



**THE INSTITUTE OF CHARTERED
ACCOUNTANTS OF NIGERIA**

PATHFINDER

**NOVEMBER 2025 DIET
PROFESSIONAL LEVEL EXAMINATIONS**

Question Papers

Suggested Solutions

Examiners' Reports

and

Marking Guides

FOREWARD

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

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

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

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

NOTES

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

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INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA



PROFESSIONAL LEVEL EXAMINATION – NOVEMBER 2025

STRATEGIC BUSINESS REPORTING

EXAMINATION INSTRUCTIONS

PLEASE READ THESE INSTRUCTIONS BEFORE THE COMMENCEMENT OF THE PAPER

1. Check your pockets, purse, mathematical set, etc. to ensure that you do not have prohibited items such as telephone handset, electronic storage device, programmable devices, wristwatches or any form of written material on you in the examination hall. You will be stopped from continuing with the examination and liable to further disciplinary actions including cancellation of examination result if caught.
2. Write your **EXAMINATION NUMBER** in the space provided above.
3. Do **NOT** write anything on your question paper **EXCEPT** your examination number.
4. Do **NOT** write anything on your docket.
5. Read all instructions in each section of the question paper carefully before answering the questions.
6. Do **NOT** answer more than the number of questions required in each section, otherwise, you will be penalised.
7. All solutions should be written in **BLUE or BLACK INK**. Any solution written in **PENCIL** or any other **COLOUR OF INK** will not be marked.
8. Cross out **ALL UNUSED SPACES ON ALL PAGES** of the Answer Booklet.
9. You are required to attempt **Question ONE** (compulsory), any **TWO** Questions in Section B and any **TWO** Questions in Section C.
10. Check that you have collected the correct question paper for the examination you are writing.

TUESDAY, NOVEMBER 18, 2025

DO NOT TURN OVER UNTIL YOU ARE TOLD TO DO SO

INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA
PROFESSIONAL LEVEL EXAMINATION – NOVEMBER 2025
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

Beverages Public Limited Company, operates in the service sector. The statement of financial position of the company and its subsidiaries as at December 31, 2024, is as follows:

	Beverages Plc ₦'m	Cocoa Plc ₦'m	Coffee Plc GH¢'m
Assets			
Non-current assets:			
Property, plant and equipment	555	165	570
Investment in subsidiaries:			
Cocoa Plc	169.5	-	-
Coffee Plc	69	-	-
Financial assets	<u>22.5</u>	<u>10.5</u>	<u>75</u>
	816	175.5	645
Current assets	<u>177</u>	<u>150</u>	<u>495</u>
Total assets	<u><u>993</u></u>	<u><u>325.5</u></u>	<u><u>1,140</u></u>
Equity and liabilities:			
Share capital	237	57	300
Retained earnings	384	84	450
Other components of equity	10.5	6	-
Total equity	<u><u>631.5</u></u>	<u><u>147</u></u>	<u><u>750</u></u>
Non-current liabilities			
Current liabilities	<u>277.5</u>	<u>115.5</u>	<u>150</u>
Total liabilities	<u><u>361.5</u></u>	<u><u>178.5</u></u>	<u><u>390</u></u>
Total equities and liabilities	<u><u>993</u></u>	<u><u>325.5</u></u>	<u><u>1,140</u></u>

The following information is relevant to the preparation of the group financial statements:

(a) On January 1, 2024, Beverages Plc acquired 70% of the equity interests in Cocoa Plc. The purchase consideration comprised cash of ₦141 million. The fair value of the identifiable net assets recognised by Cocoa Plc was ₦180 million excluding the patent. The identifiable net assets of Cocoa Plc at January 1, 2024, included a patent which had a fair value of ₦6 million. This had not been recognised in the financial statements of Cocoa Plc. The patent had a remaining term of four years to run at that date and is not renewable. The retained earnings of Cocoa Plc were ₦73.5 million and other components of equity were ₦4.5 million at the date of acquisition. The remaining excess of the fair value of the net assets is due to an increase in the value of land.

Beverages Plc wishes to use the 'full goodwill' method. The fair value of the non-controlling interests in Cocoa Plc was ₦69 million on January 1, 2024. There have been no issue of ordinary shares since acquisition and goodwill on acquisition is not impaired.

Beverages Plc acquired a further 10% interest from the non-controlling interest in Cocoa Plc on December 31, 2024, for a cash consideration of ₦28.5 million.

(b) Beverages Plc acquired 52% of the ordinary shares of Coffee Plc on January 1, 2024, when Coffee Plc retained earnings was GH¢330 million. The fair value of the identifiable net assets of Coffee Plc on January 1, 2024, was GH¢742.5 million. The excess of the fair value over the net assets of Coffee Plc is due to an increase in the value of land. The fair value of the non-controlling interests in Coffee Plc at January 1, 2024, was GH¢375 million.

Coffee Plc is located in a foreign country and operates a service business. The income of Coffee Plc is denominated and settled in Cedis. The output of the service is routinely traded in Cedis and its price is determined initially by local service and demand. Coffee Plc pays 40% of its costs and expenses in Naira with the remainder being incurred locally and settled in Cedis. Coffee Plc management has a considerable degree of authority and autonomy in carrying out the operations of Coffee Plc and is not dependent upon group companies for finance.

Beverages Plc wishes to use the 'full goodwill' method to consolidate the financial statements of Coffee Plc. There have been no issue of ordinary shares and no impairment of goodwill since acquisition.

The following exchange rates are relevant to the preparation of the group financial statements.

	GH¢ to ₦
January 1, 2024	6
December 31, 2024	5
Average for year to December 31, 2024	5.8

- (c) Beverages Plc has a property located in the same country as Coffee Plc. The property was acquired on January 1, 2024 and is carried at a cost of GH¢45 million. The property is depreciated over 20 years on any straight-line method. At December 31, 2024, the property was revalued to GH¢52.5 million. Depreciation has been charged for the year but the revaluation has not been taken into account in the preparation of the financial statements as at December 31, 2024.
- (d) Beverages Plc started a long-term bonus scheme for employees at January 1, 2024. Under the scheme, employees receive a cumulative bonus on the completion of five years' service. The bonus is 2% of the total annual salary of the employees. The total salary of employees for the year to December 31, 2024, was ₦60 million and a discount rate of 8% is assumed. Additionally at December 31, 2024, it is assumed that all employees will receive the bonus and that salaries will rise by 5% per year.
- (e) Beverages Plc purchased plant for ₦30 million on January 1, 2021, with an estimated useful life of six years. Its estimated residual value at that date was ₦2.1 million. At January 1, 2024, the estimated residual value changed to ₦3.9 million. The change in the residual value has not been taken into account when preparing the financial statements as at December 31, 2024.

Required:

Prepare a consolidated statement of financial position of the Beverages Group at December 31, 2024 in accordance with the provisions of International Financial Reporting Standards (IFRS) accounting standards, showing the exchange rate difference arising on the translation of Coffee Plc net assets.

Ignore deferred taxation.

(Total 30 Marks)

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

QUESTION 2

a. A subsidiary company in Cartella Plc, had purchased an equipment for ₦8 million on December 31, 2020, to improve its production process. Whilst re-organising the group, Cartella Plc had discovered that the producer of the equipment was now selling the same equipment for ₦5 million. The expected cash flows from the equipment are:

Year ended	Cash flows ₦'million
December 31, 2022	2.6
December 31, 2023	4.4
December 31, 2024	4.6

The residual value of the equipment is assumed to be zero. The company uses a discount rate of 10%. The directors are of the opinion that the fair value less costs of disposal of the equipment is ₦4 million. The directors of Cartella Plc propose to write down the non-current asset to the new selling price of ₦5 million. The company's policy is to depreciate its equipment by 25% per annum on the straight-line basis.

Required:

Discuss the accounting treatment of the above transactions and the impact that the resulting adjustments to the financial statements would have on Return on Capital Employed (ROCE).

Note: Your answer should include appropriate calculations, if necessary and a discussion of the accounting principles involved. (12 Marks)

b. Emmanuel Plc has a subsidiary, Akogun Plc, which has a significant amount of plant and equipment. There are specific assets on which the directors of Akogun Plc wish to seek advice:

Akogun Plc holds plant and equipment which cost ₦15 million on January 1, 2024, and are depreciated on straight-line basis over their useful life of five years. An impairment review was carried out on December 31, 2024, and the expected cash flows relating to this asset are as follows:

Year to	Dec 31, 2025	Dec 31, 2026	Dec 31, 2027	Dec 31, 2028
Cash flows (₦'000)	4,200	6,750	7,500	8,250

Akogun Plc used a discount rate of 5%. At June 30, 2025, the directors used the same expected cash flow and noticed that the resultant value-in-use was greater than carrying amount of the plant and equipment and wished to reverse any impairment loss calculated at December 31, 2024. The government has indicated that it may compensate the company for any loss in value of the asset up to 15% of the impairment loss.

Required:

Evaluate with suitable computations and reference to the principles of relevant IAS, how to account for any potential impairment of the above non-current assets in Akogun Plc financial statements for the period ended June 30, 2025.

(8 Marks)

(Total 20 Marks)

QUESTION 3

Dum dum Plc is a company in the service industry and has been operating for 10 years. Below is the statements of comprehensive income and financial position of Dum dum Plc for the last three years:

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

	2022 ₦'000	2023 ₦'000	2024 ₦'000
Revenue	1,680	1,962	1,826
Cost of sales	(1,108)	(1,290)	(1,180)
Gross profit	572	672	646
Selling, distribution and administration expenses	(372)	(428)	(438)
Profit before interest	200	244	208
Interest	(12)	(30)	(38)
Profit before taxation	188	214	170
Income tax expense	(90)	(104)	(90)
Profit for the year	98	110	80
Dividends	(48)	(48)	(48)

Statements of financial position as at December 31,

	2022 ₦'000	2023 ₦'000	2024 ₦'000
Assets:			
Non-current assets:			
Intangible assets	72	80	96
Tangible assets at carrying amount	352	412	432
	424	492	528

Current assets:

Inventories	474	606	588
Receivables	210	282	320
Bank	104	116	104
	<u>1,212</u>	<u>1,496</u>	<u>1,540</u>

Equity and liabilities:**Equity:**

Ordinary share capital	200	200	200
Retained earnings	598	660	692
	798	860	892

Non-current liabilities:

Long-term loans	148	276	276
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Current liabilities:

Trade payables	106	150	150
Other payables	160	210	222
	<u>1,212</u>	<u>1,496</u>	<u>1,540</u>

You may assume that the index of retail prices has remained constant between 2022 and 2024.

Required:

Write a report to the finance director of Dumdum Plc:

- Analysing the performance of Dumdum Plc and showing relevant calculations in an appendix to this report. (15 Marks)
- Summarising **FIVE** areas which require further investigation, including reference to other pieces of information which would complement your analysis of the performance of Dumdum Plc. (5 Marks)

(Total 20 Marks)

QUESTION 4

- Maito Plc is an entity with several subsidiaries. Trebol Plc is Maito Plc's only overseas subsidiary and Maito Plc has always disclosed Trebol Plc as an operating segment within its consolidated financial statements. The executive directors of Maito Plc are considering how the company identifies its operating segments and the basis for disclosing segmental information. To be precise, they are interested in whether it is possible to reclassify their operating segments and whether this may have influence on the usefulness of segmental reporting for the firm. There have been no internal organisational changes at Maito Plc for the past seven years.

Required:

Advise the directors on how operating segments are identified and whether they can be reclassified. Include in your discussion whether Trebol Plc should be treated as a separate segment and how it may have influence on the usefulness of the information, if its results were not separately disclosed in accordance with IFRS 8-Operating Segments. (10 Marks)

b. Mayokole Plc, has three business segments which are currently reported in its financial statements. Mayokole Plc is an international guest house group which reports to shareholders on the basis of continent. It does not currently report segmental information under IFRS 8-Operating Segments. The results of the continental segments for the year ended December 31, 2024 are as follows:

Continents	Revenue		Segment profit/Loss	Segment assets	Segment liabilities
	External	Internal			
	N'm	N'm	N'm	N'm	N'm
Africa	1,000	15	(50)	1,500	1,000
South America	1,500	10	300	4,000	1,500
Other Continents	2,500	25	525	10,000	7,000

There were no major intra-group balances in the segment assets and liabilities. The guest houses are located in capital cities in the various continents and the company sets individual performance indicators for each guest house based on its city location.

Required:

Discuss the principles in IFRS 8-Operating Segments, for the determination of a company's reportable operating segments and show how these principles would be applied for Mayokole Plc using the information given above. (10 Marks)

(Total 20 Marks)

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

QUESTION 5

a. Adoline Limited is a tin ore mining company that sells its tin ore on the spot and futures markets. On the spot market, the commodity is traded for immediate delivery and on the forward market, the commodity is traded for future delivery. The inventory is divided into different grades of tin ore. One of the categories included in inventories at December 31, 2024 is tin ore with

a low carbon content that is of a low quality. Adoline Limited will not process this low quality tin ore until all of the other tin ore has been extracted from the mine, which is likely to be in five years' time. Based on market information, Adoline Limited has calculated that the five year forecast price of tin ore will be 25% lower than the current spot price. The managing director and the chief executive officer of Adoline Limited seeks your advice on the following two matters:

- (i) Whether the Conceptual Framework affects the valuation of inventories; and
- (ii) How to calculate the net realisable value of the tin ore inventory, including the low quality tin ore.

Required:

Draft a report to advise the managing director/CEO on the above issues.

(10 Marks)

b. The managing director of Highlander Plc feels that they need additional capital in order to modernise the company's plant and equipment, as the company aims to receive new orders, to be able to produce goods to international standard. The bank's current lending policies require borrowers to show a good projected cash flow, as well as a level of profitability which would indicate that repayments would be possible. However, the current projected statement of cash flows would not meet the bank's criteria for lending. The managing director has told the bank that the company is in good financial position, the financial results and cash flow projections will meet the criteria and the director of finance will forward a report to this effect shortly. The finance director has only recently joined Highlander Plc and has openly stated that he cannot afford to lose his job because of his financial commitments.

Required:

Assess the potential ethical conflicts which may arise in the above scenario and the ethical principles which would guide how the finance director should respond in this situation.

(5 Marks)

(Total 15 Marks)

QUESTION 6

a. On January 1, 2022, Lawson Plc bought a machinery for ₦10 million and annual depreciation of ₦1,000,000 is charged on cost, with no residual value at the end of ten years of its usage. At the end of the previous financial year, December 31, 2023, when accumulated depreciation was ₦2 million, a further amount relating to an impairment loss of ₦700,000 was recognised, which resulted in the machinery being valued at its estimated value-in-use. On May 1,

2024, as a result of a proposed move to new premises, the machinery was classified as held for sale. At the time of classification as held for sale, the fair value less costs to sell was ₦6.8 million. At the date of the published interim financial statements, July 1, 2024, the machinery market had improved and the fair values less costs to sell was re-assessed at ₦7.04 million and at the year-end on December 31, 2024, it had improved even further, so that the fair value less costs to sell was ₦7.9 million. The machinery was sold on January 6, 2025 for ₦8 million.

Required:

Discuss how the above items should be dealt with in the financial statements of Lawson Plc for the relevant years. (10 Marks)

b. The ABC Public Liability Company, a multinational company is considering adopting the International Sustainability Standard Board (ISSB) standards for its sustainability reporting. You have been tasked with advising the company on the potential benefits and challenges of adopting these standards.

Required:

Prepare a report for the management of ABC Plc. (5 Marks)
(Total 15 Marks)

QUESTION 7

a. The International Sustainability Standards Board (ISSB) has issued exposure drafts aimed at amending the Sustainability Accounting Standards Board (SASB) sustainability reporting standards for nine priority industries. As a sustainability reporting expert, you have been tasked with advising a company in the oil and gas industry on the potential implications of these exposure drafts and necessary steps to take. (5 Marks)

b. A multinational firm, Bamboo Plc operates in the extractive industry and has significant environmental and social influences. The company's managing director wants to adopt a reporting framework that captures the full range of its impacts and value creation. How can Bamboo Plc apply the concept of multiple capitals to its reporting and what benefits can it expect from this approach? (5 Marks)

c. The International Sustainability Standards Board (ISSB) emerged to address the growing demand for consistent, comparable and decision useful sustainability disclosures from shareholders, investors and other stakeholders.

