal auditor.

viii. The existence of an internal audit department may enhance the reputation of the entity for sound corporate governance in the opinion of customers and investors.

(c) Disadvantages with outsourcing the internal audit function to external accounting firm

- i. Professional firms are not under the control of the entity in the same way as their 'in-house' internal audit employees. The outsourcing arrangement needs to be effectively managed and controlled by the organisation.
- ii. Fees for internal audit work can be high.
- iii. Professional firms may not have the same level of detailed knowledge of the entity and its operations that 'in house' internal auditors (working in the organisation on a daily basis) should have. The service provider may not understand the requirements of the entity in respect of the service that it is providing. If the work is not properly specified, the service provider may fail to do all things that the entity requires it to do.
- iv. There may be threats to the independence of the external audit where the firm acts as both internal auditors and external auditors.
- v. The entity relies on the service provider to do its work on time and have it ready at the time that the entity requires it. This means that management must carry out regular reviews of the service level and service quality provided. In general, this is particularly important, for example, when payroll operations are outsourced. This means that management must carry out regular reviews of the service level and service quality provided.
- vi. If the external auditor must review their own internal audit work, efforts are duplicated creating unnecessary cost to the client.

Examiner's Report

The question tests candidates' knowledge of the factors to be considered in the outsourcing of internal audit functions, the importance of internal audit functions to an organisation, and the disadvantages of outsourcing the internal audit functions. The question was attempted by more than 60% of the candidates and performance was less than average.

The commonest pitfall of the candidates was their inability to demonstrate understanding of the differences between outsourcing the internal audit and the process of outsourcing.

Candidates are advised to read the Institute's Study Text and Pathfinders to enhance their performance in future.

Marking Guide

	Marks	Marks
a. Analyse of the factors to be considered when the entity wants to outsource its internal audit functions (1 mark each, subject to a maximum of 5 points)		5
b. Discussion of the importance of internal audit functions to the organisation (1½ marks each, subject to maximum of 5 points)		7½
c. Evaluation of the disadvantages of outsourcing internal audit functions to an external audit firm (1½ marks each, subject to maximum of 5 points)		7½
Total		<u>20</u>

SOLUTION 4

- (a) **Issues to be considered before accepting sustainability assurance, including ethical and professional considerations**

Aside the fact that it is either a reasonable or limited assurance engagements, the process for accepting sustainability reporting and assurance is similar to other engagements. The risk-based approach should be employed in performing the engagement acceptance process. Consequent to this, the practitioner has to:

- i. ensure following formal acceptance and continuance procedures that are in alignment with the firm's policy. The practitioner should ensure that relevant ethical issues, including independence, will not be compromised by both the engagement team and the specialists. Background check

should be conducted on the directors. The risk associated with the engagement should be assessed and properly analysed;

- ii. ensure that there is no scope limitation that will lead to modification of the conclusion expressed on the engagement and that quality management will be in place to ensure the standard will not be compromised. There may be need for the appointment of quality assurance reviewer.
- iii. set terms of engagement with the client by the use of letter of engagement which will be the responsibility of both the directors and the practitioner. This will provide common understanding on the engagement by both parties. Also, the basis of reporting and conclusion will be stated in the terms of the engagement, for example, the need to ensure compliance with International standards on sustainability assurance and other standards or laws relevant to the engagement and whether it will be a limited or reasonable assurance conclusion.
- iv. ensure that there will be adequate competent resources, including specialists to be put on the engagement. The people that will work on the engagement need to have the necessary skills and time. The Engagement Partner shall take responsibility for the quality of work to be performed.

(b) Process for sustainability reporting and assurance

- i. There is the need to identify scope and objectives of the engagement. The practitioner shall gain a preliminary understanding of the sustainability information and whether the scope covers the whole engagement with no limitation. This will be done by making inquiries of personnel and review on documentation provided. The information obtained should be evaluated to determine whether it is consistent with the information provided for review.
- ii. The next exercise is data gathering and analysis by assessing environmental, social, and governance (ESG) impacts. This will help in understanding what to be done through robust planning of work and needed resources. The practitioner shall plan the work with professional skepticism and exercise professional judgement for accuracy to get a true reflection of company's performance. For effective planning, the practitioner is expected to understand the client's business, the internal control procedures, the reporting processes, including the information

systems and risks relating to sustainability of the business.

- iii. There should be evaluation of the sustainability policies and procedures of the organisation. It is important to ensure that the layout or format of the procedures is in accordance with sustainability reporting standards. Effective monitoring will assist in identifying areas for improvements to achieve the stipulated sustainability objectives. The practitioner is expected to perform analytical and substantive procedures on selected disclosures in the financial statement to ensure there are no material variances with the expected.
- iv. Ensuring collection of sufficient appropriate evidence to reveal how the conclusion is arrived at. Evidence are gathered through procedures of inquiry, testing and analysis and obtaining third party confirmation where necessary. This will help in developing a robust report on strengths, weaknesses, opportunities, and threats that will give insight on the sustainability activities of the company when presenting the report to those charged with governance for improvement.
- v. Ensuring maintenance of proper documentation of work done. This should include section on evaluation of misstatements and control deficiency, communication with those charged with governance, consideration of other information, the assurance report, as any other report. This will give attestation that the opinion which is publicly reported is based on the evidence obtained and documented.

(c) **Need for sustainability reporting and assurance**

- i. It helps to give transparency and accountability to stakeholders that the organisation is aware of their challenges in their environment and it is ready to assist in protecting them especially in relation to provision of amenities. It makes the report to be more credible and reliable. With this, friction between the company and the community will be avoided.
- ii. It enables the company to identify and prepare early for likely risks that may arise from climate change, scarcity of resources and societal pressures. It can help the company reduce legal and compliance risks by ensuring compliance with stipulated guidelines, laws and regulations.

- iii. **Boost good decision making:** More organised companies are better equipped to comply with increasing regulatory demands on climate change disclosures, customer and other stakeholders appetite for quality products or service which require transparent reporting. This can only be done through business decisions hinged on analysis of performance and assessment of future business risks as guided by sustainability reporting. It helps to support long term decision making.
- iv. It helps to make companies to be conscious of efficiency and cost. Areas of energy savings and wastage of resources can be pinpointed and fixed. This will increase returns to investors.
- v. It helps to boost the reputation of the company. It shows how the company thinks about its responsibility to the environment where it is situated, its future and it is working in line with international standards. It helps to attract and retain customers and staff who are interested in sustainability.
- vi. It helps to boost the reputation of the company and invariably the goodwill.

(d) **Ethical Concerns on the use of Artificial Intelligence (AI) in Sustainability Reporting**

- i. **Accuracy and reliability of information:** AI systems may generate inaccurate or misleading sustainability information if:
 - input data is incomplete;
 - algorithms are flawed; and
 - data quality is poor.
- ii. **Bias and discrimination:** AI models may produce biased outputs due to biased training data, leading to unfair or distorted sustainability reporting.
- iii. **Lack of transparency:** Some AI systems operate as “black boxes,” making it difficult to understand how conclusions or disclosures were generated. This may reduce stakeholder trust.

- iv. Data privacy and confidentiality: AI systems may process sensitive corporate and stakeholder information, creating risks of:
 - unauthorised access;
 - data breaches; and
 - misuse of confidential information.
- v. Manipulation and greenwashing: AI may be misused to exaggerate sustainability achievements or conceal adverse environmental and social impacts.
- vi. Accountability issues: It may become difficult to determine responsibility when AI-generated sustainability reports contain errors or misleading disclosures.
- vii. Reduction in professional judgement: Overreliance on AI may weaken human professional skepticism and judgement required in sustainability reporting and assurance engagements.

Examiner's Report

The question tests candidates' knowledge of the issues for consideration before accepting sustainability assurance engagements, including ethical and professional considerations, the process of sustainability assurance reporting, the justification for sustainability reporting and assurance, and the ethical concerns on the use of artificial intelligence in sustainability reporting. The question was attempted by about 60% of the candidates but performance was below average.

The commonest pitfall was the candidates' inability to properly discuss sustainability assurance services and reporting and the application of artificial intelligence (AI) in the audit process.

Candidates are advised to be conversant with the developments that have impacted on auditing and assurance services and read the Institute's Study Text and Pathfinders to enhance their performance in the future.

Marking Guide

	Marks	Marks
a. Evaluation of the issues to be considered before accepting sustainability assistance, including ethical and professional considerations (1 mark each, subject to a maximum of 5 points)		5

b.	Discussion on the process for sustainability reporting and assurance (1½ marks each, subject to a maximum of 4 points)	6
c.	Justification of the need for sustainability reporting and assurance (1 mark each, subject to a maximum of 4 points)	4
d.	Discussion on the ethical concerns on the use of Artificial Intelligence (AI) in sustainability reporting (1 mark each, subject to a maximum of 5 points)	5
	Total	<u>20</u>

SOLUTION 5

- a. The factors in the case of Clement Nigeria Limited that can raise significant doubt about the entity's ability to continue as a going concern
- i. **Recurring operating losses:** The company has continuously recorded losses: The loss of ₦3.555 billion for 2023 (2022: ₦2.723 billion loss) indicates that the company may not be generating sufficient profits to sustain operations.
 - ii. **Accumulated losses and erosion of equity:** The recurring losses have resulted in Increased accumulated losses and erosion of shareholders' funds. This weakens the financial position of the company.
 - iii. **Negative working capital position:** The entity has a net current liability position of ₦19.660 billion in 2023 and ₦16.105 billion in 2022 that suggests potential liquidity difficulties and inability to meet short-term obligations as they fall due.
 - iv. **Weak financial support from parent company:** The direct parent company, Wagge Limited, is itself not financially viable to provide adequate financial support. This weakens the reliability of expected financial assistance.
 - v. **Dependence on comfort letter:** Management relies heavily on a letter of comfort from the parent company and beneficial shareholders. The

comfort letter may not constitute legally enforceable guarantee. The assurance only covers 12 months and there is uncertainty regarding the actual capacity to provide the funds.

- vi. **Material uncertainty regarding future funding:** The company's continued operation depends significantly on external financial support rather than internally generated funds. This creates uncertainty over future solvency and liquidity.
 - vii. **Low shareholders' equity:** Although equity declined from (₦894 million) to (₦1.102 billion) indicating that the equity remains weaker for the company's scale of operation.
 - viii. **Financial distress indicators:** The combination of persistent losses, liquidity pressure, eroded capital and reliance on shareholders support, constitutes strong indicators of financial distress under ISA 570 (Going Concern).
- (b) **Audit procedures to assess the going concern status where events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern**

Where events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern, the auditor must obtain sufficient appropriate evidence to determine whether in fact a material going concern uncertainty does exist. He does this by performing the following additional audit procedures.

- i. **Discussion with management:** Management should be asked to explain the reasons why they consider the going concern assumption to be valid. They should also be asked about their future plans for the business. If the entity is expecting to make a loss the following year, the possible implications of this for the going concern assumption should be discussed extensively.
- ii. **Obtain a cash flow forecast:** A cash flow forecast should be obtained from the company and this should also be discussed with management. The assumptions in the forecast should be checked and, if appropriate, challenged. If there is a forecast of a cash shortage, the auditor should

discuss with management their plans for obtaining the additional financing that will be required.

- iii. Review the sales order book: If this indicates a decline in sales orders, the issue should be discussed with management.
- iv. Review ageing receivables: Check a list of ageing receivables and assess the average time to pay. If customers are taking longer to pay, this may have adverse implications for operational cashflow.
- v. Consider whether planned capital expenditure by the entity may be insufficient to support the business as a going concern in the future.
- vi. If key senior employees have left the company in the recent past, the possible implications (for example, the possibility of losing key customers with the loss of the key employees) should be discussed.
- vii. Litigation: If the company is involved in continuing litigation, and faces the possibility of having to pay a large amount of money to settle the dispute, the implications should be discussed.
- viii. Information from the client entity's bank: If the client entity is expecting to rely on continuing financial support from its bank (for example, a continuation of its bank overdraft facility) the bank should be asked to confirm that the finance will remain available.
- ix. After discussing the issues with management, the auditor should obtain a letter of representation from management confirming their opinion that the entity is a going concern.
- x. The financial statements are the responsibility of management, and if the auditor considers that the going concern assumption is invalid whereas management consider it to be valid, the options available to the auditor are to:
 - discuss the matter with management, having carried out audit procedures to obtain more evidence;
 - try to persuade management to change its mind and prepare the financial statements on a different basis (a break up basis); and

- If management does not agree to change its view, consider making a qualified audit report.
- xi. Unless all those charged with governance are also involved in managing the entity, the auditor must communicate to those charged with governance any events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. Such communication must include whether:
- whether the events or conditions constitute a material uncertainty;
 - whether the use of the going concern assumption is appropriate; and
 - whether the related disclosures in the financial statements are adequate.
- xii. If there is a significant delay in the approval of the financial statements, which the auditor believes is due to events or conditions related to the going concern assessment, he must:
- perform the additional audit procedures listed above; and
 - consider the effect of this delay on his conclusions.

Examiner's Report

The question tests candidates' knowledge of going concern considerations from a scenario and the audit procedures when events have been identified that may cast significant doubt on an entity's ability to continue as a going concern. The question was attempted by about 80% of the candidates but performance was just average.

The commonest pitfall was the candidates' inability to identify going concern issues raised in the scenario that was presented.

Candidates are advised to cover the syllabus adequately and read the Institute's Study Text and Pathfinders when preparing for subsequent examinations.

Marking Guide

	Marks	Marks
a. Discussion on the factors that raise significant doubts about the going concern assumptions of the entity. (1 mark each, subject to the maximum of 6 points)		6

b.	Development of the audit procedures to be carried out, where events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern	
	(½ marks each, subject to a maximum of 18 points)	<u>9</u>
	Total	<u>15</u>

SOLUTION 6

(a) The component auditor's report of work performed should include:

- i. a statement of compliance with ethical and group auditor requirements;
- ii. identification of the financial information on which the component auditor is reporting;
- iii. any instances of non-compliance with laws and/or regulations which could lead to a material misstatement of the group financial statements;
- iv. a list of uncorrected misstatements of the financial information of the component;
- v. indicators of possible management bias;
- vi. any identified material weaknesses in internal control;
- vii. any other significant matters the component auditor expects to communicate to those charged with governance of the component;
- viii. any other matters that may be relevant to the group audit; and
- ix. the component auditor's overall findings, conclusions and opinion.

(b) Factors to consider by audit firms performing joint audits

- i. Each audit firm will need to consider if the other firm is independent, there are no conflicts of interest and the technical competence to do the work as they will be providing a joint opinion.
- ii. The two audit firms will need to agree on a joint audit strategy. The joint auditors will need to agree how to co-ordinate their work. This may be difficult if each firm follows different methodologies.

- iii. Ideally, there will be no duplication of work as this increases costs for the audit client. However, there may be some key areas where this occurs, for example, both firms wish to perform risk assessment procedures.
- iv. The audit firms will need to agree how to allocate the audit work. Ideally, one firm will not be dominant, for example, performing 90% of the work. The split of work can be based on a number of factors including:
 - number of hours work performed;
 - the relevant experience of each audit firm;
 - geographical location of the audit firms in relation to the client premises; and
 - audit client business sectors.
- v. The audit firms will wish to review each other's work as they are both responsible for the audit opinion. It may be difficult to resolve situations where the firms have difference of opinions or feel that the work carried out is not sufficient and appropriate.
- vi. Other issues to consider are:
 - professional clearance has been obtained from the previous auditors of the new client(if any);
 - appropriate anti-money laundering (client identification) procedures are performed;
 - fee is sufficient considering the nature and circumstance of the engagement without compromising quality of audit; and
 - legal and regulatory compliance has been met.
- vii. The engagement will be conducted using the appropriate financial reporting framework as stipulated by the relevant laws and regulations, for example, use of International Financial Reporting Standards.
- viii. Management has accepted their responsibilities for the preparation of the financial statements and had instituted suitable internal control mechanism that will ensure that the financial statements will give a true and fair view.
- ix. All required information to execute the audit will be made available and the auditor will have access to relevant individual in the company who will provide required audit evidence.

(c) Advantages of joint audits

- i. The client company may be so large that it requires the services of more than one firm of auditors.
- ii. After the acquisition of a large subsidiary, using joint auditors may help the transition process while the group auditors become familiar with the new subsidiary. The 'old' auditors should be familiar with the business of the subsidiary and should pass their knowledge over to the parent company auditors. For the parent company auditors, this should accelerate the process of getting to know the business of the new subsidiary.
- iii. Joint auditors may provide a higher level of technical expertise than either audit firm could provide individually.
- iv. Improved geographical coverage may be obtained for the audit, where each of the joint auditors on its own does not have offices that cover all the geographical locations of the component companies in the group.
- v. It has been suggested that two medium-sized accountancy firms might 'join forces' and tender for the audit of a company for which the auditors would normally be one of the 'Big 4' accountancy firms.

Examiner's Report

The question tests the candidates' knowledge of group audit with emphasis on the work expected of the component auditor and his report, the factors to consider before accepting engagement in joint audit and the benefits attributable to the client from a joint audit. The question was attempted by about 70% of the candidates but performance was average.

The commonest pitfall of the candidates was their inability to differentiate between the respective responsibilities of the parties in a joint audit engagement and reporting on the financial statements in a group audit.

Candidates are advised to read relevant materials to enhance their performance in the future.

Marking Guide

	Marks	Marks
a. Development of the matters the group auditor expects the component auditors to perform and include in their report. (1 mark each, subject to a maximum of 5 points)		5
b. Discussion of the factors the audit firm needs to consider before participating in this type of joint audit and the report the component auditor did. (1 mark each, subject to a maximum of 5 points)		5
c. Assessment of the benefits the client might likely get from a joint audit. (1 mark each, subject to a maximum of 5 points)		<u>5</u>
Total		<u>15</u>

SOLUTION 7

(a) **Risk Consideration by an audit firm to accepting an engagement**

The firm should design and implement risk management strategies and respond to those risks identified prior to accepting an engagement. If the auditor wants to accept an engagement, to firm has to consider the following important issue or matters:

- i. **Understanding the client and its business:** The firm should understand the client and its structure, the industry and the regulatory framework where it operates. It should also ensure management is aware and accepts its responsibility.
- ii. **Risk of integrity and reputation:** There is the need to conduct background checks on those charged with governance and the company's litigation history to be sure the firm will not associate with people with criminal records. It is also important to assess whether there is any related party relationship or transactions that might likely affect the image of the firm. The background checks should be done through the internet and media search. The firm should check whether there are threats to compliance

with the fundamental principles of integrity, objectivity, professional competence and due care, confidentiality and professional behaviour. There is the need to obtain an understanding of the conditions, events, circumstances, actions or inactions that may adversely affect the performance of quality engagement.

- iii. **Financial instability:** A review of the financial records to reveal the credit status of the company and whether there is any issue on going concern, significant contraventions or breaches of laws, like loan covenants or engagement in money laundering or any other criminal financial activities.
- iv. **Nature of the client's operations:** There is the need to consider the organisation structure, if they are involved in complex transactions or in highly risky business operations. The firm needs to consider also if it is a public interest entity that is highly regulated or a group entity with complex transactions and business operations. Consideration should be given to volatility of the country's political environment if it is a public sector engagement.
- v. **Financial reporting standards and the internal control environment:** There is the need to ensure that the entity does not have a history of creative accounting, by not following appropriate accounting frameworks, or have history of wrong interpretation of standards or relevant laws and regulations, for example, tax regulations that have impact, especially on financial reporting. The firm should also assess that they have good book-keeping and accounting records.
- vi. **There is the need to ensure sufficient and appropriate resources to undertake the engagement:** This entails availability of competent human and material resources in terms of well-trained staff and specialists. Consideration of the firms tools vis a vis the entity's information technology (IT) environment.
- vi. **Consider compliance with firm's independence and conflicts of interest requirements:** Whether any partner or staff member of the firm has business relationships with the client. Whether the fee on acceptance will not compromise the ability to deliver quality work. Whether there are threats to compliance with the fundamental principles of integrity, objectivity, professional competence and due care, confidentiality and professional behaviour. There is the need to obtain an understanding of

the conditions, events, circumstances, actions or inactions that may adversely affect the performance of quality engagement.

- viii. The engagement should not be accepted, if the firm is not convinced of the reason for changing auditor or the client declines the request to communicate with the previous auditor or the previous auditor gives a valid reason why the appointment should not be accepted.

b) **Quantitative methods and automated tools and techniques likely to be used on the audit engagement**

The audit firm may use the following quantitative methods and automated tools and techniques during the audit of Jovial Limited:

Quantitative methods

i. **Ratio analysis**

The auditor may analyse ratios such as:

- liquidity ratios;
- debt ratios
- profitability ratios; and
- lease liability ratios.

This helps identify unusual trends and financial risks.

ii. **Trend analysis** comparison of:

- current year figures with prior year balances;
- changes in lease liabilities;
- movement in property values; and
- expense fluctuations.

iii. **Materiality calculations**

Quantitative benchmarks such as:

- Percentage of total assets;
- Equity;
- Revenue;
- Profit or loss; and
- May be used in determining materiality.

iv. **Statistical sampling**

The auditor may use statistical techniques to:

- select lease transactions;
- test payables;
- verify journal entries; and
- examine supporting documents.

v. **Regression and predictive analysis**

Analytical models may be used to estimate:

- Expected lease expenses;
- Property income trends; and
- Relationships between occupancy and revenue.

Automated tools and techniques include:

vi. **Computer-assisted audit techniques (CAATs)**

CAATs may be used to:

- analyse large volumes of lease data;
- recalculate amortisation and interest expenses; and
- identify unusual transactions.