Required:

Discuss the emergence of the International Sustainability Standards Board (ISSB) (5 Marks)
(Total 15 Marks)

SECTION A

SOLUTION 1

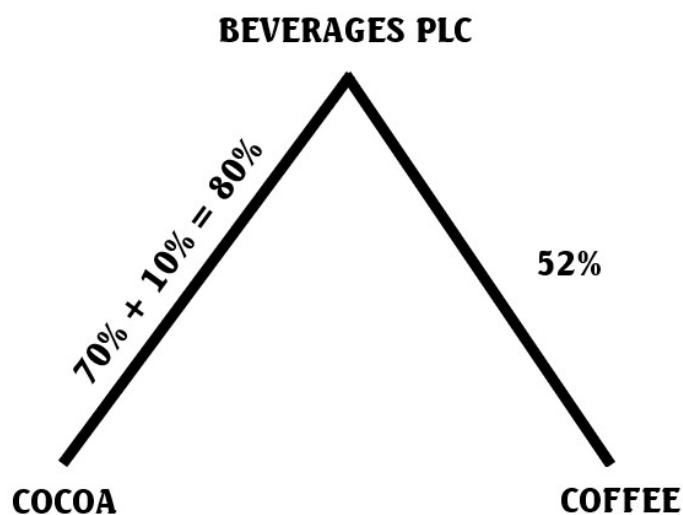
Beverages Plc group

1. Consolidated statement of financial position as at December 31, 2024

	₦'m
Non-current assets:	
Property, plant and equipment (W13)	905.475
Goodwill 24 (W3) + 9.3 (W4)	33.30
Intangible assets	4.50
Financial assets (W15)	<u>48.00</u>
	991.275
Current assets (W14)	<u>426.00</u>
Total asset	<u>1,417.275</u>
Equity and liabilities:	
Equity share capital	237.00
Retained earnings (W5)	416.085
Other components of equity (W6)	<u>10.47</u>
	663.555
Non-controlling interest (W7)	<u>134.745</u>
	798.30
Non-current liabilities (W16)	195.975
Current liabilities (W17)	<u>423.00</u>
	618.975
Total equity and liabilities	<u>1,417.275</u>

Workings:

W1 – Group structure



W2 Translation of SOFP of Coffee Plc at December 31, 2024

	GH¢ ('m)	Rate	₦'m
Property, plant & equipment	570	5	114
Financial assets	75	5	15
Current assets	<u>495</u>	5	<u>99</u>
	<u>1,140</u>	5	<u>228</u>
Share capital	300	6	50
Retained earnings (Pre-acq)	<u>330</u>	6	<u>55</u>
	630		105
Post acquisition profit	<u>120</u>		<u>45</u>
	750		150
Non-current liabilities	240	5	48
Current liabilities	<u>150</u>	5	<u>30</u>
	<u>1,140</u>		<u>228.00</u>

Retained earnings = Pre-acquisition + Post acquisition

₦100m = ₦55m + ₦45m

W3 Goodwill – Cocoa Plc	₦'m
Consideration transferred	141
Fair value of NCI	69
Fair value of NA at acq (180 + 6)	<u>(186)</u>
	<u>24</u>

W4 Goodwill – Coffee Plc	GH¢'m	Rate	₦'m
Consideration transferred (69 x 6)	414	6	69.00
Fair value of NCI	375	6	62.50
Fair value of NA at acq	<u>(742.5)</u>	6	<u>(123.75)</u>
	46.50	6	<u>7.755</u>
Exchange gain at 31/12/24	—	6	<u>1,545</u>
	<u>46.50</u>	5	<u>9.30</u>

W5 Retained earnings	Beverages Plc	Cocoa Plc	Coffee Plc
	₦'m	₦'m	₦'m
Per question as translated (w2)	384.00	84.00	100.00
Adjustment:			
Fair value movement (w8)		(1.50)	
Exchange gain on fair value (w8)			3.75
Bonus (w10)	(0.975)		
Depreciation adjustment	0.60		
Pre acq: per question		(73.50)	
Translated (w2)			<u>(55.00)</u>
	<u>9.00</u>		<u>48.75</u>

Group share: Cocoa Plc (9 x 70%)	6.30
Coffee Plc (48.75 x 52%)	25.35
Exchange gain on goodwill (w4)	
1.545 x 52%	<u>0.81</u>
	<u><u>416.085</u></u>

W6 Other component of equity (OCE)

	Beverages Plc ₦'m	Cocoa Plc ₦'m
Per question	10.50	6.00
Adjustments:		
Revaluation of foreign property (w9)	3.375	
Pre-acquisition		<u>(4.50)</u>
		<u><u>1.50</u></u>
Group share: Coffee Plc 1.5 x 70%	1.05	
Acquisition of 10% of NCI (w12)	<u>(4.455)</u>	
		<u><u>10.47</u></u>

W7 Non-controlling interest

	Cocoa Plc ₦'m	Coffee Plc ₦'m
NCI at acquisition (w3)/(w4)		
NCI share of post acq profit:	69.00	62.50
Cocoa Plc (w5) 9 x 30%	2.70	
Coffee Plc (w5) 48.75 x 48%		23.40
NCI share of post acq of OCE (w6) 1.5 x 30%	0.45	
Exchange gain on goodwill (w4) 1.545 x 48%	<u>72.15</u>	<u>0.74</u>
Acq of 10% of Cocoa Plc	<u>(24.045)</u>	<u>86.64</u>
	<u><u>48.105</u></u>	<u><u>86.64</u></u>
Total		<u><u>134.745</u></u>

W8 Fair value adjustment

	Acquisition 1/1/24 ₦'m	Movement 1 year	Year end 31/12/24 ₦'m
Cocoa Plc			
Land (180-57(sc)-73.5(RE)-4.5(OCE)	45.00		45.00
Patent	<u>6.00</u>	<u>(1/4 x 6) (1.50)</u>	<u>4.50</u>
	<u><u>51.00</u></u>	<u><u>1.50</u></u>	<u><u>49.50</u></u>
Coffee Plc:			
Land in GH¢'m			
742.5-300(sc)-330(RE)= 112.5			
In Naira(112.5/6)(112.5/5)	18.75	3.75	22.50

Note: The land is not depreciated so the movement for Coffee Plc is the change in exchange rate.

W9 Foreign property revaluation: Beverages Plc

		₦'m
Cost at January 1, 2024	(45m cedis /6)	7.50
Depreciation	(7.5/20)	<u>(0.375)</u>
		7.125
Revaluation		<u>3.375</u>
Revaluation amount at December 31, 2024 (52.5m cedis/5)		<u>10.50</u>

The revalued surplus goes to other components of equity (W6) and is added to property, plant and equipment.

W10 Long-term bonus scheme

The cumulative bonus payable is ₦6.63m, calculated as follows, with a 5% annual increase:

Bonus as at:		₦'m
Dec 31, 2024	₦60m × 2%	1.20
Dec 31, 2025	₦ 1.2m × 1.05	1.26
Dec 31, 2026	₦ 1.2m × 1.05 × 1.05	1.323
Dec 31, 2027	₦ 1.2m × 1.05 × 1.05 × 1.05	1.389
Dec 31, 2028	₦ 1.2m × 1.05 × 1.05 × 1.05 × 1.05	<u>1.458</u>
		<u>6.63</u>

This is ₦1,326,000 (₦6.63/5 years) per year. The current service cost is the present value of ₦1,326,000 at December 31, 2024:

$$₦1,326,000 \times 1/1.08 \times 1/1.08 \times 1/1.08 \times 1/1.08 = ₦0.975m$$

The double entry to record this is as follows.

Debit profit or loss or retained earnings (W5) ₦0.975m

Credit non-current liabilities ₦0.975m

W11 Residual value of plant	₦'m
Depreciation based on original residual value (30-2.1)/6	4.65
Depreciation based on revised amount (30- (4.65 × 3 years)-3.9)/3yrs	<u>4.05</u>
Adjustment to depreciation in retained earnings and add back to PPE	<u>0.60</u>

W12 Acquisition of additional 10% interest in Cocoa Plc

Beverages Plc acquired an additional 10% interest on December 31, 2024, going from 70% to 80%, so the non-controlling interests decreased by one third on that date, going from 30% to 20%. The amount of the decrease is the fair value of the net asset calculated in W7 as ₦24.045m. The adjustment to parent's equity, which goes through other components of equity (W6), is calculated as follows.

Debit non-controlling interest (W7) ₦24.045m

Debit other components of equity (W6) ₦4.455m

Credit consideration transferred ₦28.50m

W 13. Property, Plant and equipment

	₦m
Beverages plc	555
Cocoa Plc	165
Coffee plc (W2)	114
Land Cocoa Plc (Fair value adjustment) W8	45
Land Coffee Plc W8	22.50
Foreign Property revaluation – Beverages plc	3.375
Residual value of plant (W11)	<u>0.60</u>
Total to PPE to SOFP	<u>905.475</u>

W14. Currents assets

	₦m
Beverages plc	177
Cocoa Plc	150
Coffee Plc (W2)	<u>99</u>
Total to SOFP	<u>426</u>

W15 Financial assets

	₦m
Beverages plc	22.5
Cocoa Plc	10.5
Coffee Plc (W2)	<u>15.0</u>
Total to SOFP	<u>48.0</u>

W 16 Non-current liabilities

	₦m
Beverages plc	84
Cocoa Plc	63
Coffee Plc (W2)	48
Long-term bonus scheme(W10)	<u>0.975</u>
Total to SOFP	<u>195.975</u>

W17 Current liabilities

	₦m
Beverages plc	277.5
Cocoa Plc	115.5
Coffee Plc (W2)	<u>30.0</u>
Total to SOFP	<u>423.0</u>

Examiner's report

The question tests candidates' knowledge of preparation of group consolidated statement of financial position in accordance with International Financial Reporting Standards (IFRS) accounting standards, incorporating the effect of foreign exchange transactions of a subsidiary company.

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

The common pitfalls of the candidates were their inability to correctly prepare group statement of financial position; inability to correctly apply the translation of foreign currency rates; and inability to make necessary adjustments relating to goodwill and consolidated retained earnings.

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

Marking guide	Marks	Marks
Presentation of consolidated statements of financial position(SOFP)		6
Translation of SOFP of Coffee Plc	3	
Computation of the following:		
Goodwill – Cocoa Plc	1	
– Coffee Plc	1 $\frac{3}{4}$	
Retained earnings	3	
Other component of equity (OCE)	1 $\frac{3}{4}$	
Non-controlling interests	3	
Fair value adjustments	3	
Foreign property revaluation – Beverages	2	
Long-term bonus scheme	3 $\frac{3}{4}$	
Residual value of plant	1	
Acquisition of additional interest in cocoa Plc	$\frac{3}{4}$	24
Total		<u>30</u>

SOLUTION 2

a. Impairment review of equipment in Cartella Plc (IAS 36)

Step 1: Computation of carrying amount of the equipment (IAS 16)

Cost = ₦8million

Depreciation rate = 25 percent per year (straight line)

Useful life = 4 years

Depreciation per year = $8 \times 25\% = ₦2 \text{ million}$

Carrying amount at December 31, 2021

Carrying amount = ₦8 — ₦2m = ₦6 million

Step 2: Computation of recoverable amount (IAS 36)

Recoverable amount is calculated as higher of;

- Value-in-use (VIU), and
- Fair value less costs of disposal (FVLCD)

Accounting treatment:

- IAS 36 - Impairment of assets requires that no asset should be carried at more than its recoverable amount.
- At each reporting date, Cartella Plc must review all assets for indications of impairment, that is indications that the carrying value may be higher than the recoverable amount.
- Such indications include changes in circumstances in the reporting period, adverse changes in the technological, economic environment of the business etc. If impairment is indicated, then the asset's recoverable amount must be calculated.
- The producer of the equipment has reduced the selling price, but this does not automatically mean that the asset is impaired.
- The recoverable amount is defined as the higher of the asset's fair value less cost to sell and its value in use. If the recoverable amount is less than the carrying amount, then the resulting impairment loss should be charged to profit or loss as an expense.
- Value in use is the discounted present value of estimated future cash flows expected to arise from the continuing use of an asset and from its disposal at the end of its useful life.

The value in use of the equipment is calculated as follows:

Year ended cash flows discounted (10%)

	₦'m	Df at 10%	₦'m
December 31, 2022	2.6	0.909	2.363
December 31, 2023	4.4	0.826	3.634
December 31, 2024	4.6	0.751	<u>3.455</u>
			<u>9.452</u>

Conclusion

- The Value in use of the equipment (given by the Directors)
- The fair value less disposal costs of the asset is estimated at ₦4m. The recoverable amount must be the value in use of ₦9.452m, as this is higher.
- Since the recoverable amount is higher than the carrying amount of ₦6m, the asset is not impaired. Consequently there will be no effect on ROCE (Return on Capital Employed)

Principles of how to account for impairment loss

- i. The basic principle of IAS 36 is that an asset should be carried at no more than its recoverable amount, that is, the greater of amount to be recovered through use or sale of the asset.
- ii. If an asset's carrying amount is greater than its recoverable amount, an impairment loss has occurred.
- iii. The impairment loss should be written-off against profit or loss for the year.
- iv. An asset's recoverable amount is defined as the higher of: (1) The asset's fair value less costs to sell; and (2) The asset's value in use.
- v. A number of factors must be reflected in the calculation of value in use (variations, estimates of cash flows, uncertainty), but the most important is the time value of money as value in use is based on present value calculations.

Calculation of impairment loss at December 31, 2024

Akogun Plc purchased plant for ₦15 million on January 1, 2024.

Useful life = 5 years.

Straight-line basis.

Step 1: Calculate the carrying amount at December 31, 2024

Depreciation for 2024 = $15/5 = ₦3$ million

Carrying amount = $₦15 - 3 = ₦12$ million

Step 2: Impairment review 5% as at December 31, 2024

Value in use (VIU) =

$4.2 \times 0.952 = 3.998$

$6.75 \times 0.907 = 6.122$

$7.5 \times 0.864 = 6.480$

$8.25 \times 0.823 = 6.789$

Total VIU = ₦23.89 million

Fair value less cost of sell (FVLCS) is not given, so recoverable amount will be Value in Use (VIU)

- Recoverable amount = ₦23.39 million
- Carrying amount = ₦12 million

Since the recoverable amount exceeds carrying amount, no impairment at December 31, 2024.

Conclusion: No impairment exists at December 31, 2024, as the carrying amount of ₦12 million is less than the recoverable amount of ₦23.39 million.

Step 3: Review at June 30, 2025

Directors are of the opinion that the recoverable amount based on same cash flows is greater than carrying amount.

Carrying amount at June 30, 2025:

- Opening carrying amount = ₦12m
- Depreciation for half year = $(3 \times 6 / 12) = ₦1.5$ million
- Carrying amount = ₦12m — 1.5m = ₦10.5 million

Recoverable amount remains ₦23.39 million.

Recoverable amount is greater than the carrying amount.

Step 4: Reversal of impairment (IAS 36 Rules)

IAS 36 permits reversal only if:

- Impairment indicators have changed;
- Revised recoverable amount is higher than the carrying amount; and
- Reversal cannot increase asset above what the carrying amount would have been without impairment

Since the asset did not suffer any impairment at the initial stage, there will be no need to account for any reversal of impairment.

Step 5: Government compensation (IAS 20)

Government promises compensation up to 15 percent of impairment loss.

Since correct impairment = zero, compensation recognised = zero.

If an impairment had existed legitimately, compensation would be recognised as income when receivable.

Conclusion

- i. No impairment should have been recognised in year 2024.
- ii. No reversal of impairment should be accounted in year 2025.
- iii. No government grant is recognised because there is no impairment.

Examiner's report

Part (a) of the question tests candidates' knowledge of accounting treatment of impairments in accordance with the provisions of IAS 36, while part (b) dealt with the applications of the standards as it relates to the computation of carrying amount, recoverable amount, value in use and reversal of impairment rules.

Few of the candidates attempted the question and their performance was very poor.

The common pitfalls of the candidates were their inability to correctly discuss the process of impairment review; and general application of the IAS 36 with a view to determining the impairment loss.

Candidates are advised to ensure that they pay more attention to all sections of the syllabus for better performance at this level of the Institute examinations.

Marking guide	Marks	Marks
i. Accounting treatment of transactions in IAS -36 -		
Impairment of Asset		
- Computation of carrying amount of equipment	3	
- Computation of recoverable amount	1	
- Adjustment to the financial statements	2	
- Impact of the adjustments on ROCE	6	12
ii. Evaluation of the impairment principles and accounting for potential impairment in financial statements:		
- Identification of the principle of impairment	1 $\frac{1}{4}$	
- Calculation of carrying amount	1	
- Calculation of value-in-use	1 $\frac{1}{4}$	
- Determination of recoverable amount	1	
- Review of the impairment	1	
- Determination of the impairment based on IAS 36 rules	1 $\frac{1}{2}$	
- Government compensation based on IAS 20	$\frac{1}{2}$	
- Conclusion	$\frac{1}{2}$	
Total		<u>8</u> <u>20</u>

SOLUTION 3

a. To: Finance Director
From: Chief Accountant
Subject: Performance of Dumdum Plc from year 2022 to 2024

Introduction

Find below the evaluation of the financial performance of Dumdum Plc for the three years ended December 31, 2022 to 2024. This report provides an analysis of profitability, liquidity, efficiency, solvency and shareholder return trends, supported by relevant ratio calculations presented in the appendix. The analysis is based on historical cost information, consistent with the assumption that the index of retail price indices remained stable over the review period.

Executive summary

Dumdum Plc has maintained profitability, but operational efficiency and financial stability have weakened in certain areas. Revenue improved between 2022 and 2023 but declined in 2024. Gross margins remain stable, although working capital management has deteriorated. Borrowing levels increased significantly in 2023, resulting in higher gearing and increased financial risk. Dividend payments also fell in 2024, potentially indicating cash flow pressures.

Main report

An appendix is attached to this report which shows the ratios calculated as part of the performance review.

i. Profitability

The gross profit percentage has remained relatively stagnant over the three years period, although it has risen nearly by 1% in 2024. The return on capital employed (ROCE), while improving very marginally in 2023 to 21.5% has dropped significantly in 2024 to 17.8%.

The net profit percentage also fell in 2024, in spite of the improvement in the gross profit percentage. This was as a result of increase in expenses which suggest that they were not being well controlled. The utilisation of assets compared to the turnover generated has also declined reflecting the drop in trading activity between 2023 and 2024.

ii. Trading levels

It is clear that there was a rapid increase in trading activity between 2022 and 2023, but then a significant fall in 2024. Revenue increased by 17% in 2023 but fell by 7% in 2024. The reasons for this fluctuation are unclear. It may have occurred due to the effect of some kind of one-off event or change

in product mix. Whatever the reason, it appears that improved credit terms granted to customers (receivables payment period up from 46 to 64 days) has not stopped the drop in sales.

iii. Working capital

Both the current and quick ratios demonstrate an adequate working capital situation, although the quick ratio decline slightly. There has been an increased investment over the period in inventories and receivables which has been only partly financed by longer payment periods to trade payables and a rise in other payables (mainly between 2022 and 2023).

iv. Capital structure

The level of gearing of the company increased when a further ₦128,000 was raised in long-term loans in 2023 to add to the ₦ 148,000 already in the statement of financial position. Although this does not seem to be a particularly high level of gearing, the debt/equity ratio did rise from 18.5% to 32.0% in 2023. The interest charge has risen to ₦38,000 from ₦12,000 in 2022. The 2023 charge was ₦30,000, suggesting that either the interest rate on the loan is flexible, or that the full interest charge was not incurred in 2023. The new long-term loan appears to have funded the expansion in both non current and current assets in 2023.

Summary of Overall Performance

Dumdum Plc remains profitable, with stable gross margins and relatively strong liquidity. However, efficiency issues, rising receivables, increased gearing and declining dividend payouts highlight growing financial pressures. These require management attention to ensure sustainability of operations and long term financial stability.

Adams Jejelogba
Chief Accountant

Appendix

1. Schedule

	2022	2023	2024
Gross profit%	34.0%	34.3%	35.4%
ROCE	21.1%	21.5%	17.8%
Profit margin %	11.9%	12.4%	11.4%
Assets turnover	1.78	1.73	1.56
Gearing ratio	15.6%	24.3%	23.6%
Debt to equity ratio	18.5%	32.0%	30.9%
Interest cover	16.7	8.1	5.5

Current ratio	3.0	2.8	2.7
Quick ratio	1.2	1.1	1.1
Receivables payment period (days)	46	52	64
Inventory turnover period (days)	156	171	182
Payables turnover period	35	42	46

Areas for further investigation include the following:

- i. **Long-term loan:** There is no information to ascertain the reasons why the loan was raised and how it was utilised to finance the business.
- ii. **Trading activity:** The level of sales has fluctuated. Factors to consider may include pricing policies, product mix, market share etc.
- iii. **Further breakdown:** It would be useful to break down some of the information in the financial statements, perhaps into a management accounting format. Examples would include the following. (1) Sales by segment or geographical area (2) Cost of sales split, into raw materials, labour and overheads (3) Inventory broken down into raw materials, work in progress and finished goods (4) Expenses analysed between administrative expenses, sales and distribution costs.
- iv. **Accounting policies:** Accounting policies may have a significant effect on certain items. In particular, it would be useful to know what the accounting policies are in relation to intangible assets
- v. **Dividend policy:** The company has maintained the level of dividend paid to shareholders.
- vi. **Working capital problems:** There is need to investigate the inventory turnover and control over receivables.
- vii. **Earnings per share (EPS):** Cannot be calculated here as the number of shares is not given.
- viii. **Revenue decline and sales mix:** Additional information is needed on customer trends, competition and pricing policies to understand the drop in revenue in 2024. A breakdown of revenue by product or segment would provide deeper insight.
- ix. **Receivables deterioration:** Receivables days rose significantly from 46 to 64 days. Further investigation should include:
 - Aged debtors listing;
 - Bad debt history;
 - Credit policy changes; and
 - Customer concentration.

- x. **Inventory build-up:** Falling turnover rates may indicate slow moving or obsolete inventory. Information required includes:
 - Inventory ageing;
 - Inventory write-down policies; and
 - Forecasting processes.
- xi. **Impact of higher borrowing:** Gearing increased materially in 2023. Further information is needed on:
 - Interest rates;
 - Maturity profiles;
 - Loan covenants; and
 - Refinancing risks.
- xii. **Cash flow pressures and dividend reduction:** The fall in dividends may reflect cash shortages. Management should review:
 - Operating cash flows;
 - Capital expenditure plans;
 - Proposed dividend policy; and
 - Liquidity forecasts

Conclusion

Dum dum Plc has demonstrated resilience in profitability but faces rising financial and operational risks. Addressing the issues highlighted in this report will be central to strengthening performance.

Examiner's report

Part (a) of the question tests candidates' knowledge of the analysis and interpretation of financial statements. Part (b) tests the areas which require further investigation to compliment the analysis of the performance and interpretation of the financial statement.

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

Most of the candidate could not write a formal report highlighting necessary performance of the company and stating areas that require further investigation, but they concentrated more on ratios calculations.

Candidates should acquaint themselves with this section of the syllabus and also practice past questions on ratio analysis and interpretation of financial statements for better performance at this level of the Institute's examinations.

Marking guide	Marks	Marks
(a) Analysis of performance of Dumdum plc		
• Report format and presentation	1	
• Executive summary	1	
• Profitability analysis	2	
• Liquidity analysis/working capital	2	
• Trading levels/working capital	2	
• Capital structure	2	
Appendix		
• Correct calculations	4	
Overall conclusion	1	15
(b) Areas requiring further investigation		
Five correctly identified areas	2½	
Discussion of five areas correctly identified	2½	5
Total		20

SOLUTION 4

a. Identification, reclassification and disclosure of operating segments (IFRS 8)

Maito Plc has included Trebol Plc (its only overseas subsidiary) as an operating segment. Management now wishes to understand how operating segments are determined and whether reclassification is allowed.

How operating segments are identified

Under IFRS 8, an operating segment is identified using the management approach, which requires a segment to meet all of the following three conditions:

i. The segment engages in business activities

It earns revenues or incurs expenses from activities that generate economic benefits. Trebol Plc clearly meets this condition.

ii. The segment results are regularly reviewed by the chief operating decision maker (CODM)

If the CODM reviews Trebol Plc's results separately, then Trebol Plc qualifies as a distinct operating segment.

iii. Separate financial information is available

Trebol Plc must have discrete financial data available for CODM review. As an overseas subsidiary, this is likely to be the case.

Can operating segments be reclassified?

Reclassification is permitted under IFRS 8 only when there is a change in internal organisation, such as:

- i. Change in structure of management reporting;
- ii. New business model or restructuring; and
- iii. Change in how the CODM allocates resources.

There is a considerable amount of subjectivity in how an entity may apply these conditions to its choice of operating segments.

- Usually an operating segment would have a segment manager who interacts with the chief operating decision-maker to discuss operating activities, financial results, forecasts or plans for the segment.
- Therefore, segment managers could have overall responsibility for a particular product and so there could be considerable overlap in how a company may apply the conditions.
- In such situations the executive directors of Maito Plc should consider the fundamental principles of the standard. Information should be disclosed to enable users of its financial statements to appraise the nature and financial effects of the business activities in which it engages and the economic environments in which it operates.
- Since Trebol is the only overseas subsidiary, it is likely that separate disclosure is necessary so that users can better evaluate the performance of Trebol Plc and its importance to the group.
- The executive directors should also consider whether there are other segments which show similar long-term financial performance and similar economic characteristics to Trebol Plc.
- In such circumstances, it is possible to aggregate the operating segments into a single segment. For example, the segments should have products of the same nature and similar methods to distribute their products. The segments should also have similar types of customer and manufacturing processes.
- The executive directors of Maito Plc would need to assess whether such aggregation would limit the importance of the disclosures for the users of the financial statements. For example, it would no longer be possible to assess the gross margins and return on capital employed for Trebol on an individual basis, without referring to its individual financial statements.

- Operating segments can be reclassified where an entity changes its internal organisational structure. As Trebol Plc has not changed its organisational structure, it is unlikely that it would be able to argue for a reclassification of its operating segments. Should the directors of Maito Plc decide to reclassify the operating segments and combine Trebol Plc with other segments, IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors would need to be applied.

Given: There have been no organisational changes for seven years.

Therefore, operating segments should not be reclassified.

Reclassification without internal organisational changes would breach IFRS 8, because segment identification must reflect internal reporting to the CODM, not external presentation preferences.

Influence on usefulness of segment information

If Trebol Plc results were not separately disclosed:

- Users would lose visibility into the performance and risks of overseas operations;
- Financial statements would be less comparable and less transparent;
- Potentially different economic environments may distort aggregated results; and
- Risk assessment by investors becomes more difficult.

Failing to disclose Trebol as a separate segment when it meets IFRS 8 tests reduces the usefulness and predictive value of segment reporting.

Conclusion

Trebol Plc should continue to be disclosed as a separate operating segment because it meets the IFRS 8 criteria and there have been no internal reporting changes to justify reclassification.

b. Reportable operating segments

An operating segment becomes reportable and reported separately if it meets one of the quantitative thresholds:

- i. **Revenue test:** Reported revenue is 10% or more of the combined revenue of all operating segments (external and intersegment) or
- ii. **Profit or loss test:** The absolute amount of its reported profit or loss is 10% or more of the greater of, in absolute amount, all operating segments not reporting a loss, and all operating segments reporting a loss, or
- iii. **Assets test:** Its assets are 10% or more of the total assets of all operating segments.

At least 75% of total external revenue must be reported by operating segments. Where this is not the case, additional segments must be identified (even if they do not meet the 10% thresholds). Two or more operating

segments below the thresholds may be aggregated to produce a reportable segment if the segments have similar economic characteristics, and the segments are similar in a majority of the following aggregation criteria:

- The nature of the products and services;
- The nature of the production process ;
- The type or class of customer for their products or services ;
- The methods used to distribute their products or provide their services; and
- If applicable, the nature of the regulatory environment

Operating segments that do not meet any of the quantitative thresholds may be reported separately, if management believes that information about the segment would be useful to users of the financial statement

Application of reportable segments principle to Mayokole Plc

For Mayokole Plc, the thresholds are as follows:

Combined revenue is ₦5,050 million, so 10% is ₦505 million.

Combined reported profit is ₦825 million, so 10% is ₦82.5 million.

Combined reported loss is ₦50 million, so 10% is ₦5 million. Total assets are ₦15,500 million, so 10% is ₦1,550 million.

The South American segment meets the criteria, passing all three tests. Its combined revenue is ₦1,510 million, its reported profit is ₦300 million and its assets are ₦4,000 million.

The Africa segment also meets the criteria, but only marginally. Its reported revenue, at ₦1,015 million is greater than 10% of combined revenue, and only one of the tests must be satisfied.

However, its loss of ₦50 million is less than the greater of 10% of combined profit and 10% of combined loss, so it fails this test. It also fails the assets test, as its assets, at ₦1,500 million are less than 10% of combined assets (₦1,550 million).

Other IFRS 8 requirements

Mayokole Plc must disclose:

- i. Factors used to identify segments;
- ii. Types of products or services;
- iii. Geographic information;
- iv. Major customers if any; and
- v. Reconciliations between segment totals and consolidated totals

Since segments are defined by continent and management uses these for decision making, this basis complies with IFRS 8.

Conclusion

All three segments clearly meet the IFRS 8 reportability criteria. Mayokole Plc should disclose Africa, South America and other continents as separate reportable segments in its financial statements.

Examiner's report

Part (a) of the question tests candidates' knowledge of the process of identification, reclassification and disclosure of operating segments in accordance with IFRS 8 - Operating Segments. Part (b) tests the principles in IFRS 8 for the determination of company's reportable segments and the application of the principles identified to a given scenario using quantitative thresholds.

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

Majority of the candidates lack the necessary knowledge of the provision of IFRS 8 hence, it was difficult for them to practically apply this knowledge to given scenario in the questions.

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

Marking guide	Marks	Marks
a. Identification, reclassification and disclosure of operating segments (IFRS 8):		
i. How operating segments are identified	3	
ii. Reclassification of operating segments	2	
iii. Treatment of Trebol as a separate segments	2	
iv. Influence in the usefulness of segment information	2	
v. Conclusion	1	10
b. Principles in IFRS 8 for determination of a company reportable segments:		
• Reportable operating segments revenue test	1	
• Reportable operating segments profits or loss test	1	
• Reportable operating segments assets test	1	
Application of IFRS 8 principles:		
• Identifying operating segments	1/2	
Applying the quantitative threshold to:		
• Revenue test	2	
• Profit or loss test	1 1/2	
• Asset test	1	
• 75% combined revenue requirements	1	
• Other IFRS requirements and conclusion	1	10
Total		<u>20</u>

SOLUTION 5

(a) Report to the Managing Director/CEO of Adoline Limited

Subject: Valuation of tin ore Inventories and the Conceptual Framework Introduction

You requested advice on how the Conceptual Framework affects inventory valuation and how to determine the net realisable value (NRV) of all tin ore categories, including low quality ore expected to be sold only after all higher-grade ore is extracted in five years.

This report sets out how the conceptual framework affects the valuation of inventories and how to calculate the net realisable value of inventory including the low quality.

(i) How the conceptual framework affects the valuation of inventories

Although IAS 2 contains the specific requirements for valuing inventory, the conceptual framework provides the foundation that explains why these rules exist and guides their application. The framework influences inventory valuation in several important ways:

- It defines inventory as an asset**

The Conceptual Framework defines an asset as a resource controlled by the entity from which future economic benefits are expected. This definition underpins IAS 2's classification of inventory as an asset because inventory:

- is controlled through ownership;
- is expected to be sold; and
- generates future economic benefits when sold.

Thus, inventory qualifies for recognition under the framework's asset definition.

- It provides recognition criteria**

The conceptual framework states that an asset should be recognised when:

- a. It has economic benefits; and
- b. It can be measured reliably

IAS 2 applies these criteria by requiring inventory to be recognised when:

Purchased or produced and measurable at cost; and

- The framework justifies recognising inventory as soon as it is acquired or produced.**

The framework describes measurement bases such as:

- Historical cost;
- Current cost;
- Fair value; and
- Value in use

IAS 2 uses one specific measurement model consistent with the framework:

Historical cost modified by prudence - Lower of cost and net realisable value (NRV)

The framework's ideas of faithful representation, prudence and relevance supports IAS 2's requirement to write inventory down when NRV falls below cost. The framework explains the rationale behind lower of cost and NRV.

- **It supports costs components and exclusions**

The Framework requires that only costs that bring an asset to its "presents condition and location" should be included in the asset's measurement.

IAS applies this by including purchase and conversion costs and excluding abnormal waste storage costs not needed for production, and selling expenses.

The framework's cost principle shapes IAS 2's detailed cost-inclusion rules.

- **It demands faithful representation**

The conceptual framework requires financial statements to be complete neutral, free from error and prudent.

IAS 2's rule to measure inventories at lower of cost and NRV ensures that assets are not overstated, profit is not overstated and economic reality is faithfully represented.

The framework's concept of faithful representation directly influences write-downs.

- **It supports consistency and comparability**

The framework stresses the importance of consistent measurement methods and comparability across reporting periods.

IAS 2 applies this by requiring consistent use of methods of inventory valuation like FIFO or weighted average (not LIFO). The framework's qualitative characteristics justify IAS 2's restrictions on cost formulas.

- **It fills gaps when IAS 2 is silent.**

Where IAS 2 does not give guidance (e.g on new types of inventory, digital goods or unique costs) the Conceptual Framework helps accountants make judgements consistent with IFRS principles. The framework acts as a fallback guide in this type of situation.

Summary

The conceptual framework affects the valuation of inventories by:

- i. Defining inventory as an asset;
- ii. Providing the recognition criteria used by IAS 2;
- iii. Offering measurement principles (e.g historical cost, prudence) that support the lower of cost and NRV rule;
- iv. Guiding which costs should be included or excluded from inventory;
- v. Ensuring faithful representation through write-downs;
- vi. Strengthening comparability and consistency in cost formulas; and
- vii. Acting as guidance when IAS 2 does not address specific issues.