Examples include:

- ACL - Audit Command Language
- IDEA - Integrated data extraction analysis
- Excel audit functions.

vii. **Data analytics tools**

Audit software may be used to:

- identify anomalies;
- detect duplicate transactions;
- analyse journal entries; and
- assess trends and outliers.

viii. **Automated recalculation tools**

Software tools can automatically recalculate:

- right-of-use assets;
- lease liabilities;
- interest expenses; and
- depreciation/amortisation under IFRS 16.

ix. **Electronic working paper systems**

The firm may use electronic audit documentation systems to:

- store evidence;
- track audit progress;
- facilitate supervision and review; and
- enhance audit quality.

x. **Artificial intelligence and machine learning tools**

AI-enabled tools may assist in:

- risk assessment;
- pattern recognition;
- fraud detection; and
- document review.

- xī. **Spreadsheet modelling**
Advanced spreadsheet models may be used to:
- evaluate lease modifications;
 - perform sensitivity analysis; and
 - model future cash flows.
- xii. **Document management systems**
Digital systems may be used to:
- organise contacts and digital records;
 - retrieve lease agreements; and
 - Maintain audit trails securely.

Examiner’s Report

The question tests the candidates’ knowledge of risk management and the response to risk identified during the client acceptance evaluation. The candidates are also required to identify the quantitative methods and automated tools and techniques used on audit engagements. About 50% of the candidates attempted the question and the performance was below average.

The common pitfalls were the inability of the candidates to properly discuss risk management practices, the relevant quantitative methods, and the automated tools and techniques in audit.

The candidates are advised to be conversant with the quantitative tools and techniques in audit and read the Institute’s Study Text and Pathfinders for better performance in future examinations.

Marking Guide

	Marks	Marks
a. Discussion of the risk management practices to be considered in response to risks identified during the client acceptance evaluation (1 mark each, subject to a maximum of 6 points)		6
b. Identify the quantitative methods and automated tools and techniques your firm is likely to use on the audit engagement (1 mark each, subject to a maximum of 6 points)		<u>9</u>
Total		<u>15</u>

INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

PROFESSIONAL LEVEL EXAMINATION – MAY 2026

CASE STUDY

Time Allowed: 4 hours (including reading time)

INSTRUCTION: YOU ARE TO USE THE CASE STUDY ANSWER BOOKLET FOR THIS PAPER

PRE-SEEN

This material is issued prior to the examination date to enable you familiarise yourself with the case scenario so that you can undertake any research and analysis that you deem fit. This pre-seen part of the Case Study examination is also published on the Institute's website: www.icanig.org/students.

You **MUST NOT** bring this material with you to the Examination Hall. On receipt of the material, you are to spend the few days to the examination date to familiarise yourself with the information provided, carry out any additional research and or analysis about the industry, together with relevant developments and the financials provided in preparation for the examination. You should note that the use of pre-seen part of the Case Study will not significantly help you in responding to the requirements during the examination. It is essential that you carry out sufficient analysis on your own so that you can leverage the pre-seen part of the case scenario as appropriate during the examination.

At the start of the examination, you will receive the complete case scenario which will include both the pre-seen and the unseen which includes the requirements to respond to. You must use the answer booklet provided by ICAN in the Examination Hall. Any solution presented with other papers **WILL NOT** be marked.

Assessment of the Case Study

The marks in the Case Study examination are awarded for professional skills and are approximately allocated as follows:

▶ Assimilating and using information	20%
▶ Structuring problems and solutions	20%
▶ Applying judgement	20%
▶ Drawing conclusions and making recommendations	20%
▶ Demonstrating integrative and multidisciplinary skills	10%
▶ Presenting appropriate appendices	10%
	<hr/>
	100%

Of the total marks available, 20% will be assigned to the executive summary section of your response and approximately 10% will be assigned for your proper consideration of ethical issues within your answer to the requirements. Although ethical issues are not a specific requirement of this paper, as it has been tested in other subjects of the ICAN professional examination, it will be tested within a requirement which may include the following areas:

- ▶ Lack of professional independence or objectivity;
- ▶ Conflicts of interest among stakeholders;
- ▶ Doubtful accounting and or creative accounting practice;
- ▶ Unethical business/commercial practice; and
- ▶ Inappropriate pressure to achieve a reported result.

You should note that marks are not awarded for simply restating facts from the case scenario, but marks are awarded for demonstrating professional skills and technical depth. Therefore, to succeed, you are required to:

- ▶ Show sufficient evidence of knowledge of the case scenario;
- ▶ Be able to carry out appropriate analysis of the issues involved and suggest feasible solutions to the problems identified;
- ▶ Demonstrate ability to make informed judgement on the basis of analysis carried out; and
- ▶ Generate reasoned conclusions upon which relevant recommendations are made.

Omission of any one of the above will diminish your chance of success in the examination.

Case Study: Sadeco Cocoa Processing Limited (SCPL)

List of exhibits

- Exhibit 1:** About you (Tokunbo Adeolu) and your employer, Garba, Chukwuemeka, Adelani & Co.
- Exhibit 2:** The Cocoa Business in Nigeria: From the Golden Era to Challenges and Revival (1960-Present)
- Exhibit 3:** Cocoa processing industry in Nigeria
- Exhibit 4:** Sadeco Cocoa Processing Limited: Company overview, management structure, challenges and strategic direction
- Exhibit 5:** Sadeco Cocoa Processing Limited: Financial statements summary – 2022 to 2023

Exhibit 1

About you (Tokunbo Adeolu) and your employer, Garba, Chukwuemeka, Adelani & Co.

You are **Tokunbo Adeolu**, an accounting graduate, writing the Professional level of ICAN examination. You are employed as a Trainee in the firm of Garba, Chukwuemeka, Adelani & Co (Chartered Accountants), reporting directly to Thomas Chukwuemeka, a Partner in the firm. Your position requires a proactive approach to client service and technical competence in accounting, financial analysis, and business advisory.

Key responsibilities

- **Preparation of financial analyses and reports:** You are tasked with preparing detailed financial analyses and reports regarding the performance of the firm's clients. These involve gathering relevant financial data, performing rigorous analyses, and presenting findings in clear, structured reports to facilitate informed decision-making.
- **Analysis of financial statements:** Your role includes analysing clients' financial statements to identify areas of weakness. Upon identifying these anomalies, develop and recommend likely solutions aimed at correcting deficiencies and improving financial health.
- **Assessment of business proposals:** You are to assess various operational and strategic business proposals, evaluating how each aligns with the client's objectives. Additionally, you are to consider the impact of these proposals on the client's business and financial risks to ensure recommendations are both practical and strategic.
- **Evaluation of forecasts and assumptions:** You are also to examine clients' financial and business forecasts, scrutinising the assumptions upon which they are based. This is to enable you form well-grounded judgements, draw reasoned conclusions, and make relevant recommendations tailored to the client's context.
- **Strategic tax planning advice:** You are responsible for providing advice on strategic tax planning, guiding clients towards approaches that result in optimal tax liabilities and compliance with relevant regulations.
- **Drafting analytical reports:** Based on your operational and strategic business analyses, draft comprehensive reports for your partner's review, ensuring that findings and recommendations are clearly communicated and actionable.

To effectively fulfil these responsibilities, you are to keep abreast of developments in the accounting and taxation sectors, as well as matters relating to business sustainability, both on a national and international scale. This commitment to ongoing learning ensures that your work reflects current best practices and supports the firm's clients in achieving their objectives.

Exhibit 2

The Cocoa Business in Nigeria: From the Golden Era to Challenges and Revival (1960-Present)

Introduction

Nigeria's cocoa industry has witnessed dramatic changes over the decades. Once a leader on the global stage, the sector has faced considerable hurdles but is now showing signs of resurgence. This section explores the historical trajectory, challenges, and recent revival efforts shaping the cocoa business in Nigeria.

The Golden Era (1960-1980): Dominance and National Pride

During the period from 1960 to 1980, Nigeria's cocoa production thrived, placing the country among the world's leading cocoa producers, comparable with Ghana and Ivory Coast. Several key features characterised this era of prosperity:

- **Booming Production:** Cocoa output soared, underpinning Nigeria's status as a major exporter and a critical earner of foreign exchange. The revenues from cocoa exports supported vital national development projects.
- **Government Support:** The Western region government, where cocoa farming was concentrated, played a significant role in promoting the crop. This support included agricultural extension services, subsidies for inputs, and investment in research.
- **Marketing Boards:** The creation of the Nigerian Cocoa Marketing Board (NCMB) was aimed at stabilising prices, enhance quality, and guarantee fair returns for farmers.
- **Smallholder Dominance:** Smallholder farmers formed the backbone of the industry, providing livelihoods for millions and ensuring the widespread adoption of cocoa cultivation.
- **Research and Development:** The Cocoa Research Institute of Nigeria (CRIN) made notable contributions by developing improved varieties and farming techniques, leading to higher yields and better-quality beans.

Several factors contributed to the sector's success during this period, including the favourable climate and soils of the southwest rainforest belt, well-established farming traditions, supportive government policies, and robust global demand for cocoa.

The Era of Decline (1980-2000): Challenges and Setbacks

Between 1980 and 2000, Nigeria's cocoa industry suffered a marked downturn due to a combination of adverse factors such as:

- **Oil Boom:** The focus of government policy shifted towards the oil sector, leading to a decline in investment and interest in agriculture, including cocoa.
- **Collapse of Marketing Boards:** The dissolution of the NCMB as part of Structural Adjustment Programmes, exposed farmers to unstable prices and uncertain markets.
- **Aging Tree Stock:** Many cocoa trees planted decades earlier, experienced declining yields, with limited efforts made to replant or rejuvenate farms.
- **Pest and Disease Outbreaks:** Problems such as black pod disease and pest infestations devastated yields.
- **Lack of Access to Inputs:** Farmers found it increasingly difficult to obtain affordable and reliable fertilisers, pesticides, and other inputs.
- **Rural-Urban Migration:** The migration of young people to urban areas in search of better opportunities resulted in a shortage of labour on cocoa farms.
- **Political Instability:** Inconsistent policies and political uncertainty further undermined the sector's stability.

The consequences of this decline were dramatic. Export earnings from cocoa fell, many farmers were plunged into poverty, jobs were lost in related industries, and Nigeria lost its status as a world-leading cocoa producer.

The Current State (2000-Present): Striving for Revival

Recent years have brought a renewed focus on reviving the cocoa sector. Recognising its economic potential, a variety of initiatives such as the following have been launched:

- **Government Initiatives:** Programmes have been introduced to support farmers by distributing improved seedlings, providing subsidised inputs, rehabilitating old farms, and investing in research and development.
- **Private Sector Involvement:** Private companies are playing a greater role, offering finance, building processing plants, and providing technical training for farmers.
- **International Collaborations:** Organisations such as the World Bank and the International Cocoa Organisation (ICO) are supplying technical and financial assistance.
- **Focus on Sustainable Practices:** There is an increasing emphasis on agro forestry, integrated pest management, and fair labour practices to make cocoa farming more sustainable.
- **Value Addition:** The sector is shifting towards more domestic processing of cocoa beans, aiming to produce cocoa butter, powder, and other products, thereby increasing export earnings and job opportunities.

Despite these efforts, challenges remain. Farmers and processors still struggle with limited access to finance, poor infrastructure, inadequate extension services, unclear land tenure arrangements, climate change, and weak farmer cooperatives.