Thus, the conceptual framework gives the theoretical foundation, while IAS 2 gives the detailed rules for valuing inventory.

(ii) **How to calculate net realisable value (NRV)**
(Including the low-quality tin ore)

IAS 2 states NRV is:

- Estimated selling price in the ordinary course of business
- Less: Estimated costs of completion
- Less: Estimated selling costs

For Adoline Limited:

a. **High-quality ore (spot and forward markets)**

NRV = Current spot price or forward contract price minus selling or processing costs.

b. **Low-quality ore**

The ore will not be sold until five years from now, and the expected selling price is 25 percent below the current spot price.

NRV of low-quality ore =

- Future selling price x quantity
- Less: expected selling costs

Discounting is not required under IAS 2, but the future selling price must already reflect market expectations.

Therefore: NRV = 75 percent of current spot price minus selling costs

This value should be compared with cost.

- If NRV is less than cost, inventory must be written down.
This ensures inventory is not overstated.

Conclusion

- The Conceptual Framework influences inventory valuation through relevance, faithful representation and prudence.
- IAS 2 requires valuation at the lower of cost and NRV.
- Low-quality tin ore must be valued using the five-year forecast selling price, not today's price.
- Inventory must be written down where NRV is lower.

(b) **Ethical assessment for Highlander Plc finance director**

The managing director wants the finance director to issue a report to the bank stating that projected cash flows will meet lending criteria, even though the finance director knows this is not true.

This creates several ethical threats under the ICAN and IFAC Code of Ethics as follows:

(i) Ethical conflicts

- **Self-interest threat**
 - The finance director fears losing his job due to personal financial commitments.
 - This creates pressure to manipulate information.
- **Intimidation threat**

The managing director is exerting pressure to produce misleading financial projections.
- **Advocacy threat**

Producing a favourable report to secure a loan could make the finance director an advocate for misleading financial information.
- **Misrepresentation risk**

Providing false or biased cash flow projections breaches professional ethics and may constitute fraud.

Ethical principles applicable

- **Integrity:** The finance director must not be associated with information that is misleading or false.
- **Objectivity:** He must avoid bias due to personal interest or pressure from the managing director.
- **Professional competence and due care:** He must ensure projections are based on realistic and supportable assumptions.
- **Professional behaviour:** Must comply with laws and regulations and avoid any action that discredits the profession.

(ii) Recommended response

- Decline to issue misleading projections.
- Explain to the managing director that issuing inaccurate statements violates ethical and legal requirements.
- Provide a factual, supportable cash flow projection.
- If pressure continues, escalate to the audit committee or board.
- If unresolved, consider resignation to comply with ethical standards.
- Document all communications.

Conclusion

The finance director must uphold ethical principles and refuse to prepare misleading reports. Accurate projections improve decision making and protect stakeholders, including the bank and shareholders.

Mr XYZ
CFO

Examiner's report

Part (a) of the question tests candidates' knowledge of report writing on whether the conceptual framework affects the valuation of inventories and how to calculate the net realisable value of inventory, while part (b) tests candidates' knowledge of the assessment of potential ethical conflicts in a given scenario and the ethical principles to guide accountants.

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

The common pitfalls of the candidates were their inability to interpret the question correctly; inability to clearly state how the conceptual framework affects valuation of inventories; and inability to state how the ethical principles can guide accountants in a potential ethical conflicts.

Candidates are advised to familiarise themselves with all sections of the syllabus and pay special attention to ICAN code of ethics and guide for professional accountants, for better performance at this level of the Institute examinations.

Marking guide	Marks	Marks
(a) Report to the Managing Director on valuation of tin ore inventories and the conceptual framework:		
i. How the conceptual framework affects the valuation of inventories		
• Introduction	1/2	
• Definition of inventory as an asset	1	
• Provision of recognition criterion	2	
• Measurement concepts underlying IAS 2	1	
• Support of costs component and exclusion	1	
• Support of consistency and comparability	1	
ii. How to calculate net realisable value (NRV):		
• High quality ore	1½	
• Low quality ore	1½	
• Conclusion	½	10
(b) Potential ethical conflicts and the ethical principles:		
• Identifying and discussing of three ethical conflicts	3	
• Identifying and discussing of two ethical principles	2	5
Total		15

SOLUTION 6

a. IAS 34 requirement

In accordance with IAS 34 - Interim Financial Reporting, a company must apply the same accounting policies in its interim financial statements as in its annual financial statements. Measurements should be made on a 'year to date' basis.

Lawson Plc interim financial statements are for the six months to June 30, 2024. Lawson Plc must apply the provisions of IFRS 5 - Non-Current Assets Held for Sale and Discontinued Operations to the valuation of the machinery.

In accordance with IFRS 5, an asset held for sale should be measured at the lower of its carrying amount and fair value less costs to sell immediately before classification of the asset as held for sale, the company must recognise impairment in accordance with applicable IFRS.

Any impairment loss is generally recognised in profit or loss, but if the asset has been measured at a revalued amount under IAS 16, the impairment will be treated as a revaluation decrease. Once the asset has been classified as held for sale, any impairment loss will be based on the difference between the adjusted carrying amounts and the fair value less cost to sell. The impairment loss (if any) will be recognised in profit or loss. A subsequent increase in fair value less costs to sell may be recognised in profit or loss only to the extent of any impairment previously recognised.

Accounting treatment in the financial statements of Lawson Plc

Step1:

Calculate carrying amount under the applicable accounting standard (IAS 16):

Depreciation of ₦1,000,000 per year implies a useful life of 10 years

Remaining years to January 1, 2024 = 8 years

Depreciation must then be charged for the four months to May 1, 2024, the date of classification as held for sale is calculated on the carrying amount net of the impairment loss incurred on December 31, 2023, over the remaining useful life of eight years:

₦ 10m cost - ₦ 2m accumulated depreciation - ₦ 0.7m impairment/8years x 4/12
= ₦ 304,166 (rounded to ₦0.30 million)

The carrying amount at May 1, 2024 = ₦ 10m - ₦ 2m - ₦ 0.7m - ₦ 0.30m = ₦ 7.0 million

Step 2

Classified as held for sale

Compare the carrying amount (₦7 million) with fair value less costs to sell (₦ 6.8 million). Measure at the lower of carrying amount and fair value less costs to sell, here ₦6.8 million, giving an initial write-down of ₦ 200,000.

Step 3

Determine fair value less costs to sell at the date of the interim financial statements, July 1, 2024, here given as ₦7.04 million and compare with carrying amount of ₦6.8 million. This gives a gain of ₦240,000. The impairment previously recognised is: ₦70,000 + ₦200,000 = ₦900,000. The gain of ₦240,000 is less than this, and may therefore be credited to profit or loss, and the property is carried at ₦ 7.04 million.

Step 4

On December 31, 2024, fair value less costs to sell is ₦7.9 million. The change in fair value less cost to sell is recognised but the gain recognised cannot exceed any impairment losses to date. Impairment losses to date are ₦700,000 + ₦200,000 - ₦240,000 = ₦ 660,000, and this is less than the change in fair value less costs to sell of ₦860,000 (₦7.9m - ₦7.04m). This restricted gain of ₦660,000 is recognised and the machinery is carried at ₦7.7 million (₦7.04m + ₦660,000).

Step 5

On January 6 2025, the machinery is sold for ₦8 million, at which point a gain of ₦30,000 is recognised.

(b) Report to Management of ABC Plc on adopting ISSB standards

Subject: Potential benefits and challenges of adopting ISSB sustainability standards

i. Introduction

ABC Plc is considering adopting ISSB sustainability standards, specifically IFRS S1 and IFRS S2. These standards provide a global baseline for sustainability-related disclosures. This report outlines the major benefits and challenges that may arise from adoption.

ii. Potential benefits

- Improved transparency and credibility:** ISSB standards enhance the quality and comparability of sustainability disclosures. Investors gain confidence in consistent, decision-useful information.
- Better access to capital markets:** Global investors increasingly require sustainability data. Compliance may reduce perceived risk and reduce cost of capital.
- Enhanced risk management:** IFRS S2 (climate-related disclosures) requires identification and monitoring of climate risks, improving ABC Plc's resilience.

- **Competitive advantage:** Early adoption signals strong governance, responsible business practices and may attract ESG-focused investors.
- **Alignment with global sustainability regulations:** ISSB standards are becoming internationally accepted. Adoption helps avoid future compliance gaps.

iii. Potential challenges

- **Cost of implementation:** New systems, training, data gathering processes and external assurance increase operating costs.
- **Data collection difficulties:** Obtaining reliable sustainability data across multiple subsidiaries and jurisdictions may be challenging.
- **Transitional workload:** Initial adoption requires integrating sustainability reporting into existing financial reporting cycles.
- **Skill gap:** Staff may lack expertise in climate risk assessment, emissions measurement and non-financial reporting.
- **Increased scrutiny and accountability:** Disclosures expose ABC Plc to higher compliance risk, if information is inaccurate or incomplete.

Recommendations

- The company should outline steps that are necessary to adopt ISSB standards including data collection, reporting system and training.
- The company should communicate with customers, investors and other concerned stakeholders to understand their expectations and requirement for sustainability reporting.
- The company should assess current sustainability reporting practices against ISSB standards to identify areas for improvement.
- The company must ensure compliance and maximise the inherent benefits.

Conclusion

By adopting ISSB standards, ABC Plc can demonstrate its commitment to transparency and accountability, enhance decision making and increase investor confidence. However, adequate planning must be made to overcome the challenges it may pose in order to maximise the benefits inherent in it.

Examiner's report

Part (a) of the question tests candidates' knowledge of how to apply the principles of IAS 34-Interim Financial Reporting, to assess a practical scenario in the financial statements, while part (b) tests candidate's knowledge of how to prepare a report to advise management on potential benefits and challenges of adopting the International Sustainability Accounting Standard Board (ISSB) standards for Sustainability reporting.

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

The common pitfalls of the candidates were their inability to understand the provisions of IAS 34. Also, they did not know the potential benefits and challenges of adopting the International Sustainability Accounting Standard Board (ISSB) standards for Sustainability reporting.

Candidates are advised to pay more attention to all aspects of the syllabus, and the relevant accounting standards for better performance in the Institute's future examinations.

Marking guide	Marks	Marks
a) IAS 34- Interim Financial Reporting requirements:		
• Identification of the requirements	1½	
Accounting treatment of the property, plant and Equipments:		
• Calculation of the carrying amount	1½	
• Classification as held for sale	1½	
• Determination of fair value less costs to sell	1½	
• Recognition of change in fair value less cost to sell	1½	
• Determination of gain on sales of machinery	1½	
• Conclusion	1	10
b) Report to the management of ABC Plc on adopting ISSB standards:		
• Introduction	1	
• Potential benefits	1	
• Potential changes	1	
• Recommendations	1	
• Conclusion	1	5
Total		<u>15</u>

SOLUTION 7

(a) Potential implications of ISSB exposure drafts amending SASB standards for the oil and gas industry

The ISSB has issued exposure drafts to update SASB standards for nine industries, including oil and gas. These drafts aim to align existing SASB metrics with the global IFRS Sustainability Disclosure Standards (IFRS S1 and IFRS S2).

A company in the oil and gas sector should expect the following implications and actions:

i. Implications for the Oil and Gas Industry

Enhanced climate-related disclosure expectations

Stricter requirements for disclosures on greenhouse gas emissions, methane leakage, flaring, carbon intensity and climate transition risks.

Stronger linkage to IFRS S2's climate-related risks

Oil and gas entities must describe:

- Physical risks (storm damage, flooding, heat);
- Transition risks (carbon pricing, stranded assets, renewable shift); and
- Governance and strategy for climate resilience.

Greater comparability across jurisdictions

The amended SASB standards will align with global ISSB guidance, making disclosures comparable across international oil and gas companies.

Increased operational data requirements

Companies must gather more granular data on exploration, production, processing and product stewardship.

Higher assurance expectations

Enhanced disclosure quality may lead to external assurance and internal control improvements.

ii. Necessary steps the company should take

- Perform a readiness and gap assessment comparing current SASB disclosures with ISSB exposure draft requirements.
- Strengthen emissions measurement systems, especially methane quantification and flaring metrics.
- Enhance governance, ensuring board oversight of climate risks.
- Integrate sustainability into strategy and scenario analysis, in line with IFRS S2.
- Develop internal capacity and systems to collect, validate and report sustainability data.
- Engage stakeholders to understand data expectations from investors and regulators.

(b) **Applying the concept of multiple capitals in Bamboo Plc's reporting**

Bamboo Plc operates in the extractive industry, which has extensive environmental and social effects. The managing director wants a framework that reflects value creation beyond financial results. The Integrated Reporting Framework is most suitable, as it is based on the six capitals model.

i. **How Bamboo Plc can apply multiple capitals to its reporting**

Financial capital: Report on revenue, profitability, reinvestment and return on investment.

Manufactured capital: Show how mines, machinery and processing plants contribute to production and efficiency.

Intellectual capital: Disclose geological expertise, extraction technology and process innovations.

Human capital: Explain safety programmes, training, skills retention and workforce welfare.

Social and relationship capital: Report on community engagement, compensation processes, stakeholder relationships and social licence to operate.

Natural capital

Disclose environmental impacts which include:

- Land disturbance;
- Water use;
- Emissions;
- Biodiversity restoration; and
- Waste management.

This is the most important for extractive industries.

ii. **The benefits that Bamboo Plc can expect from its reporting approach are:**

- **Enhanced transparency and stakeholder trust:** Multiple capital reporting demonstrates a commitment to responsible resource extraction.
- **Improved risk management:** Better identification and management of social, environmental and regulatory risks.
- **Better access to capital:** Investors reward companies that demonstrate sustainable value creation.
- **Stronger long-term strategy:** The six-capital model helps management understand how operational decisions affect future value.

- **Competitive advantage:** Integrated thinking improves efficiency, resource and corporate reputation.
- Improved decision making and resource allocation.

(c) **Emergence of the International Sustainability Standards Board (ISSB)**

The ISSB was created in response to global demand for consistent sustainability disclosures. Its emergence can be explained as follows:

i. **Need for harmonisation of sustainability reporting**

Before ISSB sustainability reporting was fragmented with many frameworks:

- SASB: Sustainability Accounting Standards Board
- TCFD: Task Force on Climate-related Financial Disclosures
- GRI: Global Reporting Initiative
- CDSB: Climate Disclosure Standards Board
- Integrated Reporting (IR): International Integrated Reporting Framework (IIRC or IR Framework)

These led to inconsistent, incomparable and sometimes unreliable data.

ii. **Investor demand for decision-useful information**

Global investors needed high-quality, comparable sustainability information to assess risks such as climate change, supply chain disruption and regulatory exposure.

iii. **IOSCO and IFRS Foundation Initiative**

The IFRS Foundation, which oversees IASB, created ISSB in response to calls from:

- IOSCO: International Organisation of Securities Commissions
- G20 Finance Ministers - Group of Twenty Finance Ministers and Central Bank Governors
- Global Capital Market Authorities - Worldwide Securities, Markets and Financial Regulators (generic collective term)

These ensured legitimacy and global governance.

iv. **Development of IFRS S1 and IFRS S2**

ISSB has issued two baseline global sustainability standards:

- **IFRS S1 General Requirements for Disclosure of sustainability – related Financial Information**
- **IFRS S2 Climate-related disclosures**

These integrate SASB and TCFD concepts into a consistent global framework.

v. **Objective of ISSB**

Its purpose is to:

- Provide globally consistent sustainability disclosure standards;
- Improve comparability across jurisdictions;
- Enhance the usefulness of sustainability reporting for capital markets; and
- Support efficient cross-border investment

Conclusion

The ISSB strengthens global sustainability reporting by harmonising frameworks, improving transparency and enabling better investment decisions.

Examiner's report

Part (a) of the question tests candidates' practical understanding of the potential implications of ISSB exposure drafts to amend SASB standards, especially standard on oil and gas industry. Part (b) tests candidate's knowledge of practical application of concept of multiple capitals to the operations of extractive industry and the benefits from the approach, while part (c) tests the emergence of the International Sustainability Accounting Standard Board (ISSB) standards for consistent sustainability disclosures

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

Commonest pitfall of the candidates was their inadequate knowledge of International Sustainability Accounting Standard Board (ISSB) activities.

Candidates are advised to understand the requirements and practical application of all the International Sustainability Accounting Standard Board (ISSB) standards because they are examinable at this level of the Institute's examination.