The Future of Cocoa in Nigeria: Prospects and Opportunities

Nigeria possesses several advantages that could help restore its status as a major cocoa producer. The country benefits from favourable agro-ecological conditions, an abundance of arable land, and rising demand for cocoa products both at home and abroad.

Key opportunities for growth include adopting modern farming techniques, expanding value-added processing, strengthening farmer cooperatives, promoting sustainable practices, attracting foreign investment, exploring new export markets, and improving infrastructure, particularly in rural areas.

Conclusion

The cocoa business in Nigeria has undergone substantial transformation since 1960. From a position of global dominance, the industry suffered decline due to neglect and unfavourable policies. Today, new efforts are being made to revitalise the sector. By confronting ongoing challenges, seizing emerging opportunities, and formulating sound policies, Nigeria can re-establish itself as a leading force in the world cocoa market. The road to success lies in the sustained commitment and collaboration of all stakeholders-government, farmers, private sector, and international partners to ensure the long-term sustainability and prosperity of the country's cocoa industry.

Exhibit 3

Cocoa Processing Industry in Nigeria

Nigeria, once a prominent player in the global cocoa market, has experienced significant fluctuations in its cocoa industry over the years. While the nation remains a significant producer of raw cocoa beans, its cocoa processing sector has not developed at the same pace, limiting Nigeria's ability to fully benefit from its abundant cocoa resources.

Overview of the Nigerian cocoa industry

Historical context

In the 1960s, Nigeria was among the world's leading cocoa exporters, with export income from the product making a substantial contribution to the national economy. However, several factors led to the decline of the sector, including the oil boom, the ageing of cocoa farmers, neglect of agricultural policy, and volatility in cocoa prices.

Current status

Presently, Nigeria is the fourth-largest cocoa producer in Africa, following Ivory Coast, Ghana and Cameroon. Cocoa production is primarily concentrated in the southwestern states, notably Ondo, Osun, Oyo, Ogun and Ekiti.

Production volume

The country's annual production of cocoa beans typically fluctuates between 250,000 and 350,000 metric tons.

Export orientation

A large share of Nigeria's cocoa output is exported as raw beans, with only a smaller proportion processed domestically.

The Nigerian cocoa processing industry: A detailed assessment

Size and capacity

The cocoa processing sector in Nigeria is relatively small compared to other major cocoa-producing nations. Although there is significant installed processing capacity, much of it remains underutilised. Most processors operate below capacity due to factors such as limited availability of beans, financial constraints, and outdated equipment. The industry is primarily dominated by a few large-scale processors, with several smaller participants also present.

Technology and infrastructure

Many cocoa processing plants in Nigeria rely on outdated technology, resulting in operational inefficiencies and increased production costs. The sector faces inadequate infrastructure, including unreliable electricity supply, poor transportation networks, and limited access to modern storage facilities. Access to dependable water sources, which is essential for processing, is not always assured.

Product range and quality

The main products resulting from domestic cocoa processing are cocoa liquor, cocoa butter, and cocoa powder. The quality of these processed products varies; while some processors meet international standards, others struggle with inconsistency. There is also a limited range of value-added products beyond these ones.

Market and distribution

Within Nigeria, the domestic market for processed cocoa products remains relatively small, restricting the growth potential of the processing industry. Export markets include Europe, Asia, and North America, but Nigerian processed cocoa faces intense competition from established processors in other countries. Distribution within Nigeria and for export is further hampered by inadequate transportation and logistics infrastructure.

Regulatory and policy environment

While government policies exist to promote the cocoa industry, their implementation has often been inconsistent and ineffective. Enforcement of quality standards and regulations is weak, and processors have limited access to financing and incentives.

Financing and investment

Access to affordable financing remains a major challenge for cocoa processors. Commercial banks are frequently hesitant to lend to the sector, perceiving it as high-risk due to insufficient collateral. There is also limited foreign direct investment in Nigeria's cocoa processing industry.

SWOT analysis: Strengths, weaknesses, opportunities, and threats

Strengths

- Abundant and relatively steady supply of cocoa beans.
- Favourable climate and soil conditions for cocoa cultivation.
- Longstanding expertise among cocoa farmers, developed over generations.
- Potential to meet growing global demand for organic cocoa.

Weaknesses

- Underdeveloped processing capacity relative to production levels.
- Reliance on outdated technology and inefficient equipment.
- Poor electricity, transportation, and storage infrastructure.
- Inconsistent quality control for processed cocoa products.
- Restricted access to affordable financing for processing businesses.
- Ineffective regulatory framework and enforcement of standards.

Opportunities

- Rising global demand for cocoa, particularly in emerging markets.
- Potential to increase exports of processed cocoa products instead of raw beans.
- Possible increase in government support and incentives for processing activities.
- Opportunities to expand exports to neighbouring African countries through regional trade agreements.
- Chance to attract both foreign and domestic investments to modernise and expand the sector.
- Development of specialty cocoa and chocolate products targeting niche markets.

Threats

- Price volatility in global cocoa markets, affecting profitability.
- Stiff competition from established processors in other countries.
- Adverse effects of climate change on cocoa production.
- Risks from pests and diseases reducing crop yields.
- Political instability and insecurity impacting production and processing.
- Fluctuations in the value of the Naira, affecting costs and competitiveness.

Challenges facing the Nigerian cocoa processing industry

Despite Nigeria's significant cocoa output, processors sometimes struggle to source enough high-quality beans, due to competition from exporters and logistical hurdles. Unreliable electricity supply is a persistent problem, raising production costs and causing operational disruptions. Poor transportation infrastructure increases costs and delays deliveries of both raw beans and processed products. Limited access to affordable financing constrains investments in technology upgrades and capacity expansion. Nigerian processors also face intense competition from more advanced industries in countries like Ivory Coast and Ghana. Finally, policy inconsistencies and unstable regulations create uncertainty that discourages further investment in the sector.

Exhibit 4

Sadeco Cocoa Processing Limited: Company overview, management structure, challenges and strategic direction

Company overview

Sadeco Cocoa Processing Limited (SCPL) was founded in 2014 in Ondo State, a region renowned for its significant contribution to Nigeria's cocoa output. The company was established with the aim of adding value to Nigerian cocoa industry and positioning itself competitively on the global stage. To achieve this, SCPL invested in a medium-sized cocoa processing facility with the capability to process around 10,000 metric tons of cocoa beans each year. The company's initial operations focused on the production of cocoa butter, cocoa cake, and cocoa powder, supplying both the domestic and export markets.

During its formative years, SCPL experienced moderate growth by tapping into the rising domestic demand for cocoa products and securing a handful of export contracts. However, over the last five years, the company has encountered numerous difficulties, which have resulted in considerable financial losses.

Board of directors and management team

SCPL is governed by a board of directors comprising six members:

Dr. Olafemi Aderopo	Chairman
Jide Ademokun	Managing Director/CEO
Dorcas Folagade	Non-executive Director
Johnson Eze	Executive Director, Finance and Strategy
Zamani Garuba	Non-executive Director
Marian Adewole	Non-executive Director

The management team is led by:

Jide Ademokun	Managing Director/CEO
Johnson Eze	Executive Director, Finance and Strategy
Dunni Abioye	Marketing Controller
Ibiyemi Adebola	Supply Chain and Logistics Controller
Michael Abimboye	Human Resources Controller
John Omiyale	Technical/Production Controller

Current challenges – The two main challenges are:

(1) Lack of working capital

SCPL is currently grappling with a severe shortage of working capital, which is attributable to several factors:

- **Delayed payments from customers:** Both domestic and international clients often delay their payments, which places significant strain on the company's cash flow.
- **High interest rates:** Borrowing costs in Nigeria are high, making it challenging for SCPL to secure loans for working capital on reasonable terms.

Outdated plant: The processing plant is obsolete and frequently breaks down, resulting in inefficiency and lower product quality. This has also affected the acceptability of SCPL's products in international markets.

- **Inefficient inventory management:** Excessive inventory levels have tied up capital that could be used more productively elsewhere.
- **Poor financial planning:** Inadequate financial planning and budgeting have exacerbated cash flow issues and led to excessive borrowing.

These challenges have resulted in a number of adverse consequences, including:

- Inability to purchase sufficient quantities of raw cocoa beans, leading to underutilisation of the processing plant capacity.
- Delayed payments to suppliers, which has damaged relationships with cocoa farmers and other partners.
- Operational inefficiencies caused by insufficient funds for maintenance and repairs, resulting in plant breakdowns and reduced efficiency.

(2) International rejection of products

The company is also contending with rejection of its products in international markets, primarily due to:

- **Poor quality control:** Inconsistent quality control has led to contamination and failure to comply with international standards, such as the European Union's regulations on pesticide residue.
- **Lack of certification:** The absence of certifications like UTZ, Rainforest Alliance, or Fairtrade, has restricted access to premium markets.
- **Inadequate packaging:** The packaging currently used by SCPL is not robust enough for long-distance shipping and does not sufficiently protect the products.
- **Lack of market research:** Insufficient research has resulted in a poor understanding of customer preferences and quality expectations abroad.
- **Industry risk:** International organisations perceive that industry players in Nigeria adopt unethical practices.

The repercussions of these issues include:

- Loss of export markets due to repeated product rejections.
- Damage to the brand's reputation arising from negative publicity about product quality.
- Increased costs associated with the storage, handling, and disposal of rejected products.

Strategic direction: The way forward

To address these challenges and restore profitability, SCPL's board has adopted a comprehensive strategy focused on resolving financial constraints, enhancing product quality, and expanding market reach. The key components of this strategy are as follows:

(1) Financial restructuring and working capital management

- Engage with creditors to restructure existing debts, which may involve extending repayment periods or negotiating lower interest rates.
- Seek equity investment from private equity firms, venture capitalists, or strategic partners to inject new working capital into the business.
- Adopt a just-in-time (JIT) inventory management system to minimise capital tied up in inventory.
- Develop a detailed financial plan and budget with a strong focus on cash flow forecasting and cost control.
- Investigate and apply for government grants and incentives available to agro-processing companies.

(2) Quality improvement and certification

- Implement a robust Quality Management System (QMS), incorporating stringent quality control procedures throughout the production process-from raw material sourcing to packaging and storage. Consideration should be given to implementing ISO 22000 (Food Safety Management System).
- Invest in up-to-date quality control equipment to ensure compliance with international standards regarding pesticide residues, heavy metals, and other contaminants.
- Provide comprehensive training to staff involved in production on quality control best practices.
- Obtain relevant certifications such as UTZ, Rainforest Alliance, and Fairtrade to gain access to premium markets and demonstrate a commitment to sustainable practices.
- Launch a supplier development programme to work with cocoa farmers, offering training and improved agricultural inputs to enhance the quality of cocoa beans and reduce contamination risks.
- Upgrade packaging by investing in high-quality materials that protect the products during shipping and meet international requirements.

(3) Backward integration

- Consider acquiring or leasing cocoa farms to ensure a stable supply of high-quality cocoa beans and lessen dependency on external suppliers. This approach will require substantial capital investment and management expertise.

- Form partnerships with cocoa farmers through cooperatives or outgrower schemes, providing them with training, inputs, and financial support in exchange for a consistent supply of quality beans at competitive prices.

(4) Strategic alliances

SCPL intends to pursue strategic alliances with global chocolate and cocoa-based consumer goods manufacturers. Such partnerships are expected to be mutually beneficial:

International Partner Contribution: Supply of modern chocolate manufacturing machinery, provision of technical expertise in quality control, branding, and product development, and injection of additional working capital.

SCPL Contribution: Access to raw cocoa supply chains within Nigeria, existing processing facilities and workforce, and established local market knowledge and government relationships.

The anticipated benefits for SCPL include value addition by moving up the value chain to produce branded chocolate products, improvement in quality through the adoption of international best practices, enhanced financial stability, and improved market access via the partner's global distribution network.

For the international partner, the advantages encompass a secure supply of Nigerian cocoa beans, production cost savings by processing near the source, access to the expanding West African chocolate market, and an opportunity to enhance sustainability branding by supporting local cocoa processing.

(5) Risks and mitigation strategies

Risk	Impact	Mitigation strategy
Policy inconsistency in Nigeria.	Could affect incentives and export grants.	Negotiate long-term agreements with government support.
Quality control lapses.	Could damage brand reputation.	Continuous training, strict quality control protocols, and obtaining certifications such as ISO, Fairtrade, and UTZ.
Currency volatility (Naira depreciation).	Increases cost of imports, including machinery and other inputs.	Use forward contracts to hedge currency exposure and maintain foreign exchange reserves.
Cultural/operational differences.	Misalignment in management styles.	Establish a joint venture governance structure with clearly defined roles and responsibilities.

Exhibit 5**Sadeco Cocoa Processing Limited (SCPL)
Financial statements summary
Statement of financial position summary**

	2023	2022
	₹	₹
Assets		
Non-current assets		
Property, plant and equipment	<u>549,161,545</u>	<u>571,452,635</u>
Total Non-current assets	<u>549,161,545</u>	<u>571,452,635</u>
Current assets		
Inventories	72,299,705	88,369,695
Trade and other receivables	15,694,405	24,765,295
Prepayments	2,793,810	2,642,620
Fixed deposit investments	13,620,025	13,539,205
Cash and cash equivalents	<u>3,337,305</u>	<u>4,052,290</u>
Total Current assets	<u>107,745,250</u>	<u>133,369,105</u>
Total assets	<u>656,906,795</u>	<u>704,821,740</u>
Equity and Liabilities		
Equity		
Share capital	130,358,150	130,358,150
Deposit for shares	435,000,000	435,000,000
Revaluation reserve	267,082,800	265,565,630
Fair value reserve	35,206,055	35,206,055
Retained earnings	<u>(816,901,875)</u>	<u>(755,159,330)</u>
Total equity	<u>50,745,130</u>	<u>110,970,505</u>
Liabilities		
Non-current liabilities		
Borrowings	8,312,040	9,926,500
Employee benefit obligations	15,798,870	14,358,250
Deferred tax liabilities	<u>87,367,505</u>	<u>89,499,590</u>
Total non-current liabilities	<u>111,478,415</u>	<u>113,784,340</u>
Current liabilities		
Bank overdraft	3,022,625	9,663,715
Trade and other payables	333,850,735	236,587,895
Borrowings	<u>157,809,890</u>	<u>233,815,285</u>
Total current liabilities	<u>494,683,250</u>	<u>480,066,895</u>
Total liabilities	<u>606,161,665</u>	<u>593,851,235</u>
Total equity and liabilities	<u>656,906,795</u>	<u>704,821,740</u>

Sadeco Cocoa Processing Company Limited (SCPL)**Income statement summary**

	2023	2022
	₹	₹
Revenue	161,721,160	217,448,285
Cost of sales	<u>(185,235,905)</u>	<u>(236,819,840)</u>
Gross loss	(23,514,745)	(19,371,555)
Other income	10,148,530	7,514,425
Selling and distribution costs	(3,510,425)	(4,022,870)
General and administrative expenses	(19,007,670)	(22,848,410)
Impairment	<u>(2,479,285)</u>	<u>2,669,255</u>
Operating loss	(38,363,595)	(36,059,155)
Finance income	285,540	250,360
Finance costs	<u>(23,664,490)</u>	<u>(28,920,335)</u>
Loss before tax	(61,742,545)	(64,729,130)
Income tax	-	<u>4,434,305</u>
Loss for the year	<u>(61,742,545)</u>	<u>(60,294,825)</u>

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Sadeco Cocoa Processing Limited (SCPL)

List of exhibits

The following exhibits are newly provided and did not form part of the material provided as Pre-seen:

- Exhibit 6:** Email from Thomas Chukwuemeka to Tokunbo Adeolu
- Exhibit 7:** Email from Johnson Eze to Thomas Chukwuemeka
- Exhibit 8:** Business working agreement
- Exhibit 9:** Sadeco Cocoa Processing Limited: Business Expansion into Food Processing
- Exhibit 10:** Sadeco Cocoa Processing Limited: Board of Directors resolutions
- Exhibit 11:** Sadeco Cocoa Processing Limited: 2024 Financial statements summary
- Exhibit 12:** An NGO's Report on the Cocoa Business in Nigeria

Sadeco Cocoa Processing Limited: Case Study requirement

You are **Tokunbo Adeolu**, writing the Professional level of ICAN examination. You are employed as a Trainee Consultant by Garba, Chukwuemeka, Adelani & Co (Chartered Accountants). You report to Thomas Chukwuemeka, a Partner in charge of the consulting arm of the firm.

Requirement

You are required to prepare a draft report, as set out in the email dated October 17, 2025 from Thomas Chukwuemeka to you (**Exhibit 6**). Your report should comprise the following:

- ▶ An executive summary
- ▶ Responses to the two detailed requirements set out in Exhibit 6, including appropriate appendices.

State clearly any assumptions you have made. All workings should be attached to your answer.

The following time allocation is suggested:

- ▶ Reading and planning 1 hour
- ▶ Performing calculations and financial analysis 1 hour
- ▶ Drafting report 2 hours

Marks allocation

All of the marks in the Case Study are awarded for the demonstration of professional skills, allocated broadly as follows:

Applied to the four elements of your report (as described above)	
▶ Assimilating and using information	20%
▶ Structuring problems and solutions	20%
▶ Applying judgement	20%
▶ Drawing conclusions and making recommendations	<u>20%</u>
	80%

Applied to your report as a whole:	
▶ Demonstrating integrative and multidisciplinary skills	10%
▶ Presenting appropriate appendices	<u>10%</u>
	<u>100%</u>

Of the total marks available, 20% are awarded for the executive summary and approximately 10% for the relevant discussion of ethical issues within your answer to the requirements.

Ensure that you address the two requirements in your report, as failure to address any requirement, including not submitting an executive summary, will adversely affect your chances of success. In addition, as indicated above, all four skills areas will be assessed under each of the four elements of your report. Accordingly, not demonstrating your judgement, or failing to include appropriate conclusions and/or recommendations in your report will adversely affect your chances of success.

Email from Thomas Chukwuemeka to Tokunbo Adeolu

From: Thomas Chukwuemeka

Sent :October 17, 2025

To: Tokunbo Adeolu

Subject: Sadeco Cocoa Processing Limited (SCPL)

Financial restructuring and expansion of operations

Due to accumulated losses over the past five years, Sadeco Cocoa Processing Limited has decided to undertake a comprehensive restructuring of its operations. This will involve the introduction of new equity capital, the restructuring of existing short-term borrowing, and the formation of a strategic alliance with a food processing company based in Europe.

The prospective foreign partner is anticipated to contribute equity in the form of plant and machinery, facilitating the company's planned expansion into food processing. Additionally, the partner will provide ₦500 million in working capital. Technical support will also be supplied, alongside the appointment of two executive directors and one non-executive director from the foreign company to the SCPL's board of directors.

Required evaluations

The company has requested an evaluation of its financial statements for the years 2022 to 2024, with the aim of identifying areas of weakness. The findings of this analysis will be discussed at a forthcoming joint board meeting between the directors of Sadeco Cocoa Processing Limited and the foreign partner's board. The evaluation will serve as the foundation for discussions on the proposed financial restructuring. Suggestions should also be provided on how to address any weaknesses identified during the analysis.

Furthermore, the directors require an assessment of the financial aspects related to the proposed expansion into food processing. Information relevant to this project is provided in Exhibit 9.

Specific tasks for the report

1. Evaluate the financial statements for the period 2022 to 2024, focusing on profitability, costs, short and long-term stability, and future prospects. Also, recommend actions that management could take to improve areas of weakness identified in the analysis.
2. Assess the viability of the proposed expansion into food processing, using the financial data supplied by management. Exhibits 8 to 12 are attached for reference, with additional details available in the Sadeco Cocoa Processing Limited file.

Next step

Please prepare a draft report addressing the points outlined above for review prior to its submission to the board of directors of Sadeco Cocoa Processing Limited.

I would like to review a draft of your report today.

Kind regards,

Thomas

Exhibit 7

Email from Johnson Eze to Thomas Chukwuemeka

To: Thomas Chukwuemeka

From: Johnson Eze

Date: October 16, 2025

Dear Thomas,

I hope this message finds you well.

As part of our ongoing desire to address two pressing issues facing the company: ongoing financial difficulties over the past several years and the intention to expand operations into food processing, we need your firm's professional services to facilitate this expansion. The company has decided to pursue a business alliance with an European food processing organisation.

Scope of the evaluation

The company's board of directors has formally requested a comprehensive evaluation of the summary financial statements for the years 2022 to 2024. This review is to focus specifically on the following areas:

- Profitability;
- Costs;
- Short and long-term financial stability; and
- Future prospects.

Additionally, recommend corrective actions that management could take to address any areas of weakness identified during the analysis.

Assessment of proposed expansion

The board also requests an evaluation of the proposed food processing project. Relevant details and supporting information for this initiative have been included in the attachments provided.

Timeline

I would like to receive your completed report within one week. The findings will be reviewed at the upcoming joint board meeting between the company and the foreign partner, scheduled for the second week of November.

I am counting on your usual cooperation to receiving this report within the time stipulated.

Best regards,

Johnson

Exhibit 8

Business working agreement

Between Sadeco Cocoa Processing Limited and Betco Food Processing Limited, UK.

Date:10/15/2025

Recitals

This Business Working Agreement (“Agreement”) is entered into on 10/15/2025 by and between Sadeco Cocoa Processing Limited, a company incorporated under the laws of Nigeria with its principal office at Plot 1 – 5, Lagos Road, Ondo, Ondo State, Nigeria and Betco Food Processing Limited, a company incorporated under the laws of United Kingdom with its principal office at 14 – 16 Bradford Road, Yorkshire, United Kingdom.