Marking guide

	Marks	Marks
a) Potential implications of ISSB exposure draft Necessary steps to take by the company	$2\frac{1}{2}$	<u>5</u>
b) How the concept of multiple capitals can be applied in reporting	$2\frac{1}{2}$	
c) Benefits to expect from the reporting approach	$2\frac{1}{2}$	<u>5</u>
d) Discussion of the emergence of the International Sustainability Standards Board (ISSB)		<u>5</u>
Total		<u>15</u>

INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA



PROFESSIONAL LEVEL EXAMINATION – NOVEMBER 2025

ADVANCED AUDIT, ASSURANCE AND FORENSICS

EXAMINATION INSTRUCTIONS

PLEASE READ THESE INSTRUCTIONS BEFORE THE COMMENCEMENT OF THE PAPER

1. Check your pockets, purse, mathematical set, etc. to ensure that you do not have prohibited items such as telephone handset, electronic storage device, programmable devices, wristwatches or any form of written material on you in the examination hall. You will be stopped from continuing with the examination and liable to further disciplinary actions including cancellation of examination result if caught.
2. Write your **EXAMINATION NUMBER** in the space provided above.
3. Do **NOT** write anything on your question paper **EXCEPT** your Examination number.
4. Do **NOT** write anything on your docket.
5. Read all instructions in each section of the question paper carefully before answering the questions.
6. Do **NOT** answer more than the number of questions required in each section, otherwise, you will be penalised.
7. All solutions should be written in **BLUE or BLACK INK**. Any solution written in **PENCIL** or any other **COLOUR OF INK** will not be marked
8. Cross out **ALL UNUSED SPACES ON ALL PAGES** of the Answer Booklet.
9. You are required to attempt **Question ONE** (compulsory), any **TWO** Questions in Section B and any **TWO** Questions in Section C.
10. Check that you have collected the correct question paper for the examination you are writing.

WEDNESDAY, NOVEMBER 19, 2025

DO NOT TURN OVER UNTIL YOU ARE TOLD TO DO SO

INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

PROFESSIONAL LEVEL EXAMINATION – NOVEMBER 2025

ADVANCED AUDIT, ASSURANCE AND FORENSICS

Time Allowed: 3 $\frac{1}{4}$ hours (including 15 minutes reading time)

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

SECTION A: COMPULSORY QUESTION (30 MARKS)

QUESTION 1

FinEdge Technologies Plc is a fast-growing Nigerian fintech company that provides digital payments and artificial intelligence (AI)-driven fraud detection services. Over the past five years, FinEdge has expanded rapidly, processing millions of transactions daily for banks, retailers, and individual users. The company's revenue recognition, credit scoring, and risk monitoring systems are largely automated, through proprietary AI algorithms developed in-house.

For the last ten years, FinEdge has been audited by Adeniyi, Okonkwo & Co. (Chartered Accountants). The Engagement Partner, Mr. Okonkwo, has led the audit for seven consecutive years. While his familiarity with FinEdge's operations has enhanced audit efficiency, the board members of the Audit Committee have begun to express concerns about compliance with partner rotation requirements under professional and regulatory standards. Some shareholders have also questioned whether such long association could not impair independence and objectivity.

During the 2024 audit, the management requested the firm to assist in developing a governance, risk, and compliance (GRC) software to strengthen internal control processes. Although the proposed engagement was disclosed to those charged with governance, some stakeholder critics argued that the additional fees might create fee dependence, potentially compromising independence, especially since the firm already earned a significant proportion of its annual revenue from FinEdge.

Meanwhile, a senior audit assistant, Ms. Zainab Ahmed, raised concerns through internal channels that management was exerting pressure on the audit team to limit testing on AI-based transaction systems, citing "proprietary data restrictions." When she feared retaliation for her ethical stance, she escalated the matter externally to ICAN's Professional Practice Monitoring Committee. This incident revealed deficiencies in the firm's internal whistleblower protection framework and highlighted the need for stronger safeguards to encourage ethical reporting without fear of victimisation.

In addition, due to disagreements on the accounting treatment of internally generated software and AI-related model risk reserves, FinEdge's Board informed the auditors and sought a second opinion from another firm, Oladapo & Partners, to validate certain aspects of the audit conclusions. The situation raised professional questions about the boundaries and ethical implications of seeking and obtaining a second opinion while an audit engagement is ongoing.

As Adeniyi, Okonkwo & Co. prepared its final report, it needed to identify key audit matters (KAMs), particularly those relating to AI reliance in revenue recognition, technology asset valuation, and automated control testing.

Required:

- a. Evaluate the requirements for audit firm and partner rotation in an audit engagement. (9 Marks)
- b. Discuss how fee dependence undermines independence, even if disclosure is made. (4 Marks)
- c. Discuss the concept of second opinion and the factors to be considered by Oladapo & Partners in deciding to accept the engagement to provide a second opinion to FinEdge following the disagreement between the auditors and FinEdge. (7 Marks)
- d. Explain the system a firm should establish to protect whistleblowers like Zainab. (5 Marks)
- e. Prepare a draft of the key audit matters (KAMs) required for disclosure in the independent auditor's report for AI reliance. (5 Marks)

(Total 30 Marks)

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

QUESTION 2

Zenith Allied Holdings Plc is a diversified Nigerian conglomerate with subsidiaries engaged in manufacturing, financial, and information technology services across West Africa. The group's head office is located in Lagos, with major subsidiaries located in Ghana, Sierra Leone, and Kenya. Each subsidiary maintains its own finance function, accounting policies, and external auditor, though the consolidated financial statements are prepared at the group's headquarters, using IFRS.

The group's principal auditor, Adeyemi & Partners (Chartered Accountants), has been engaged to conduct the audit of the group financial statements for the year ended December 31, 2024. The engagement presents significant challenges in scope determination, as the subsidiaries vary in size, operations, and regulatory environments. While the manufacturing arm accounts for over 60% of group assets, the

financial services subsidiary in Ghana contributes the majority of revenue. The IT subsidiary, though smaller, accounts for the critical intellectual property and AI-based assets that influence the group's overall valuation.

In determining the scope of the group audit, Adeyemi & Partners must assess which components are significant and require the full scope audits, analytical procedures or specific audit work. The engagement team also needs to establish the framework for group risk assessment, identifying risks that could materially affect the consolidated financial statements, such as inter-company transactions, transfer pricing issues, and foreign currency translation differences.

A key professional judgment involves setting group and component materiality. The group auditor must consider quantitative factors like total assets and revenue, alongside qualitative aspects, such as regulatory sensitivity and stakeholder expectations. Differences in local audit thresholds among subsidiaries further complicate the determination.

Component auditors in each subsidiary – particularly Kwame & Associates in Ghana and Musa Auditing Services in Sierra Leone – have been appointed independently by the respective boards. This requires the group auditor to carefully evaluate their competence, independence, and adherence to auditing standards. To ensure audit quality, Adeyemi & Partners must determine the extent of involvement in the work of component auditors, including reviewing their working papers, discussing key findings, and performing additional procedures on areas of significant risk.

Required:

From the above scenario, discuss:

- a. The concept and purpose of scope determination and group risk assessment in group audit. (12 Marks)
- b. Considerations for setting group and component materiality. (2 Marks)
- c. The involvement of the group auditor in the work performed by component auditors. (6 Marks)

(Total 20 Marks)

QUESTION 3

The Audit Committee of a listed multinational manufacturing company consists of five non-executive directors, chaired by a retired banker. Other members include two accountants, one legal practitioner, and one corporate governance expert. The committee meets quarterly and is responsible for overseeing financial reporting, internal control, risk management and compliance, including tax-related risks.

In early 2024, the Federal Inland Revenue Service (FIRS) carried out a tax audit of one of the company's subsidiaries, alleging under-declaration of taxable income through transfer pricing and deferred tax misstatements.

A review of the situation revealed that:

- (i) the external auditors raised concerns about inadequate documentation for inter-company transactions, but these were downplayed by the management;
- (ii) the Audit Committee failed to challenge management or request detailed evidence of auditor-management discussions on tax exposures;
- (iii) when the tax audit findings were communicated, the Audit Committee did not convene an emergency meeting to address the risk; and
- (iv) the issue was only reported to those charged with governance after the FIRS took the company to court and it attracted the attention of the Financial Reporting Council of Nigeria on the basis of possible breach of reporting standards, and the company had to restate its 2023 financial statements, recognising a ₦30 million tax liability and penalties.

Following shareholders' pressure, the Chairman of the Audit Committee and a member resigned. In addition, the external auditors also resigned due to governance and disclosure concerns.

Required:

- a. Evaluate the roles of the Audit Committee in this case and suggest possible post-crisis reforms. (14 Marks)
- b. Discuss strategies to resolve the issues raised in this scenario. (6 Marks)

(Total 20 Marks)

QUESTION 4

Enogiexy Energy is a listed renewable energy company, financed heavily by debts and complex financial arrangements. The company in the just concluded financial year, experienced supply chain disruptions, interest rate hikes and falling renewable energy subsidies which have impacted negatively on the entity's fortunes, casting significant doubts on its ability to continue as a going concern. Bright Chartered Accountants are engaged to audit Enogiexy's consolidated financial statements.

Enogiexy holds significant financial assets derivatives for hedging power purchase agreements and long-term investments in carbon credit contracts. These assets are classified at *fair value through profit or loss under IFRS 9*. The management used internal models with assumptions about future energy prices and discount rates. The valuation report was prepared by an in-house team with no involvement of an external valuer.

The company invested ₦800 million in a wind farm in a fast-developing part of the country, but regulatory changes have reduced feed-in tariffs, lowering expected cash inflows. The carrying amount of the wind farm is ₦780 million, while the recoverable amount estimated by management is ₦770 million (based on value-in-use).

The management's forecasts assumed stable energy prices, but the entity's present reality suggests otherwise.

Required:

- a. Discuss the risks the auditors must recognise and consider in auditing the fair value measurements, using the facts of the above case. (6 Marks)
- b. Discuss possible implications for the audit, if Enogiexy's management refuses to appropriately disclose in the financial statements the existence of a material uncertainty together with the management's disposition of the uncertainty. (5 Marks)
- c. Identify indicators of possible management bias in estimates that should be challenged by the auditor. (2 Marks)
- d. Evaluate the form of audit report to be expected when going concern assumption is appropriate, but a material uncertainty exists. (7 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

Zybra Plc. is a consumer goods manufacturer in Nigeria that supplies major retail chains and had rapid growth over the years. The company's 2023 financial statements revealed low cash and cash equivalent balances, despite robust revenue. The external auditor examined the financial statements and issued an unmodified opinion in February 2024. By August 2024, Zybra Plc. announced major inventory write-downs and revealed undisclosed related-party purchases.

The stakeholders called for the external auditor to be sanctioned, while the auditor's position was that they followed applicable standards and procedures. The evidence available at the time of the audit did not meet the auditor's threshold to conclude that fraud existed or was material.

Required:

From the above scenario:

- a. Discuss elements or components of audit expectation gap. (6 Marks)
- b. Discuss strategies that could be implemented by practitioners to close the expectation gap. (9 Marks)

(Total 15 Marks)

QUESTION 6

FedRex is a digital payment and crypto-asset trading platform. The company offers mobile wallet services, peer-to-peer crypto trading and lending services, using crypto-assets as collaterals. The company reported ₦150 billion revenue (up by 65% from preceding year). Customer assets under custody were running to ₦600 billion in crypto currencies.

FedRex launched a new stablecoin (PX-coin), pegged to the Nigerian currency. The company holds ₦120 billion worth of crypto assets on its statement of financial position (both trading and custodial holdings). Valuation is based on crypto exchange prices, but these vary widely across platforms. Some tokens have very low trading volumes, creating measurement challenges.

The company's external auditor was engaged to examine the financial statements and provide an assurance report over the proof of reserves (PoR).

Required:

From the above scenario:

- a. Discuss the external auditor's application of information technology in the examination of the financial statements of FedRex and in providing the assurance report over the PoR. (10 Marks)
- b. Explain the impact of blockchain technology on audit and assurance services. (5 Marks)

(Total 15 Marks)

QUESTION 7

BISI Furniture Limited is a private company, which makes customised office furniture. The company exceeds the small company threshold, so an annual audit is mandatory. The audit team underestimated the risk of inventory obsolescence, given rapid changes in office design trends. Materiality level was set at 10% of profit before tax, which is high for a business with low profit margin. As a result, significant material misstatements in receivables and inventory were overlooked.

Despite weak controls (manual records, outdated accounting software), the audit team decided to adopt a control-reliance approach. They did not perform adequate test on the reliability of controls before relying on them. Tax computations and bookkeeping services were also provided along with annual audit.

Required:

From the facts of the case above:

- a. Explain the factors the auditor should consider in the choice of audit strategy. (5 Marks)
- b. Discuss the principles set out to assist the auditor in assessing the reliability of audit evidence. (10 Marks)

(Total 15 Marks)

SECTION A

SOLUTION 1

a. Requirement for audit firm and partner rotation

- i. The need for auditor rotation has been a topic of discussion, following various major corporate failures in recent years.
- ii. There has been a general perception that in many cases of corporate collapse, the accounting firm was 'too close' to the audit client and had failed to detect the warning signs of collapse for the client to take appropriate preventive measures. This triggered the regulatory requirement to mandate change of the statutory auditor of a public interest entity after a certain period.
- iii. The essence of this is to ensure independence, objectivity, quality service delivery and transparency in the discharge of audit work.
- iv. It has been observed that long association with audit clients can lead to familiarity threat, which could create an integrity issue. Rotation reduces complacency on part of auditors and helps to protect the interest of stakeholders.

These are two different suggestions about how auditor rotation should be achieved.

Audit partner rotation: The accounting firm may remain as auditors of the same client for a number of years (or until the company decides to change its auditors). However, the 'lead' Engagement Partner and other key members of the audit team should be 'rotated' regularly.

Audit firm rotation: The accounting firm should remain as auditor of a client company for no longer than a specified maximum number of years, say up to ten years. Note that in many countries (including Nigeria), this would require legislative amendment, as the law frequently provides that auditor's appointment is for one year, renewable indefinitely.

The regulatory requirements for audit firm and partner rotation

- i) The rules regarding rotation of audit firms vary from country to country.

According to Nigeria's Code of Corporate Governance 2018 and Audit Regulations 2020, released by Financial Reporting Council of Nigeria for all public interest entities, external audit firms shall be statutory auditor to a company for a continuous period of ten years and shall not be reappointed until after a period of seven years after disengagement.

- ii) In the case of a joint audit situation, no firm of statutory auditors will be on the audit for more than a period of fifteen years. It is also required that an Engagement Partner should only be on an engagement for a maximum period of five years before he rotates out.

- iii) Rotating audit firms and partners can make clients have access to expertise and innovation that will improve the financial reporting process.
- iv) From the perspective of investors, it is believed that rotation of audit firms will bring out credibility in financial reporting process, which leads to accuracy and reliability of the financial statements. However, the challenge associated with appointing a new auditor on a complex audit is delay in ability to understand the business environment and the internal control process, especially if the new firm does not have adequate resources to work on the engagement. This may lead to transition stress on the entity when onboarding the new engagement team and likely delay reporting. It can also affect deliverables on other business activities of the company.
- v) It has, therefore, been suggested that there should be a regular change in the individuals who are involved in the audit of a client company. This should prevent the auditor from becoming too familiar with the client and key members of the client's staff, because of developing a long and 'comfortable' relationship.

b. **How fees dependence undermines the independence of an auditor**

- i) Where the fee from a particular client represents a large proportion of a firm's total fee income, there is a significant self-interest or intimidation threat. This will depend on factors, such as the structure of the firm and whether it is established or emerging.
- ii) The International Ethics Standard Board for Accountants (IESBA) Code of Ethics states that, for public interest entities, when recurring fees paid by one client or a related group of clients exceed 15% of the total fee income of the audit practice for two consecutive years, the firm shall:
 - disclose the fact to those charged with governance: Disclosure to those charged with governance (TCWG) is a necessary step but it is not a sufficient safeguard. Disclosure merely informs TCWG of the situation; it does not eliminate the underlying financial incentive and the resulting pressure on the audit team; and
 - conduct a review (either by an external professional accountant or a regulatory body).
- iii) If total fees significantly exceed 15%, then a pre-issuance review is likely to be necessary rather than a post-issuance review:
 - a pre-issuance review is a review of the audit work performed by a party who is not a member of the audit team (typically another partner) before the auditor's report is issued; and
 - a post-issuance review is a review of the audit work performed by a party who is not a member of the audit team (typically another partner) after the auditor's report has been issued.
- iv) The ICAN code of ethics applies a higher threshold of 25%.