Whereas, the Nigerian Company is engaged in the processing and export of cocoa products and seeks to expand its operations and technological capabilities; and whereas the Foreign Partner possesses expertise in cocoa processing technology and is prepared to participate in the Nigerian company’s growth through equity investment, loan provision, technical support, and management contributions;

Now, therefore, the parties agree as follows:

Definitions

“Plant and Machinery”: The equipment, systems, and technology supplied by the Foreign Partner for cocoa processing is valued at 850 million naira.

“Working Capital Loan”: The sum of 500 million naira provided by the Foreign Partner as a long-term loan is, repayable over ten years.

“Board”: The Board of Directors of the Nigerian company.

“Technical Support”: The provision of expertise, training, and operational assistance by the Foreign partner.

“Refurbishment”: The process of upgrading and restoring existing plant and machinery of the Nigerian Company.

Equity participation

The foreign partner shall supply plant and machinery to the Nigerian company, valued at 850 million naira, which shall be recognised as equity participation. In consideration, the Foreign partner shall receive shares in the Nigerian company proportional to the value of the plant and machinery contributed, as mutually agreed and documented in the company’s share register.

Working capital loan

The Foreign Partner shall provide 500 million naira as working capital to the Nigerian Company in the form of a long-term loan. The loan shall bear interest at an annual rate of 18% and shall be repayable in equal instalments over a period of ten (10) years commencing from 2026. Early repayment shall be permitted without penalty. All repayments shall be made to the Foreign Partner's designated account.

Board and management structure

The Board of Directors shall be composed as follows:

- The Nigerian company shall appoint the Chairman of the Board and three (3) Non-Executive Directors.
- The foreign partner shall appoint the Managing Director, the Technical/Production Director, and one (1) Non-Executive Director.
- All appointments shall be made in accordance with applicable corporate governance standards and the Nigerian Company's Articles of Association.

Technical support and services

The foreign partner shall provide ongoing technical support to the Nigerian Company, including:

- Deployment of qualified personnel for operational management and production oversight.
- Training of local staff in best practices and advanced cocoa processing techniques.
- Assistance in quality assurance, maintenance, and optimisation of production output.
- The scope, duration, and terms of technical support shall be further specified in a technical services schedule, mutually agreed upon by both parties.

Plant refurbishment

The foreign partner shall undertake the refurbishment of the Nigerian Company's existing plant and machinery. Responsibilities include:

- Assessment of current equipment and facilities.
- Supply and installation of necessary upgrades and replacement parts.
- Supervision of refurbishment activities and testing of upgraded systems.
- Completion of refurbishment within six months, subject to mutual agreement and force majeure.
- All refurbishment works shall comply with international standards and local regulatory requirements.

Obligations of each party

Nigerian company:

- Provide access to premises and support for installation and refurbishment.
- Ensure compliance with local laws and regulations.
- Appoint Board members as stipulated.
- Facilitate integration of technical support personnel.

Foreign partner:

- Supply plant and machinery as equity contribution.
- Provide working capital loan under agreed terms.
- Appoint designated management and Board members.
- Deliver technical support and refurbishment services.

Profit sharing and dividends

Profit distribution and dividends shall be allocated in accordance with the shareholding structure as established by the parties. Dividends shall be distributed annually, subject to the Nigerian Company's audited financial statements and local regulations.

Dispute resolution

Any dispute arising from or relating to this Agreement shall be resolved amicably through negotiation between the parties. If unresolved, disputes shall be referred to arbitration under the rules of the Lagos Chamber of Commerce International Arbitration Centre, with the seat of arbitration in Nigeria. The decision of the arbitrator(s) shall be final and binding.

Governing law and jurisdiction

This Agreement shall be governed by and construed in accordance with the laws of the Federal Republic of Nigeria. Any legal proceedings shall be subject to the exclusive jurisdiction of the courts located in Nigeria.

Miscellaneous

Confidentiality: Both parties shall maintain confidentiality regarding proprietary information and trade secrets acquired during the partnership.

Amendments: Any amendment to this Agreement shall be made in writing and signed by authorised representatives of both parties.

Termination: This Agreement may be terminated by mutual consent or upon breach of material terms, subject to notice and opportunity to cure.

Entire agreement: This document constitutes the entire agreement between the parties and supersedes all prior understandings.

Signatures

For: Sadeco Cocoa Processing Limited, Nigeria For: Betco Food Processing Limited, Uk

Sadeco Cocoa Processing Limited: Business Expansion into Food Processing**Strategic business expansion**

Sadeco Cocoa Processing Limited (SCPL), in collaboration with Betco Food Processing Limited, UK. (Betco) is set to broaden its business operations by entering the food processing sector. This expansion represents an upward integration from SCPL's established cocoa processing activities, moving further along the value chain to encompass the manufacture of chocolate and cocoa-based beverages. The decision to proceed with this initiative was reached by the board of directors in agreement with Betco.

Project overview and investment

The expansion project requires a considerable initial investment, allocated as follows:

- Plant and machinery: ₦850 million
- Working capital: ₦300 million

Production plan

The proposed factory will commence operations by processing 80 metric tonnes of cocoa beans annually. Of this quantity, 60 tonnes will be dedicated to chocolate production, while the remaining 20 tonnes will be used to produce cocoa beverages. The prevailing market price for cocoa is ₦5.1 million per metric tonne.

Chocolate production

- Processing one tonne (2,205 pounds lbs) of cocoa beans yields approximately 1,985 lbs of cocoa liquor, representing a 90% yield by weight. The remaining 10% (220 lbs) is cocoa shaft, a by-product of the process.
- Each tonne of cocoa beans can produce 3,000 lbs of chocolate.
- Additional ingredients - such as sugar, salt, emulsifiers, and flavouring-cost roughly ₦50 per pound of chocolate produced.
- Labour costs are estimated at ₦250 per pound of chocolate.
- Variable overheads are projected at ₦250 per pound of chocolate, while fixed overheads (excluding depreciation) are estimated at ₦60 million annually, specifically attributed to the expansion.

The selling price for chocolate is set at ₦4,000 per lbs.

Projected annual demand for chocolate

Demand scenario	Volume (lbs)	Probability (%)
High	240,000	30
Medium	180,000	40
Low	120,000	30

Cocoa beverage production

Each tonne of cocoa beans yields 480 kg of cocoa drink and 420 kg of cocoa butter.

No additional ingredients are required for cocoa drink production, aside from packaging costs, which are ₦5,000 per kg.

Cocoa butter is packaged for export, incurring packaging costs of ₦10,000 per kg and shipping and logistics expenses of ₦20,000 per kg.

Labour costs are estimated at ₦1,500 per kg for cocoa drink and ₦1,000 per kg for cocoa butter.

Variable overheads for both products are ₦250 per kg.

Selling prices

- Cocoa drink: ₦15,000 per kg
- Cocoa butter: ₦50,000 per kg

It is anticipated that all cocoa drink and cocoa butter produced will be sold in the market.

Financial consideration

The company's cost of capital for this expansion has been calculated at 18% per annum. Betco Food Processing Limited will deem the business arrangement with SCPL as favourable if the payback period is 5 years.

Exhibit 10

Sadeco Cocoa Processing Limited Board of Directors Resolutions on Financial Restructuring and Business Alliance

Extract from the Board Minutes of Sadeco Cocoa Processing Limited

The Board convened to discuss the proposed financial restructuring of Sadeco Cocoa Processing Limited, Nigeria and to deliberate on the business alliance with Betco Food Processing Limited, United Kingdom. The following resolutions were unanimously adopted:

1. Financial restructuring

The Board resolved that the current deposit for shares amounting to ₦435 million shall be converted into ordinary shares. These shares will have a nominal value of 50 kobo each, resulting in the issuance of an additional 870 million ordinary shares.

Furthermore, it was agreed that the existing borrowing balances would be restructured as a term loan. This loan will be repayable over a period of five years, in line with agreements reached with the various banks involved.

2. Business Alliance with Betco Food Processing Limited

The Board also considered and approved the terms of the alliance with Betco Food Processing Limited. As part of this arrangement, Betco will introduce additional plant and machinery valued at ₦850 million. This contribution will be converted into equity at a nominal value of 50 kobo per share, resulting in the issuance of an additional 1,700,000,000 ordinary shares of 50 kobo each to Betco.

Additionally, Betco will provide an extra loan facility of ₦500 million. The allocation of this loan was agreed as follows:

- ₦300 million will be utilised as working capital for the new food processing project.
- ₦200 million will be injected as working capital into Sadeco's existing cocoa processing business.

Exhibit 11**Sadeco Cocoa Processing Limited
Financial statements summary
Statement of financial position summary****2024****₹****Assets****Non-current assets**Property, plant and equipment 527,734,695**Total Non-current assets** **527,734,695****Current assets**

Inventories 49,253,955

Trade and other receivables 17,765,615

Prepayments 2,357,730

Fixed deposit investments 13,620,025

Cash and cash equivalents 11,047,700**Total Current assets** **94,045,025****Total assets** **621,779,720****Equity and Liabilities****Equity**

Share capital 130,358,150

Deposit for shares 435,000,000

Revaluation reserve 265,793,255

Fair value reserve 35,206,055

Retained earnings (882,284,080)**Total equity** **(15,926,620)****Liabilities****Non-current liabilities**

Loans and borrowings 10,064,385

Employee benefit obligations 15,795,975

Deferred tax liabilities 87,367,505**Total non-current liabilities** **113,227,865****Current liabilities**

Bank overdraft -

Trade and other payables 346,668,585

Loans and borrowings 177,809,890**Total current liabilities** **524,478,475****Total liabilities** **637,706,340****Total equity and liabilities** **621,779,720**

Sadeco Cocoa Processing Company Limited
Income statement summary

	2024
	₹
Revenue	155,482,710
Cost of sales	<u>(165,643,105)</u>
Gross loss	(10,160,395)
Other income	81,860
Selling and distribution costs	(2,805,425)
General and administrative expenses	(18,708,120)
Impairment	<u>(12,492,065)</u>
Operating loss	(44,084,145)
Finance income	3,439,905
Finance costs	<u>(24,737,965)</u>
Loss before tax	(65,382,205)
Income tax	-
Loss for the year	<u>(65,382,205)</u>

Exhibit 12

An NGO's Report on the Cocoa Business in Nigeria

A recent article published by a non-governmental organisation in a national daily highlighted several critical issues within the cocoa business value chain in Nigeria. The report, with implications for SCPL focused on a range of ethical, social, and environmental challenges affecting the sector.

Child labour in the supply chain

Investigations conducted by the NGO revealed that certain suppliers of cocoa to the company were employing child labour, particularly for harvesting cocoa pods and fermenting the beans. Despite the existence of company policies intended to prevent such practices, the monitoring systems in place were found to be inadequate. Audits were infrequent, allowing these violations to persist without intervention.

Unfair farmer compensation

The report further highlighted that farmers were routinely paid less than the established living income benchmark, leaving many cocoa farmers in a state of poverty. Contracts between the company and the farmers lacked transparency, with deductions made for so-called "quality penalties" that were not clearly explained or justified to the farmers.

Lack of traceability

Another key concern raised was the lack of traceability within the company's supply chain. As cocoa beans from multiple sources were bulked together without proper segregation or record-keeping, it was impossible for the company to guarantee that its products were free from unethical practices, such as child labour or unfair compensation.