- v) Larger firms may find that the proportion of an individual office's income is higher than these figures, but not the firm's income as a whole. Where an individual office has fee income in excess of these figures from a single client, responsibility for signing off the audit file should be passed to a different office.
- vi) Overdue fees from an assurance client might become a loan to client and should be avoided;

Specific guidance regarding fees as provided by ICAN Code of conduct

- i) ICAN advises minimum charge-out rates in respect of fees for professional services, which are intended to set a benchmark below which members are not ordinarily expected to charge. A member should inform a client in writing prior to commencement of any engagement the basis upon which any fee he proposes to charge for his services will be calculated and, on request and where practicable, the level of fees likely to be charged for any assignment.
- ii) The members should discuss and explain the basis on which fees will be calculated, including the estimated initial fee, at the earliest opportunity. This discussion should be confirmed in writing, normally in an engagement letter.
- iii) Firms should not quote a level of fees for new audit work, which is lower than that charged by an existing auditor. Firms should also not quote by tender a level of fees which they have reason to believe is significantly lower than those quoted by other tendering firms. In both instances the firm's objectivity could be threatened.
- iv) when performing audit work, firms should ensure that their work complies with auditing standards and guidelines and quality control procedures. In the event of a report being made to the Institute (which might have arisen because of a Professional Practice Monitoring Committee's inspection), where fees were a feature in obtaining or retaining the work, firms should be prepared to demonstrate that:
 - the work done was in accordance with Auditing Standards; and
 - the client was not misled as to the basis on which fees for the current and subsequent years were to be determined.
- v) The request for governance, risk and compliance (GRC) software development not only increases the fee dependence, but also triggers a self-review threat (auditing a system the firm helped design), compounding the ethical dilemma).

c. Concept of second opinion

- i) In an audit context, a second opinion is when a different auditor provides professional advice on a matter (like accounting, auditing, or reporting standards) that has been or maybe considered by the client's current auditor.
- ii) This process helps a company confirm or question its existing auditor's approach, but it is distinct from "opinion shopping," which is the unethical practice of seeking an auditor who will give a desired answer.

The primary ethical concern is that the client may be engaging in **Opinion Shopping**.

- iii) For a second opinion to be conducted ethically, the new auditor must address potential threats to independence, such as self-interest, by ensuring the opinion is based on accurate facts and often by communicating with the existing auditor.

A second opinion occurs when an entity seeks advice from an accountant (Oladapo & Partners) who is **not their existing auditor** on the application of accounting principles or the appropriateness of an audit conclusion.

For factors to be considered by Oladapo & Partners (Consulting Firm), they must address the **self-interest** and **advocacy** threats by considering the following factors before acceptance:

- **Communication with existing auditor:** Oladapo & Partners must request the client's permission to communicate with Adeniyi, Okonkwo & Co. to understand all relevant facts and the basis of the disagreement. If permission is denied, they should decline the engagement.
- **Access to comprehensive facts:** The firm must ensure they are provided with all available documentation, including management's full argument and the existing auditor's technical rationale for their conclusion.
- **Motive of the client:** The firm must evaluate the reason FinEdge is seeking the opinion (that is, whether the disagreement is based on legitimate technical uncertainty or an attempt to undermine the current auditor).
- **Assumptions:** They must ensure the opinion is based on the same set of facts and assumptions provided to the existing auditor, avoiding misrepresentation.
- **Competence:** Oladapo & Partners must confirm they possess the specialised expertise in software capitalisation, AI valuation, and IFRS to render a credible and objective opinion.

d. **The system a firm should establish to protect whistleblowers like Zainab**

The firm must establish a robust internal whistleblower protection framework to promote ethical reporting and safeguard employees like Ms. Zainab Ahmed from retaliation (victimisation). This is fundamental to ensuring that the principle of integrity is upheld.

The system the firm should establish to protect whistleblowers should include:

- i) **Clear, and documented policy:** A formal policy, accessible to all staff, that explicitly outlines the procedures for reporting suspected misconduct, specifying what can be reported and to whom.
- ii) **Confidential reporting channels:** Provision of independent and secure channels (for example, external hotline, dedicated email) to allow reporting anonymously and without the risk of immediate identification by those involved in the alleged misconduct.
- iii) **Designated independent authority:** Appointment of an individual or committee (for example, the Chief Compliance Officer or the Audit Committee) with the authority and independence to receive, investigate, and handle sensitive reports outside the normal line of management structure.
- iv) **Commitment to non-retaliation:** An explicit guarantee and disciplinary measures for any employee found to have victimised or retaliated against the whistleblower, even if the reported concern is ultimately unfounded (provided it was made in good faith).
- v) **Secure follow-up:** A process for promptly investigating the concern and providing feedback to the whistleblower (where feasible and non-compromising) on the action taken.
- vi) **Tone from the top:** Senior leadership must visibly demonstrate a strong commitment to ethical behavior and a "speak up" culture, showing that all concerns are valued and taken seriously.
- vii) **Continuous monitoring:** Periodically monitor and audit the effectiveness of the whistleblower programme and anti-retaliation policies to identify and address weaknesses.
- viii) **Managerial training:** Train managers and supervisors on how to respond constructively to reports, understand what constitutes retaliation, and ensure they do not discourage reporting.

ix) **Fundamental principles of the IESBA Code include:**

- dilemma in the need to maintain confidentiality and disclosure of unethical behaviour could be an issue. The international standards on auditing regarding non-compliance with laws and regulations may require the auditor's disclosure of issues on contraventions or non-compliance with certain guidelines or regulations. This could be a challenge for the auditor. This challenge could be addressed by ensuring confidentiality through proper channel for whistleblowing and making management to be aware of this requirement of the laws and regulations as well as the implication of suppression of such information; and
- anonymous hotlines, encrypted email systems, or third-party reporting platforms.

e. Statement of key audit matters for inclusion in the independent auditor's report for AI reliance:

Key Audit Matters

"The company applies Artificial Intelligence (AI) algorithms to allocate transaction prices across bundled product and service contracts (Note xx). These AI models are self-learning and operate using large datasets, which increase complexity and reduce transparency of the allocation process. There is a risk that errors in training data, algorithm bias, or inadequate monitoring controls could lead to misstatement of revenue. Due to the significance of revenue to the financial statements and the inherent complexity of AI systems, this area requires significant audit attention.

The company capitalises significant costs related to the in-house development of proprietary AI algorithms. This area requires substantial audit effort due to high degree of management judgement, specifically in determining when the *technical feasibility* threshold was met, the appropriate capitalisation of costs, and the ongoing assessment of their useful economic lives and potential impairment.

FinEdge's high volume of transactions and reliance on proprietary AI Algorithms for determining and allocating revenue streams presented significant risks to the completeness and accuracy of recorded revenue. Our audit focused on the design and operational effectiveness of the automated IT controls embedded within the AI platform, requiring specialised skills to test the logic".

Examiner's Report

The question tests the candidates' knowledge of audit firm and partner rotation, fee dependence and independence, the concept of second opinion, whistle blowing in a firm and key audit matters in audit report.

This being a compulsory question, all the candidates attempted it. The performance was below average.

The common pitfall of the candidates was the lack of understanding of audit firm and partner rotation, the second opinion in the audit process, the process of whistle blowing in the firm and reporting of key audit matters.

Candidates are advised to familiarise themselves with aspects of practice management, compliance with laws and regulations, and also read the Institute's Study Text and review the Pathfinder which are freely available on the institute's website.

Marking guide

		Marks	Marks
1a.	Requirements for audit firm and partner rotation in an audit engagement Auditor rotation process (1 mark each for any 3 points) Suggestions about how auditor rotation should be achieved (1½ marks each for any 4 points)	3	
b.	Discussion of fee dependence and independence even if disclosed. Stating various guidelines and processes relating to fee dependence (1 mark each for any 4 points)	6	<u>9</u>
c.	Discuss the concept of second opinion and factors to be considered in deciding to accept an engagement to provide a second opinion. Concept of second opinion and factors to be considered (1 mark each for any 7 points)		7
d.	The system a firm should establish to protect whistleblowers and fundamental principles of IESBA. Protection of whistleblowers (1 mark each for any 5 points)		5

e.	The draft of the key audit matters required for disclosure in the independence auditor's report:	
	Title of the statement of the key audit matters	
	(1 mark)	1
	(2 marks each for any 2 statements included)	4
	Total	<u>5</u> <u>30</u>

SECTION B

SOLUTION 2

a. (i) **The concept and purpose of scope determination and group risk assessment in group audit**

- In a group audit, scope determination defines the specific audit areas and components to be examined, and to what extent.
- Group risk assessment identifies and analyses the potential risks of material misstatement across the entire group.
- The purpose is to develop an effective audit strategy by focusing resources on the most significant risks and areas, ensuring the group audit opinion is supported by sufficient evidence. The group auditor (Adeyemi & Partners) is responsible for the overall audit opinion on the consolidated financial statements.

(ii) The concept and purpose of scope determination required are further discussed as follows:

- scope determination involves identifying which components (subsidiaries in Ghana, Sierra Leone, Kenya, etc.) are significant to the group and deciding the appropriate level of audit work required for each one;
- components are usually deemed significant based on size (for example, assets, revenue, or specific risks or critical intellectual property assets and AI based assets);
- the purpose is to ensure that the group auditor obtains sufficient appropriate audit evidence to reduce the risk of material misstatements in the consolidated financial statements to an acceptably low level and guides the allocation of resources;
- scope determination results in classifying components into categories;
- for financially significant components (for example, the manufacturing arm or the Ghana financial services subsidiary);

- for components significant only due to specific balances (for example, testing inter-company balances in a small subsidiary); and
- for components not considered individually significant, analytical procedure would apply.

(iii) **The concept and purpose of group risk assessment are as follows:**

Concept: This is the process of identifying and assessing the risks of material misstatement in the **consolidated** financial statements. This requires understanding the group, its environment, and its control over financial reporting.

Purpose: To establish the overall group audit strategy and determine the nature, timing, and extent of procedures.

(v) **The group auditor must identify risks arising from:**

- **Consolidation process:** Risks related to accounting for complex consolidation adjustments, goodwill calculation, and the elimination of inter-company transactions (for example, transfer pricing issues).
- **Regulatory differences:** Risks arising from subsidiaries operating in diverse regulatory environments (Ghana, Sierra Leone, Kenya) which may affect the application of the group's accounting policies (IFRS);
- **Foreign currency:** Risks related to foreign currency translation differences and the complex conversion process.
- **Specific group assets:** Risks related to critical assets held in smaller subsidiaries (for example, the IT subsidiary holding critical intellectual property) which may affect the overall valuation.

b. **Considerations for setting group and component materiality**

When setting group and component materiality, group auditors consider the group's financial statement context, the risk of misstatement, and the significance of each component. This involves setting a lower aggregate component materiality that may exceed the group materiality level and may vary for each component based on factors like size, complexity, and risk. The goal is to manage the risk that the aggregate of uncorrected misstatements exceeds the group materiality for the financial statements as a whole.

Materiality is fundamental in determining the scope and sufficiency of audit evidence (ISA 320) detailed below:

- i) **Group materiality:** This is set for the consolidated financial statements as a whole. It is typically determined by applying a percentage to a chosen benchmark (e.g., Group profit before tax (PBT), total assets, or revenue). The choice of benchmark reflects the primary interests of the stakeholders.
- ii) **Component materiality:** This must be set at an amount that is lower than group materiality.

- iii) **Purpose:** To reduce the probability that the aggregate of uncorrected and undetected misstatements in the components, when consolidated, exceeds the group materiality level.
- iv) **Qualitative factors:** Adeyemi & Partners must consider qualitative aspects, such as the regulatory sensitivity of the financial services subsidiary in Ghana and stakeholder expectations, which may require lower materiality levels even if the quantitative thresholds are not strictly met.

c. **Involvement of the group auditor in the work performed by component auditors**

- i) It is the group auditor's responsibility to decide what work is to be performed on the financial information of the component by the component auditor.
- ii) The group auditor then must decide the extent of his involvement in that work. For significant components he must, as a minimum:
 - discuss with component management or the component auditor the business activities of the component that are significant to the group;
 - discuss with the component auditor the risk of material misstatement of the financial information of the component; and
 - review the component auditor's documentation of identified significant risks of material misstatement of the group financial statements.
- iii) Where significant risks of material misstatement of the group financial statements have been identified at a component, the group auditor should:
 - evaluate the further audit procedures to be performed to address the risks; and
 - consider whether it is necessary to be involved in those procedures. Such involvement might include:
 - meeting with component management/auditors to obtain an understanding of the component;
 - reviewing the component auditor's overall audit strategy and plan ; and
 - performing risk assessment procedures at the component.
 - designing and/or performing further audit procedures;
 - participating in closing/other key meetings between component auditors and management; and
 - reviewing other relevant parts of the component auditor's documentation.
- iv) For other components, the extent of the group auditor's involvement will depend on his understanding of that component auditor. If he has concerns about that particular component auditor's competence, or a lack of local regulation, he may decide that he needs to be involved in that component auditor's risk assessment.

v) In all cases, the group auditor is required to evaluate the report of the work performed by the component auditor. If, after such evaluation and after discussion with the component auditor/management, the group auditor concludes that the work is insufficient, he should:

- determine what additional procedures are needed, and
- whether such procedures should be performed by the component auditor or himself.

Examiner's report

The question tests the candidates' knowledge of scope determination and risk assessment in group audit, and related materiality and responsibilities toward component auditors.

The question was attempted by about 70% of the candidates. The performance was above average.

The common pitfall was the lack of understanding of the various aspects of group engagement and the respective responsibilities of the firms involved.

Candidates are advised to pay attention to the requirements of the question and understand codes and responsibilities of various parties in engagement.

Marking guide

	Marks	Marks
a. The concept and purpose of scope determination and group risk in group audit (1 mark each for any 12 points)	12	
b. Consideration for setting group and component materiality Consideration for setting group and component materiality (1 mark each for any 2 points)	2	
c. The involvement of the group auditor in the work performed by the component auditor Involvement of the group auditor in the work performed by tax component auditor (1 mark each for any 6 points)	6	
Total	<u>20</u>	

SOLUTION 3

a) Roles of Audit Committee

The Audit Committee's fundamental role is oversight of financial reporting, internal controls, and risk management. In this scenario, the committee failed significantly across all these responsibilities, directly contributing to the ₦30 million tax liability restatement and subsequent resignations.

In terms of composition of the committee, in the scenario, it consists of five non-executive directors instead of three shareholder representatives and two non-executive directors.

i) Evaluation of failed roles

- Oversight of internal control**

The committee ignored the external auditors' repeated concerns about inadequate documentation for inter-company transactions.

This critical failure created the high-risk environment exploited by the FIRS, as a result of transfer pricing allegation and deferred tax misstatements leading to tax liability.

- Oversight of financial reporting**

The committee failed to ensure appropriate accounting for deferred tax misstatements and ultimately presided over the restatement of the 2023 financial statements as the issues have been reported to relevant authorities. This showed a lack of due diligence in validating the tax provisions which resulted in a material misstatement requiring correction.

- Risk management and compliance**

The committee failed to convene an emergency meeting to address the FIRS audit findings promptly. This displayed a complete failure of the risk response mechanism. By delaying action, they escalated the problem, leading to intervention by the Financial Reporting Council of Nigeria (FRC).

- Interaction with external auditor**

The committee failed to challenge management or request detailed evidence of discussions on tax exposures. This is a primary oversight lapse. The committee is meant to provide a communication channel independent of management; its failure to intervene forced the external auditors to resign due to lack of governance support.

ii) Post-crisis reforms should include:

- **Enhance independence and expertise:** The remaining committee members must be evaluated. New members should possess demonstrable need expertise that are required to carry out the statutory roles required of them.
- **Mandatory auditor/management review:** Establish a formal protocol requiring the Audit Committee to hold a dedicated and private session with the external auditors (without management presence) or as required.
- **Risk escalation protocol:** Implement a mandatory documented risk threshold. Any communication from a major regulator (FIRS, SEC, FRC) that alleges material non-compliance must trigger a mandatory emergency meeting (e.g., within 48 hours) to form a crisis response team.
- **Strengthen whistleblowing:** Ensure the company's internal whistleblowing policy allows auditors or compliance personnel to directly contact the Chairman of the Audit Committee or a non-executive member of the audit committee regarding significant unresolved issues.
- **External consultant engagement:** Commission an independent, one-time review by a forensic accounting or governance expert to assess the root cause of the breakdown and recommend specific controls for inter-company transactions management.
- Review the Audit Committee requirements to explicitly include oversight of tax strategy and compliance.
- Implement a tax governance framework, defining responsibilities, thresholds for disclosures, and escalation procedures.

b) The strategies to resolve the issues raised include:

- i) **Immediate governance crisis:** The Board must immediately appoint a new, independent external auditor to ensure compliance with listing requirements. New suitably qualified members must be appointed to the Audit Committee to restore stakeholder confidence.
- ii) **Tax and transfer pricing dispute:** Engage specialised tax consultant and forensic accountant to conduct an independent review of the subsidiary's transfer pricing policy and documentation. This team will quantify the true liability, handle the negotiations with FIRS, and prepare the necessary documentation for FRC compliance.
- iii) **Internal control remediation:** The company must immediately invest in governance, risk, and compliance (GRC) software and strengthen the finance function to ensure that documentation for all inter-company transactions is rigorous and subject to strong review controls before financial reporting.