Deforestation

Using satellite imagery, the NGO linked some of the company's cocoa supply to areas that had been deforested within protected forest reserves. The expansion of cocoa farms into these forested regions was found to contribute significantly to biodiversity loss and increased carbon emissions.

Environmental mismanagement

The NGO also identified instances of environmental mismanagement by the company's processing plant. Untreated wastewater was discharged directly into nearby rivers, negatively impacting both local communities and surrounding ecosystems. In addition, cocoa husks and other by-products were simply dumped rather than being recycled for use as fertiliser or converted into bio-mass energy.

Greenwashing practices

Despite these ongoing issues, the company marketed its products as "sustainably sourced." However, the report noted the absence of credible third-party certifications, such as Fairtrade or Rainforest Alliance, calling into question the validity of these sustainability claims.

Consequences and community response

Following the publication of the NGO's article, numerous European buyers suspended their contracts, leading to a significant decline in revenue for many cocoa processing companies in Nigeria. Additionally, communities situated near these processing plants organised protests in response to the alleged pollution and poor labour practices.

ICAN CASE STUDY - MAY 2026

Sadeco Cocoa Processing Limited

First Marking

DATE			CANDIDATE NO.	
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TIME			MARKER NUMBER	
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	Exc Summary	Req 1	Req 2	Overall	TOTAL
SA					
CA					
BC					
NC					
V					
Total	5	8	8	4	25

**Sadeco Cocoa Processing Limited
Executive Summary**

<p>1. General</p> <ul style="list-style-type: none"> • States the purpose of the report • States the summary of the two requirements • States the assumptions • States reservation, e. g. scepticism 	<p>4. Requirement 2: Conclusions</p> <ul style="list-style-type: none"> • The business working agreement with the foreign partner is in the right direction. • The proposed financial restructuring is a good step. • Concludes on the company's sustainability practices. • The company's sustainability footprints need improvement. • There is a need to restructure suppliers' payments. • The food processing project has a positive NPV.
<p>2. Requirement 1: Conclusions</p> <ul style="list-style-type: none"> • There is need for urgent financial restructuring. • Liquidity is poor, as seen from the working capital ratio. • The company is owing suppliers for upward of 2 years. • The company faces serious financial risk. • There is need for urgent injection of equity capital. 	<p>5. Requirement 2: Recommendations</p> <ul style="list-style-type: none"> • Go ahead with the business alliance with Betco Food Processing Limited • The proposed financial restructuring is in the right direction. • Meet with the cocoa suppliers to reschedule their payments. • Go ahead with the food processing project, since it has a positive NPV. • Improve on the company's sustainability footprints.
<p>3. Requirement 1: Recommendations</p> <ul style="list-style-type: none"> • Improve liquidity immediately. • Carry out a financial restructuring. • Discuss with suppliers on how to restructure the payment of their outstandings. • Take immediate steps to inject equity capital to reduce the financial risk. • Institute cost control and cost reduction measures. 	

Requirement 1: Sadeco Cocoa Processing Financial Statements Analysis

<p>1. USES DATA AND INFORMATION APPROPRIATELY</p> <ul style="list-style-type: none"> • Uses information in exhibit 2 - The cocoa business in Nigeria • Uses information in exhibit 3 - Cocoa processing Industry in Nigeria. • Uses information in exhibit 4 - Sadeco Cocoa Processing Limited. • Uses information in exhibit 5 - Sadeco Cocoa Processing: 2022 - 2023 summarised financial statements. • Uses information in exhibit 6 - Email from Thomas Chukwuemeka. • Uses information in exhibit 7 - Email from Johnson Eze • Uses information in exhibit 11: 2024 financial statements summary 	<p>4. IDENTIFIES ISSUES AND OPTIONS</p> <ul style="list-style-type: none"> • Identifies that the company is in a serious financial distress. • Identifies that the creditors can call for the liquidation of the company, if urgent steps are not taken for financial restructuring. • Identifies that the company could no longer cover its variable costs therefore, it is having a negative gross profit. • Identifies that the company is owing its suppliers for more than 2 years. No supplier will supply cocoa to the company on credit. • Identifies that the company could not utilise its assets to generate revenue because of lack of working capital. • Identifies that despite drop in revenue, the administrative cost increases from 10.51% of revenue to 12.03% during the period.
<p>2. USES PROFESSIONAL TOOLS AND KNOWLEDGE</p> <ul style="list-style-type: none"> • Calculates gross profit margin. • Calculates finance costs to revenue ratio. • Calculates selling and distribution cost to revenue ratio. • Calculate operating profit margin. • Calculates administrative expenses to revenue ratio. • Calculates the return on capital employed. • Calculates net profit margin. • Calculates the working capital ratio. • Calculates acid test ratio. • Calculates total liabilities to total assets ratio. • Calculates debt/equity ratio. • Calculates debt/equity + debt ratio. • Calculates Non-current assets turnover. • Calculates total assets turnover. • Calculates inventories turnover. • Calculates receivables turnover. • Calculates payable days. 	<p>5. APPLIES PROFESSIONAL SCEPTICISM AND ETHICS</p> <ul style="list-style-type: none"> • Recognises that the going concern assumption of the company is seriously under threat. • Recognises the ethics of owning farmers that supplied cocoa to the company for over two years. • Recognises that the auditors' reports on the financial statements for the 3 years are not provided for scrutiny. • Recognises that the auditors' management letters on the 3 years financial statement are not provided.
<p>3. USES ANALYTICAL SKILLS (material points) written report</p> <ul style="list-style-type: none"> • Discusses that the gross margin was negative throughout the period. • Discusses that operating profit margin was negative and kept on increasing throughout the period. • Discusses that net profit margin increased from a negative of 29.77% to 42.05% during the period. • Discusses that returns on capital employed increased from a negative 15.93% in 2022 to 41.77% in 2024. • Discusses that working capital ratio was 0.28 in 2022 and 0.18 in 2024. This is very poor and below the standard benchmark of 2.0. • Discusses that Acid test ratio of 0.09 in 2022 and 0.09 in 2024 is not within the standard benchmark of 1.0. • Discusses that the total liabilities to total assets was 84.26% in 2022 and 102.56% in 2024. This is considered very high and risky. • Discusses that the debts to equity ratio in 2022 was 102.54% and 710.93% in 2024. This is too high and risky. • Discusses that non-current assets turnover was a paltry 0.38 time and 0.29 time in 2024. • Discusses that total assets turnover was 0.31 time in 2022 and 0.25time in 2024. 	<p>6. EVALUATIVE SKILLS AND JUDGEMENT</p> <ul style="list-style-type: none"> • Recognises the danger of the company having a negative equity, which means that the company now belongs to the creditors. • Recognises that the company may not be able to meet its day to day obligations, including its ability to pay interest on its borrowings. • Recognises that the company is having a serious financial risk. • Recognises that the company needs to institute cost control and reduction measures.

<ul style="list-style-type: none"> • Discusses that the inventory turnover was 2.68 times in 2022 and 3.36 times in 2024. • Discusses that receivable turnover was 8.78 times in 2022 and 8.75 times in 2024. • Discusses that payable days in 2022 was 365 days and 764 days in 2024. 	
<p>7. CONCLUSIONS (Draws distinct conclusions under a heading)</p> <ul style="list-style-type: none"> • Concludes on the liquidity problems facing the company. • Concludes on the company's financial risk. • Concludes on payable days. • Concludes on the need for urgent financial restructuring • Concludes on the need to inject more equity capital. • Government supply contract. 	<p>8. RECOMMENDATIONS (commercial/ relevant)</p> <ul style="list-style-type: none"> • Recommends that the company should immediately improve its liquidity. • Recommends that the company should seek for immediate injection of equity capital. • Recommends that the company should carry out a financial restructuring, including opportunity to turn the short-term borrowing to term loan. • Recommends that the company should enter into discussions with its suppliers, with a view of restructuring their outstandings. • Recommends that the company must improve on payments to its suppliers, otherwise they may stop extending credit to the company. • Recommends that the company should introduce costs control and reduction processes.

Requirement 2:

Sadeco Cocoa Processing Limited: Evaluation of Proposed Food Processing Project

<p>1. USES DATA AND INFORMATION APPROPRIATELY</p> <ul style="list-style-type: none"> • Uses information in exhibit 2 - The cocoa business in Nigeria. • Uses information in exhibit 3 - The cocoa processing industry. • Uses information in exhibit 4 - Sadeco Cocoa Processing Limited. • Uses information in exhibit 6 - Email from Thomas Chukwuemeka. • Uses information in exhibit 7 - Email from Johnson Eze. • Uses information in exhibit 8: Business working agreement. • Uses information in exhibit 9: Sadeco Cocoa Processing Limited: Expansion into food processing. • Uses information in exhibit 10: Sadeco Cocoa Processing Limited: Board of Directors of Resolutions. • Uses information in exhibit 12: An NGO's Report on Cocoa business in Nigeria. 	<p>3. USES ANALYTICAL SKILLS (material points)</p> <ul style="list-style-type: none"> • Discusses that chocolate has a positive contribution • Discusses that cocoa drink has a positive contribution • Discusses that cocoa butter has a positive contribution • Discusses that the whole project has a positive contribution • Discusses that the project has a positive NPV • Discusses that the project meets the foreign partner's expectation.
<p>2. USES PROFESSIONAL TOOLS AND KNOWLEDGE (written into report)</p> <ul style="list-style-type: none"> • Calculates the total initial investment • Calculates the expected revenue for chocolate • Calculates the revenue for cocoa drink • Calculates the revenue for cocoa butter • Calculates the cost of production for chocolate • Calculates the cost of production for cocoa drink • Calculates the contribution from chocolate • Calculates the contribution from cocoa drink • Calculates the contribution from cocoa butter • Calculates the estimated total net contribution • Calculates the net present value. 	<p>4. IDENTIFIES ISSUES AND OPTIONS</p> <ul style="list-style-type: none"> • Identifies that the business agreement with the foreign partner will help the company to stabilise its operations • Identifies that the food processing project will bring the company back into profitability. • Identifies that the food processing project will bring the company back into profitability • Identifies that the proposed financial restructuring will assist the company to manage its liquidity problem. • Identifies that the company will need to reach agreement with its cocoa suppliers to support the new project • Identifies that the foreign partner will bring in equity capital which the company needs desperately. • Identifies that the working capital loan from the foreign partner will help reduce the company's liquidity problem
<p>5. APPLYING PROFESSIONAL SCEPTICISM AND ETHICS</p> <ul style="list-style-type: none"> • Discusses the need for the company to ensure it manages its supply chain to avoid buying from cocoa producers using child labour. • Discusses that the company needs to review its contract with farmers to ensure they are given fair compensation. • Discusses that company should put in place measures that will guarantee the traceability of its supplies. • Discusses that management should ensure that waste water from the company's processing plant is either retreated or disposed of in a way that will not affect the environment. • Discusses that the company should ensure correct reporting of its sustainability practices and avoid greenwashing. 	<p>7. CONCLUSIONS (Draws distinct conclusions under a heading)</p> <ul style="list-style-type: none"> • Concludes on the business working agreement with the foreign partner. • Concludes on the proposed financial restructuring. • Concludes on the company's sustainability practices. • Concludes on reaching a repayment agreement with the company's suppliers. • Concludes on the food processing project.
<p>6. EVALUATIVE SKILLS AND JUDGEMENT (uses analytical headings)</p> <ul style="list-style-type: none"> • Recognises the effect of the company's sustainability footprints on the company's reputation. • Recognises that the company's ability to continue operation depends 	<p>8. RECOMMENDATIONS (commercial/relevant)</p> <ul style="list-style-type: none"> • Recommends that the business alliance with Betco Food Processing Limited is a good decision and the company should go ahead with the agreement. • Recommends that the proposed financial restructuring