- iv) **Accountability and culture:** The Board must thoroughly investigate why management downplayed the auditor's concerns and respect to refusal to take disciplinary action where necessary. The "tone from the top" must shift to prioritise compliance and ethical of reporting over short-term financial targets.
- v) **Restructuring of the composition of the audit committee:** The committee should be restructured to be in line with the provision of CAMA 2020 (as amended), which stipulates that this membership of the committee should comprise three members of shareholders and two non-executives directors.
- vi) **Proper documentation and notification of material weaknesses in the system.** Every major observation by the external auditor should be well documented in the management letter that should be given to the company's management and those charged with governance and feedback should be obtained by the auditors for proper resolution of the issues.
- vii) **Auditors' rotation** The company should have policies on rotation of auditors and other professionals in order to align with the expected professional practices.

Examiner's report

The question tests the candidates' knowledge of the role and responsibilities of the audit committee in a given business scenario.

The question was attempted by about 80% of the candidates and performance was less than average.

The common pitfall was the candidates' inability to evaluate responsibilities as given in standards and other regulations, and apply them to given situations.

Candidates are advised to pay close attention to the Institute's Study Text and the Pathfinder to enhance performance in future.

Marking guide

	Marks	Marks
3a Evaluation of the roles of Audit committee in this case and suggest of possible post-crisis reforms		
Roles of Audit committee and consequences of failure: (1 mark each for any 7 points)	7	
Post crisis reforms (1 mark each for any 7 points)	7	14
b Discussion of the strategies to resolve the issues raised in the scenario:		
(1 mark each for identification of any 3 points)	3	
(1 mark each for discussion of the points identified)	3	6
		<u>20</u>

SOLUTION 4

a. **The risks that the external auditor must consider and recognise in auditing the fair value measurements:**

- i) The auditor must consider risks related to inherent limitations, management bias and the complexity of the valuation process, when auditing fair value measurements. These risks can lead to material misstatement and include challenges like using subjective inputs, complex models and the potential for management to manipulate estimates to their benefit.
- ii) Auditors must also consider the risk that the company's internal controls are ineffective at preventing or detecting these misstatements.
- iii) Issues relating to the audit of fair value measurements are similar to those for the audit of accounting estimates (both are covered by ISA540). Balances of items measured at fair value, such as property and financial instruments, are often significant items in the statement of financial position.

The following risks scenarios would manifest through the conventional audit risks which are given below:

- i) **Inherent risk:** Many fair value measurements are largely subjective and imprecise, and there is unavoidable inherent risk in their measurement. Valuation models may be used, but these are often complex and may be unreliable (for example, in the case of non-marketable financial instruments, or models to assess the amount of liabilities to a company's pension fund). The inherent risk is much less when an open market exists for the items measured at fair value.
- ii) **Control risk:** There are some risks that the entity's systems may fail to prevent or detect valuation errors. Fair value measurements are often made by external experts, outside the normal course of routine business operations, and controls over the valuation process are, therefore, likely to be weak.
- iii) **Detection risk:** The auditor should try to minimise detection risk, but the auditor may lack the knowledge and expertise to verify fair value measurements. This means that the auditor may need to rely on the work of an external expert, increasing the risk that errors in fair value measurements will not be discovered.
- iv) The audit of fair value measurements (derivatives, carbon credit contracts) is governed by ISA 540 (Auditing Accounting Estimates) and presents significant inherent risks, especially since Enogexy uses internal, Level 3 inputs.

The auditors, must recognise the following specific risks:

- i) Valuation model risk (Level 3 Inputs): Enogieny uses internal models with highly subjective and complex assumptions (future energy prices, discount rates). These are Level 3 inputs under IFRS 13, meaning they are unobservable. The risk is that small, subjective changes to these assumptions can lead to a material misstatement in the reported fair value of the derivatives and carbon credit contracts.
- ii) Management bias risk: The in-house team prepared the valuation report without an external valuer. This creates a high risk that management's internal assumptions are overly optimistic (for example, maintaining assumptions about stable energy prices despite market volatility), intended to conceal the true financial impact of the subsidy cuts and interest rate hikes.
- iii) Specialised knowledge risk: The complexity of financial instruments like derivatives and carbon credit contracts requires the audit team to possess specialised knowledge. If Bright Chartered Accountants lack this expertise, they risk failing to adequately challenge the internal valuation models or the appropriateness of the underlying assumptions.
- iv) Impairment risk (Wind farm asset): The regulatory changes that reduced feed-in tariffs clearly indicate a potential reduction in future cash flows. Although management estimated the recoverable amount at ₦770 million (a ₦10 million impairment, as carrying value is ₦780 million), the auditor must recognise the risk that the valuation models supporting the 'value-in-use' are aggressively optimistic and that the impairment recognised is materially understated.

b) The implications for the amount as are likely to be reflected in the audit report due to the scenario

- i. The scenario indicates a material uncertainty related to going concern (debt, interest rate hikes, falling subsidies). The auditor's response is governed by ISA 570 (Going Concern) and ISA 705 (Modified Opinions).
- ii. If management refuses to make the required appropriate disclosure about the material uncertainty, the financial statements are considered materially misstated due to inadequate disclosure.

As a result of the scenarios, the possible reflections on the opinion are as follows:

- i. Modified opinion: The auditor must modify the opinion due to material misstatement. Given the fundamental nature of the going concern assumption, the modification is likely to be a qualified opinion (if the misstatement is material, but not pervasive) or, more likely, an adverse opinion (if the lack of disclosure is judged to be pervasive to the users' understanding of the financial statements).

- ii. **Basis for opinion section:** The Basis for Opinion section of the audit report must explicitly state that the financial statements are materially misstated because management has failed to disclose the nature and future impact of the material uncertainty related to going concern.

On the attitude to the disclosure, the management of a client company will probably be reluctant to include a disclosure about material uncertainty in relation to the going concern assumption. There are several reasons for this:

- i. admitting that there is material uncertainty about whether the company can continue as a going concern for the next 12 months can be seen as a sign of management failure. Management will probably be reluctant to admit their responsibility for failure to the company's shareholders;
- ii. a statement that there is material uncertainty about the ability of the company to continue in business will make the situation even worse for the company. Banks will be reluctant to lend more money and may withdraw existing lending facilities. Suppliers may be reluctant to supply more goods without a credit guarantee (which the company would have to buy from an insurance company). Customers may stop buying the company's products due to concern that the company will not be in existence to provide after-sales service;
- iii. employees will become more concerned about job security, and many might look for jobs with other employers. Staff turnover, would, therefore, increase.
- iv. it is also possible that management does not accept that there is material uncertainty about the ability of the company to continue in business. There could therefore be genuine disagreement between management and the auditor on this issue; and
- v. If management refuses to provide suitable disclosure, the audit opinion shall be modified.

c. **Indicators of possible management bias in estimates that must be challenged by auditor**

- i. Changes in an accounting estimate, or the method for making it, where this is a subjective assessment.
- ii. Use of an entity's own assumptions for fair value accounting estimates when they are inconsistent with observable market place assumptions.
- iii. Selection or construction of significant assumptions that yield an estimate which favours management objectives.
- iv. Selection of an unduly optimistic or pessimistic estimate.
- v. Management's refusal to engage an expert in the area.

d. The form of Audit Report where the use of the going concern assumption is appropriate but a material uncertainty exists

- i. Where the auditor considers that the going concern assumption is **appropriate, but a material uncertainty exists**, he must consider whether the financial statements:
 - adequately describe the principal events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and management's plans to deal with those events or conditions; and
 - disclose clearly that there is a material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern.
- ii. If there is **adequate disclosure**, then the auditor shall express an unmodified opinion;
- iii. The auditor would add a separate section to the auditor's report immediately after the 'Basis for Opinion' paragraph entitled **Material Uncertainty Relating to Going Concern**.
- iv. The separate section would:
 - highlight the uncertainty;
 - draw attention to the relevant note in the financial statements; and
 - state that the audit opinion is not modified in respect of this matter.
- v. A minor amendment would be made in the introductory paragraph of the *Key Audit Matters* section (if relevant) referring to the *Material Uncertainty Relating to Going Concern* paragraph.
- vi. If there is **no adequate disclosure of the uncertainty**, then the auditor shall express a **qualified or adverse opinion**. In this instance, the auditor would not include the separate '*Material Uncertainty Related to Going Concern*' section because the material uncertainty would be fully explained in the '*Basis for Qualified (Adverse) Opinion*' section.
- vii. **There will be the inclusion of going concern because of material uncertainty If:**
 - the use of the going concern basis of accounting is appropriate, but a material uncertainty exists; and
 - the auditor considers that adequate disclosure about the material uncertainty has been made in the financial statements.
 - then the auditor shall express an unmodified opinion and include an extra paragraph in the auditor's report entitled '*Material Uncertainty Related to Going Concern*'.

viii. The extra paragraph to be included shall:

- draw attention to the note in the financial statements that describe the material uncertainty.
- state that these events or conditions indicate that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern; and
- state that the auditor's opinion is not modified in respect of the matter.

Examiner's report

The question tests the candidates' knowledge of fair value measurement, uncertainties in the financial reporting process and going concern situation of an entity.

The question was well attempted by about 70% of the candidates but the performance was just average.

The common pitfall was the candidates' inability to evaluate developments and standards guiding businesses and the reporting of their financial statements.

Candidates are advised to be acquainted with developments that impact on entities that are reported on. They are also advised to pay close attention to the Institute's Study Text and the Pathfinder to enhance their performance in future.

Marking guide

		Marks	Marks
a)	The risks the auditors must recognise and consider in auditing the fair value measurement (1 mark each for any 3 points)	3	
	Specific risks to be recognised by the auditor (1 mark each for any 3 specific risks)	<u>3</u>	6
b)	Possible implications for the audit if management refuses to appropriately disclose in the financial statements the existence of a material uncertainty together with management attitude (1 mark each for any 3 points)	3	
	The reason management may be reluctant to include a disclosure about material uncertainty (1 mark each for any 2 reasons)	<u>2</u>	5
c)	Indicators of possible management bias in estimates that should be challenged by the auditor (1 mark each for any 2 points)		2

d)	Evaluate the form of audit report to be expected when going concern assumption is appropriate but a material uncertainty exists (1 mark each for any 7 points)	<u>7</u>
	Total	<u>20</u>

SOLUTION 5

a. Elements or components of audit expectation gap

The term 'expectation gap' refers to the fact that the public perception of the role and responsibilities of an external auditor is different from his statutory role and responsibilities. The expectations of the public are often set at a level higher than that at which the external auditor actually operates. This is the difference between:

- i. the view of the role and responsibilities of the auditors that is held by the users of financial statements; and
- ii. the auditor's actual (statutory) role and responsibilities.

The elements/components of expectation gap are:

- i. **Performance (reasonableness) gap:** Users often expect auditors to detect all fraud, illegal acts or to guarantee company solvency. Research and regulatory reviews repeatedly find that many users misunderstand the auditor's ability to find cleverly concealed fraud or to predict going concern failures. This occurs because of a perception that audit work has fallen below the required standards.
- ii. **Liability gap:** This arises from a lack of understanding about the auditor's liability and who the auditor may be liable to.
- iii. **Standards gap:** Auditing standards set reasonable-assurance objectives, not absolute assurance; the public often expects absolute assurance. Regulatory bodies (International Auditing and Assurance Standards Board, Public Company Auditing Oversight Board) have examined how audit reporting and standards contribute to misperception.
- iv. **Knowledge gap:** Education levels, financial literacy, and low public awareness of audit scope and limitations feed misunderstandings - many empirical studies in emerging markets (including Nigeria, Morocco, Libya) document significant knowledge gaps and their contribution to public mistrust.
- v. **Evolution gap:** The gap in areas where the audit function needs to develop to meet changing societal demands, are technologies and evolving business complexities.

b. Strategies for closing the expectations gap

To reduce the frequency and cost of legal action, and to maintain the image of the audit profession in the mind of the public, it is in the interest of the profession to take steps to close the expectations gap.

Strategies that could assist in closing the expectation gap include:

- i) attempting to improve the general level of knowledge in the profession and understanding about the audit process. One such attempt has been made with updates to the auditing standards on auditor's reports published by IFAC in 2015. These updates enhanced the auditor's report to make it more relevant and transparent to users, for example, by introducing a new section on key audit matters, more requirements with regards to reporting going concern and improved descriptions of the responsibilities of the auditor;
- ii) ensuring controls over the auditing profession are important in enhancing public confidence, for example:
 - The European Union requires the audit of companies whose shares are quoted on a stock market in the EU to be conducted in accordance with international auditing standards (ISAs); and
 - national oversight bodies such as PCAOB (Public Company Accounting Oversight Board) in USA and FRCs (Financial Reporting Councils) in the UK and Nigeria monitor the compliance of audit firms in their conduct of audits by performing audit inspections;
- iii) ensuring significant guidance for auditors and management aimed at increasing quality and addressing issues such as going concern has been issued by standard setters, professional bodies and regulators. There has been an increased focus on corporate governance and the role that Audit Committees play in companies, reducing inconsistencies and enhancing quality;
- iv) opening candid communication between internal and external auditors, financial management and the Audit Committee is increasingly seen as critical in helping reduce the expectation gap. Such communication helps the Audit Committee to perform their governance role with the necessary transparency and realistic expectations that will help achieve effective risk management;
- v) enhancing communication between the parties and confirmation of their respective roles and responsibilities should be presented in the Audit Committee's and directors' reports to the shareholders. This will ensure that users become much more aware of the various parties' roles and responsibilities beyond the understanding they gain just from the audit report;

- vi) hoping that expectation gap will hopefully narrow further as financial reporting participants work together even more effectively to improve the deterrence and detection of financial reporting fraud;
- vii) hoping that the level of success in narrowing the expectation gap will vary considerably between territories depending on factors, such as culture, ethics, the level of incidence of governance mechanisms beyond the minimum required by law and regulation and the quality, availability and transparency of corporate reporting;
- viii) positioning the audit committees to play a vital role in reducing the expectation gap, given their open and direct relationship with all the key parties, including shareholders, board of directors, internal audit and external audit;
- ix) applying enhanced fraud risk mitigation procedures by applying more forensic-style testing in high-risk areas (journals, related parties, unusual transactions), using data analytics across full populations, where feasible. (Note: more testing raises costs, hence must be targeted);
- x) ensuring stronger documentation and transparency by explicitly documenting judgment calls and why evidence did or did not support fraud findings; prepare clear internal briefings for regulators if needed;
- xi) strengthening audit committees and internal controls improve oversight, reduce fraud risk and narrow the performance gap; and
- xii) conducting public education: coordinated outreach by professional bodies and regulators to improve financial literacy about audit since research shows that education reduces the knowledge gap.

Examiner's Report

The question tests the candidates' knowledge of the expectation gap in the audit processes and the strategies to closing the gap.

The question was attempted by about 90% of the candidates, but the performance was just about average.

The common pitfall was the candidates' inability to link the requirements of the question to the scenario presented and poor demonstration of the understanding of expectation gap.

Candidates are advised to be abreast of professional developments and with the ICAN Study Text and Pathfinder.

Marking guide

		Marks	Marks
5a	Discussion of the elements or components of audit expectation gap Meaning of expectation gap (1½ mark for definition)		
	Difference/perception of roles and responsibilities of auditors (1½ mark for any 1 role mentioned)	1½	
	The elements/components of expectation gap (½ mark for any 2 elements mentioned)		1
	(1 mark for any 2 elements explained)	2	
			6
	Discussion of strategies that could be implemented by practitioners to close the expectation gap Strategies for closing expectations gap: (1 mark each for any 9 points)		9
	Total		<u>15</u>

SOLUTION 6

- The auditor's application of information technology in the examination of the financial statements of FedRex:**
 - Audit engagement plannings:** Audit planning involves identifying the areas to be audited; audit team set up, assigning responsibilities to each audit staff, time allocation, establishing the materiality threshold. There are many aspects of these activities that could be automated and made more efficient with the use of technology. Most available off-the-shelf audit software have capabilities and in-built tools to enhance audit planning activities.
 - Audit risk assessment:** Audit software and advanced data analytics solutions can be used to conduct audit risk assessment – both qualitative and quantitative risk assessments. For instance, in conducting quantitative risk assessment, all that is required is to upload the financial information of the client into the audit software and use existing functions to select and compute the relevant ratios, percentages and proportions for the auditor to interpret. In some cases, the results from the computations are given interpretation by the software and made available for the auditor to review and exercise human judgement.