<p>on the implementation of its business alliance with Betco Foods.</p> <ul style="list-style-type: none"> • Recognises that the company needs to take care of farmers to ensure cooperation. • Recognises that the restructuring of the company's outstanding payable is crucial to the company's ability to source raw materials. 	<p>should be pursued.</p> <ul style="list-style-type: none"> • Recommends that the company should meet with its cocoa suppliers and reschedule their payments. • Recommends that the company should go ahead with the food processing project, since it has a positive NPV. • Recommends that the company should improve on its sustainability practices.
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<p>1. R1 Appendices</p> <ul style="list-style-type: none"> • Shows gross profit margin • Shows operating profit margin • Shows the return on capital employed. • Shows net profit margin. • Shows the working capital ratio. • Shows acid test ratio • Shows leverage ratios. • Shows inventories turnover • Shows receivables turnover • Shows Non-current assets turnover • Shows total assets turnover • Shows payable days • Shows selling and distribution costs to revenue ratio. • Shows finance costs to revenue ratio. • Shows administrative expenses to revenue ratio. 	<p>3. Report: Structure</p> <ul style="list-style-type: none"> • Sufficient appropriate headings • Appropriate use of paragraphs/sentences • Appropriate use of paragraphs/sentences • legible/clear handwriting • Correctly numbered pages
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Overall

<p>2. R2 Appendices</p> <ul style="list-style-type: none">• Shows the calculation of the total initial investment• Shows the calculation of the expected revenue for chocolate • Shows revenue from cocoa drink• Shows therevenue from cocoa butter• Shows the calculation of the production cost for chocolate • Shows the calculation of the production cost for cocoa drink • Shows the production cost for cocoa butter• Shows the calculation of the contribution from chocolate• Shows the calculation of the contribution from cocoa drink• Shows the calculation of the contribution from cocoa butter • Shows the total net contribution.• Shows the net present value.	<p>4. Report: Style and language</p> <ul style="list-style-type: none">• Relevant disclaimer (external report)• Suitable language for the board• Tactful/ethical comments• Acceptable spelling and punctuation
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Appendix 1
Sadeco Cocoa Processing Limited
Financial Statements analysis
Profitability

	2022	2023	2024
Gross profit margin	$(19371555/217448285 \times 100)$	$23514745/161721160 \times 100$	$(10160395)/155482710 \times 100$
(GP/Revenue × 100)	-8.91%	-14.54%	-6.53%
Selling and distribution cost/Revenue	$4022870/217448285 \times 100$	$3510425/161721160 \times 100$	$2805425/155482710 \times 100$
	1.85%	2.17%	1.80%
Administrative costs/Revenue	$22848410/217448285 \times 100$	$19007670/161721160 \times 100$	$18708120/155482710 \times 100$
	10.51%	11.75%	12.03%
Operating profit margin	$(36059155)/217448285 \times 100$	$(38363595)/161721160 \times 100$	$(44084145)/155482710 \times 100$
OP/Revenue × 100	-16.58%	-23.72%	-28.35%
Finance cost/Revenue	$28920335/217448285 \times 100\%$	$23664490/161721160 \times 100$	$24737965/155482710 \times 100$
	13.30%	14.63%	15.91%
Net profit margin			
(Profit before tax exp/Revenue ×100)	$(64729130)/217448285 \times 100$	$(61742545)/161721160 \times 100$	$(65382205)/155482710 \times 100$
	-29.77%	-38-18%	-42.05%
Return on capital employed			
ROCE/Capital employed × 100	$(35808795)/224754845 \times 100$	$(38078055)/162223545 \times 100$	$(40644240)/97301245 \times 100$
	-15.93%	-23.47%	-41.77%
Liquidity			
Current ratio			
Current assets/Current liabilities	$133369105/480066895$	$107745250/494683250$	$94045025/524478475$
	0.28:1.00	0.22:1.00	0.18:1.00
Quick ratio - Acid test			
CA - Inventories/Current liabilities	$44999410/480066895$	$35445545/494683250$	$44791070/524478475$
	0.09:1.00	0.07:1.00	0.09:1.00
Leverage			
Total liabilities/Total Assets	$593851235/704821740 \times 100$	$606161665/656906795 \times 100$	$637706340/621779720 \times 100$
	84.26%	92.28%	102.56%
Debts/Equity	$113784340/110970505 \times 100$	$111478415/50745130 \times 100$	$113,227,865/(15,926,620)$
	102.54%	219.68%	-710.93%
Debts/Equity + Debt	$113784340/22475448455 \times 100$	$111478415/162223545 \times 100$	$113227860/97301245 \times 100$
	50.63%	68.72%	116.37%
Interest cover	$(35808795)/28920335$	$(38078055)/23664490$	$(40644240)/24737965$
	Nil	Nil	Nil
Efficiency			
Non-current assets turnover			
Revenue /Non-current assets	$217448285/571452635$	$161721160/549161545$	$155482710/527734695$
	0.38 time	0.29time	0.29 time
Total assets turnover			

(Revenue/Total assets	217448285/704821740	161721160/656906795	155482710/621779720
	0.31 time	0.25 time	0.25 time
Inventories turnover			
Cost of sales ÷ Inventory	236819840/88369695	185235905/72299705	165643105/49253955
	2.68 times	2.56 times	3.36 times
Receivable turnover			
Revenue ÷ Receivables	217448285/24765295	161721160/15694405	155482710/17765615
	8.78 times	10.30 times	8.75 times
Payable days			
Payables/Cost of sales × 365	236587895/236819840 × 365	333850735/185235905	346668585/165643105 × 365
	365 days	658 days	764 days

Appendix 2

Sadeco Cocoa Processing Limited

Appraisal of proposed food processing project

Initial costs/Investment

	₦
Plant and machinery	<u>850,000,000</u>
Working capital	<u>300,000,000</u>

Annual chocolate expected demand

Demand	Probability	Demand	Expected demand
High	0.3	240,000	72,000
Medium	0.4	180,000	72,000
Low	0.3	120,000	<u>36,000</u>
			<u>180,000</u>

Chocolate production

Output:Output

1 ton of cocoa **3,000lbs**

Price per ton ₦5,100,000

Cost of cocoa per lbs (5100000/3000) **₦1,700**

Chocolate costs of production

Cocoa 1,700

Other materials 50

Labour 250

Variable overheads 250

(2,250)

Selling price 4,000

Contribution per lbs **1,750**

Total production (60 × 3,000) 180,000

Total contribution **315,000,000**

Production of Cocoa drink

Total ton of cocoa	20tons
Cocoa drink per ton	480kgs
Total production (480 x 20)	9,600
Cost of cocoa per kg (5,100,000/(480 + 420))	<u>5,667</u>
Cost of production	
Cocoa	5,667
Packaging	5,000
Labour	1,500
Variable overheads	250
	(12,417)
Selling price per kg	15,000
Contribution per kg	2,583
Total production (480 x 20)	9,600
Total contribution	<u>24,796,800</u>

Costs of Production for cocoa butter

Cocoa	5,667
Packaging	10,000
Labour	1,000
Variable overheads	250
Shipping expenses	<u>20,000</u>
	(36,917)
Selling price	<u>50,000</u>
Contribution per kg	13,083
Total produced (20 x 420)	<u>8,400</u>
Total contribution	<u>109,897,200</u>

Total Contribution for the project

Chocolate	315,000,000
Cocoa drink	24,796,800
Cocoa butter	<u>109,897,200</u>
	449,694,000
Less fixed overheads (Specific)	<u>(60,000,000)</u>
Total Net Contribution	<u>389,694,000</u>

yr	Cashflow (₦)	Dcf	PV
0	(1,150,000,000)	1.0000	(1,150,000,000)
1	389,694,000	0.8475	330,265,665
2	389,694,000	0.7182	279,878,231
3	389,694,000	0.6086	237,167,768
4	389,694,000	0.5158	201,004,165
5	389,694,000	0.4371	170,335,247
5	300,000,000	0.4371	<u>131,130,000</u>
			<u>199,781,076</u>

The project meets the foreign partner's expectation.

EXAMINER'S REPORT

The case scenario is on Sadeco Cocoa Processing Limited (SCPL), a company that operates in the cocoa processing industry. The Pre-seen case scenario includes: The Cocoa Business in Nigeria: From Golden Era to Challenges and Revival (1960-Present); Cocoa Processing Industry in Nigeria; Sadeco Cocoa Processing Limited:

Company overview, management structure, challenges and strategic direction; and Sadeco Cocoa Processing Limited: Financial statements summary – 2022 to 2023. While the Unseen introduces Email from Thomas Chukwuemeka to Tokunbo Adeolu; Email from Johnson Eze to Thomas Chukwuemeka; Business working agreement; Sadeco Cocoa Processing Limited: Business Expansion into Food Processing; Sadeco Cocoa Processing Limited: Board resolutions; Sadeco Cocoa Processing Limited: 2024 Financial statements summary; and An NGO's Report on the Cocoa Business in Nigeria.

Candidates are required to address the following requirements:

- Evaluate the financial statements for the period 2022 to 2024, focusing on profitability, costs, short and long-term stability, and future prospects. Also, recommend actions that management could take to improve areas of weakness identified in the analysis.
- Assess the viability of the proposed expansion into food processing, using the financial data supplied by management. Exhibits 8 to 12 are attached for reference, with additional details available in the Sadeco Cocoa Processing Limited file.

To perform very well in this Case Study, candidates must prepare the following appendices:

The following appendices are required:

Requirement 1:

Appendix 1: Financial analyses appraising the company's profitability, costs, short-and long-term financial stability and future prospects; and

Requirement 2:

Appendix 2: Appraisal of proposed food processing project, using net present value technique.

The candidates' performance was poor, as only very few of them scored up to 50%.

The common pitfalls of the candidates are:

- Most of the candidates did not respond appropriately to requirement 2, possibly because they did not know how to determine the net contribution to be used for the calculation of NPV of the project;
- Lack of understanding of how to write a formal report with appropriate headings and subheadings to address issues required; and
- Inability to write a good executive summary.

Candidates are advised to practise and perfect the art of report writing, learn to address specific requirements of each Case Study and ensure they bring to bear the knowledge they have gained in other subjects of the professional examination, especially Performance Management and Strategic Financial Management, when preparing for future examinations.