- iii. **Evaluation of internal controls:** After planning and risk assessment, the external auditor is expected to evaluate the operating effectiveness of internal controls which would most likely include computer controls. The only viable means to evaluate computer or IT controls is using computer assisted audit tools (CAATs). Many audits software are built with the capacity to test IT controls to ascertain their level of adequacy and operating effectiveness.
- iv. **Audit substantive testing:** Substantive testing involves the use of analytical procedures and test of details to confirm the completeness, accuracy and validity of financial statements amounts and disclosures. Ratios and trend analysis can easily be carried out by auditors using software. Also automated audit solutions could be used to prepare and serve circularisation letters to obtain third party confirmations.
- v. **Audit reporting:** Auditors normally use word processors and spreadsheets to compile their reports at the end of the exercise. However, modern audit software has embedded reporting modules that could be used by the auditor to put together relevant reports to users. With the help of the reporting modules of these applications, the auditor could convert aspects of his findings into diagrams and pictures which are easier to understand by the executives.
- vi. **Data analytics/CAATs:** The use of specialised software to analyse the reported \$150 billion revenue (a 65% increase) derived from digital payments.
- vii. **Automated data feeds:** The use of automated bots and scripts to pull exchange price data from multiple crypto platforms to independently assess the fair value range of the ₦120 billion crypto holdings.
- viii. **System review:** Reviewing and testing controls over FedRex's critical IT infrastructure, including access controls to the mobile wallet services and the encryption/security controls over customer data.
- ix. **Testing logic:** Testing the programming logic of the stable coin (PX-coin) system and the peer-to-peer lending collateral mechanism to ensure transactions are recorded accurately and completely, based on the programmed rules.
- x. **Cryptographic verification:** Utilising cryptographic tools to independently verify the existence of the ₦600 billion in customer crypto assets under custody on the public blockchain ledger.
- xi. **Private key attestation:** Applying cryptographic procedures to verify that FedRex possesses the private keys (cryptographic control) necessary to access and move the verified wallet balances.

b. i. Blockchain technology became popular globally through the advancements in digital currency transactions, such as Bitcoin. Many businesses now leverage blockchain technology to record their financial and non-financial transactions in an open, secured and decentralised ledger. Blockchain technology fundamentally changes the audit environment by altering how transactions are recorded, authenticated, and secured.

ii. Where the auditors are made part of the transaction flow and given access to the data chain, it makes it possible for them to see each transaction as they occur and be able to advise the client in real time.

iii. Blockchain enables smart contracts, protecting and transferring ownership of assets, verifying people's identities and credentials;

iv. Once blockchain is widely adopted, and challenges around industry regulation are overcome, it will benefit businesses by reducing costs, increasing traceability, and enhancing security.

v. There is an increasing fear that with blockchain, auditors may no longer be useful since the transactions are recorded in an open and distributed ledger where every party's consent is required for the recording to be complete.

vi. Blockchain creates a distributed, immutable ledger. This inherently reduces the risk associated with transaction completeness and accuracy, as data recorded is verifiable and cannot be unilaterally altered, making transaction history more reliable.

vii. With blockchain, auditor's focus shifts away from extensive testing of the historical record of transactions and toward verifying the smart contracts (the self-executing business logic) and the integrity of the initial data entry onto the blockchain.

viii. Blockchain creates a demand for specialised assurance services, such as auditing the code of smart contracts and providing assurance over digital asset control (as seen in the PoR engagement).

ix. The real-time, transparent nature of the ledger facilitates the development and deployment of continuous auditing techniques, allowing auditors to monitor transactions and controls constantly rather than relying on year-end sampling.

x. The chain provides a full, verifiable audit trail of asset ownership (provenance), which enhances the ability to trace assets and transactions.

Examiner's Report

The question tests the candidates' knowledge of the application of information technology in the audit process and examination of financial statements

The question was attempted by most of the candidates and the performance was average.

The common pitfall of the candidates was their inability to exhibit proper knowledge of the application of Information Technology in preparing financial statement and offering assurance services.

Candidates are advised to read relevant materials on information technology and assurance provision when preparing for subsequent examinations.

Marking guide

	Marks	Marks
6a. The external auditor's application of information technology in the examination of financial statements of FedRex and providing assurance report over the PoR		
Auditor's application of information technology in the examination of the financial statements (½ mark each for any 5 points mentioned)	2½	
(1½ mark each for any 5 points explained)	7½	10
b. The impact of blockchain technology on audit and assurance services (1 mark each for any 5 points)		5
Total		<u>15</u>

SOLUTION 7

a. An audit strategy is the overall approach that the auditor decides to take for an audit, from which a detailed audit plan can be developed. The audit strategy determines the scope, timing, and direction of the audit, essentially deciding the planned reliance on internal controls (control reliance approach) versus direct testing of balances (Substantive Approach).

The auditor's choice of strategy should be influenced by the following factors:

i. **Risk assessment:** This is the auditor's assessment of the risk of material misstatement (RMM) at the assertion level. If the risk of material misstatement (RMM) is assessed as low, a control reliance approach may be chosen, if RMM is high (as implied by BISI's weak controls), a purely substantive approach is adopted.

- ii. **Effectiveness of controls:** The initial assessment and subsequent testing of the client's internal controls. The control reliance approach is only suitable if controls are strong and reliable (BISI's controls were weak - manual records/outdated software - making reliance inappropriate).
- iii. **Cost-benefit analysis:** The relative cost-effectiveness of testing controls versus performing extensive substantive procedures. For large volumes of highly automated transactions, the control reliance approach is often more efficient.
- iv. **Nature and complexity of operations:** Complex transactions and the use of outdated manual records (as in BISI) usually necessitates a high degree of substantive testing, due to the high inherent risk.
- v. **Information technology environment:** The sophistication and reliability of the IT system. Manual records and outdated software increase complexity and lower the reliability of controls, demanding less reliance.
- vi. **Size and nature of the client's business:** Client's business might be small or large and this may affect the choice of audit strategy that may be applied by the auditor during the course of his audit. A business risk approach is best suited for large companies, and a statement for financial position approach is usually the most suitable for small companies.
- vii. **Control environment in place:** Where management does not have good attitude and awareness towards the establishment of sound internal control system within an entity, a substantive test approach would be appropriate for the audit strategy to be applied.
- viii. **The audit methods and techniques favoured by the audit firm:** For example, larger audit firms may favour a business risk approach.
- ix. Materiality of items involved.

b. The auditor must obtain sufficient appropriate audit evidence (ISA 500). Appropriateness refers to the quality of the evidence, determined by its relevance and reliability.

The reliability of audit evidence is determined by the following principles:

- i. **Source independence:** Evidence obtained from independent sources outside the entity (for example, bank confirmations, external valuation reports) is generally more reliable than evidence obtained solely from the entity;

- ii. **Internal control effectiveness:** Evidence generated internally is more reliable when the entity's related controls (for example, controls over inventory counting or receivables recording) are effective. In BISI's case, the weak controls undermine the reliability of the internal records;
- iii. **Direct knowledge:** Audit evidence obtained directly by the auditor (for example, physical observation of inventory, recalculation of depreciation) is more reliable than evidence obtained indirectly or by inference (for example, through management representation);
- iv. **Documentary form:** Evidence that exists in documentary form (paper or electronic) is more reliable than evidence obtained orally (for example, verbal inquiries to management).
- v. **Originality:** Original documents (contracts, invoices) are more reliable than copies or facsimiles.
- vi. **Consistency of evidence:** Evidence obtained from different sources or of different natures that points to the same conclusion is more reliable than evidence that contradicts other evidence;
- vii. **Expertise:** When information is provided by a qualified expert (for example, a valuer or actuary), that evidence is more reliable than that provided by management alone, provided the expert is objective and their work is understood by the auditor;
- viii. **Timeliness:** The reliability of evidence is enhanced when it is obtained from a period close to the date of the financial statements (for example, obtaining a stock count on the balance sheet date is more reliable than a count six months prior);
- ix. **Cost-benefit consideration:** Auditors weigh the persuasiveness of the evidence against the cost of obtaining them. However, difficulty or expenses is not a valid basis for omitting a necessary audit procedure for which there is no problem.
- x. **Professional judgment:** The determination of what constitutes sufficient appropriate evidence is a matter of professional judgement.
- xi. **Professional skepticism:** Auditors must maintain a questioning mind and critically assess audit evidence, being alert to any contradictory information or circumstances that might cast doubt on the reliability of documents and responses from management.

Examiner's Report

The question tests the candidates' knowledge of the requirements of audit strategy and audit evidence gathering.

About 80% of the candidates attempted the question but the performance was average.

The common pitfall was the candidates' inability to demonstrate relevant knowledge of standards and processes applied in auditing.

The candidates are advised to study relevant materials before entering for examinations.

Marking Guide	Marks	Marks
a. The factors the auditor should consider in the choice of audit strategy Definition of Audit strategy (1 mark for definition)	1	
Factors that influenced the choice of audit strategy to be used by auditor (1 mark each for any 4 points)	4	5
b. The principles set out to assist the auditor in assessing the reliability of audit evidence (1 mark each for mentioning any 5 points) (1 mark each for discussing the 5 points mentioned)	5	5
Total		10 <u>15</u>

INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA



PROFESSIONAL LEVEL EXAMINATION – NOVEMBER 2025

STRATEGIC FINANCIAL MANAGEMENT

EXAMINATION INSTRUCTIONS

PLEASE READ THESE INSTRUCTIONS BEFORE THE COMMENCEMENT OF THE PAPER

1. Check your pockets, purse, mathematical set, etc. to ensure that you do not have prohibited items such as telephone handset, electronic storage device, programmable devices, wristwatches or any form of written material on you in the examination hall. You will be stopped from continuing with the examination and liable to further disciplinary actions including cancellation of examination result if caught.
2. Write your **EXAMINATION NUMBER** in the space provided above.
3. Do **NOT** write anything on your question paper **EXCEPT** your Examination number.
4. Do **NOT** write anything on your docket.
5. Read all instructions in each section of the question paper carefully before answering the questions.
6. Do **NOT** answer more than the number of questions required in each section, otherwise, you will be penalised.
7. All solutions should be written in **BLUE** or **BLACK INK**. Any solution written in **PENCIL** or any other **COLOUR OF INK** will not be marked.
8. Cross out **ALL UNUSED SPACES ON ALL PAGES** of the Answer Booklet.
9. A formula sheet and discount tables are provided with this examination paper.
10. You are required to attempt **Question ONE (Compulsory)**, any **TWO Questions in Section B** and any **TWO Questions in Section C**.
11. Check that you have collected the correct question paper for the examination you are writing.

WEDNESDAY, NOVEMBER 19, 2025

DO NOT TURN OVER UNTIL YOU ARE TOLD TO DO SO

INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA
PROFESSIONAL LEVEL EXAMINATION – NOVEMBER 2025

STRATEGIC FINANCIAL MANAGEMENT

Time Allowed: $3\frac{1}{4}$ hours (including 15 minutes reading time)

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

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

QUESTION 1

JJ Plc, a leading inter-city transport company based in Lagos, Nigeria, operates across the southern regions of the country and into Abuja. It also has a strong presence along major routes in the ECOWAS sub-region, serving destinations like Benin, Ghana, and Togo. Despite its regional success, JJ Plc has struggled to establish a stable foothold in northern Nigeria, where infrastructure and market dynamics differ considerably. To serve northern routes, JJ has only been able to maintain limited services, resulting in underutilised vehicles and higher operational costs in that area.

Recently, JJ Plc identified KN Ltd, a well-established transportation company headquartered in Kano, as a potential acquisition target. KN Ltd specialises in transport services within northern Nigeria and extends its operations to Chad and Niger. Its well-developed local network and infrastructure gives it a dominant position in the region, and it is known for its reliability, local customer loyalty, and strong brand presence in the north.

KN Ltd's resources and capabilities

- **Infrastructure:** KN Ltd has invested significantly in assets along its routes, including well-maintained bus stations and motels, which attract both transport customers and transient travelers. It has service facilities and workshops equipped to handle vehicle repairs efficiently, reducing downtime and ensuring a high standard of vehicle maintenance.
- **Skilled workforce:** KN Ltd employs a team of skilled and motivated automobile engineers and technicians. Its workshops ensure that maintenance is conducted in-house, minimising reliance on third-party providers.
- **Local market expertise:** KN Ltd's management has strong relationships with local regulatory bodies, suppliers, and other stakeholders in northern Nigeria, Chad, and Niger. Its knowledge of local market dynamics and customer preferences has enabled it to maintain high customer retention and operational efficiency in these areas.

Proposed acquisition

The directors of JJ Plc are considering the acquisition of KN Ltd's entire share capital to establish a national footprint and a stronger presence in northern Nigeria. The acquisition is expected to yield multiple benefits, with synergies across operational, financial, and strategic areas.

The following information has been extracted from the most recent audited financial statements of KN Ltd.

Statement of profit or loss, December 2024

	₦ Million
Sales revenue	7,895
Costs of sales	<u>(6,757)</u>
EBITDA	1,138
Depreciation and amortisation	<u>(220)</u>
EBIT	918
Interest expenses	<u>(165)</u>
EBT	753
Tax (30%)	<u>(225.90)</u>
Profit after tax	<u>527.10</u>

Statement of financial position as at December:

	2024	2023
	₦m	₦m
Non-current assets	<u>3,112</u>	<u>2,971</u>
Current assets:		
Cash and cash equivalents	238	271
Inventory	1,271	1,039
Accounts receivable	<u>536</u>	<u>490</u>
Total current assets	<u>2,045</u>	<u>1,800</u>
Total assets	<u>5,157</u>	<u>4,771</u>
Equity and liabilities		
Non-current liabilities	<u>1,200</u>	<u>1,250</u>
Current liabilities		
Short term loans	968	716
Accounts payable	<u>1,542</u>	<u>1,396</u>
Total current liabilities	<u>2,510</u>	<u>2,112</u>
Equity	<u>1,447</u>	<u>1,409</u>
Total equity and liabilities	<u>5,157</u>	<u>4,771</u>

You head a team of financial analysts put in place by the directors of JJ Plc to advise on the appropriate valuation of KN Ltd. Your team has come up with the following facts:

- (i) KN is to be valued using free cash flow to the firm model. It is estimated that in the absence of acquisition, the company's free cash flow will grow at a high rate of 15% for the next five years before reverting to normalised rate of 4% p.a. in the sixth year and beyond;
- (ii) Since the company is not quoted, an appropriate cost of capital is not available. However, your team working with some investment bankers and considering a number of key economic and financial variables pertaining to the industrial sector has estimated the following cost of capital:
Years 1 – 5 10%, and 12% thereafter;
- (iii) KN Ltd's non-current liabilities consist entirely of ₦1,000 nominal value bonds which are redeemable in five years at par value, on which the company pays an annual coupon of 8%. The debt is rated at A+ and the credit spread on A+ rated debt is 70 basis points (0.70%) above the risk-free rate of return which is currently 4.3%;
- (iv) There are currently 96.20 million ordinary shares in KN Ltd and 250 million shares in JJ Plc;
- (v) JJ is currently trading at ₦90 per share with P/E ratio of 12;
- (vi) It is generally believed that the shareholders of KN Ltd will demand a premium of at least 30% on the estimated equity value of the company;
- (vii) JJ Plc has proposed to pay for the acquisition using one of the following two methods:
 - A cash offer of ₦75 per share in KN Ltd; or
 - Shares offer of 4 shares in JJ Plc for every 5 shares in KN Ltd;
- (viii) If the acquisition succeeds, it is expected that JJ plc can increase its P/E ratio to 14.

You are required to:

- a. Advise on types of synergistic benefits that might arise from the acquisition of KN Ltd. (6 Marks)
- b. i. Calculate the free cash flow to the firm for KN Ltd as at December 31, 2024. Show all workings in an orderly manner. (6 Marks)
- ii. Using free cash flow to the firm model, determine the value per share of KN Ltd as at December 31, 2024.

State any assumptions made and show all workings

Note: Irrespective of your answer in (b)(i) above, assume free cash flow to the firm (FCFF) of ₦369.60 million. (10 Marks)

- c. Calculate the percentage premium per share that KN Ltd's shareholders will receive under each acquisition payment method and justify with explanations, which method would be more acceptable to them. (8 Marks)

(Total 30 Marks)

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

QUESTION 2

Kay Plc, an all-equity financed multinational, is contemplating expansion into an overseas market. It is considering whether to invest directly in the country concerned by building a greenfield-site factory (i.e. undeveloped areas typically outside a city on agricultural land). The expected pay-off from the project would depend on future state of the economy of the host country, as shown below:

State of economy	Probability	IRR from project (%)
E_1	0.6	10
E_2	0.4	20

Kay's existing activities are expected to generate an overall return of 30% with standard deviation of 14%. The correlation coefficient of Kay's returns with that of the new project is -0.36, Kay's returns have a correlation of 0.80 with return on the market, while the new project has a correlation coefficient of -0.10 with the Nigerian market portfolio.

The beta coefficient for Kay is 1.20.

The risk-free rate is 12% and the risk premium on the Nigerian market portfolio is 15%.

Assume Kay's shares are correctly priced by the market.

Required:

- a. Identify and discuss **FIVE** major risks that Kay Plc is likely to face in undertaking a greenfield-site investment in a foreign country. (5 Marks)
- b. (i) Estimate the expected rate of return and standard deviation of the return from the new project. (3 Marks)
(ii) If the new project requires capital funding equal to 25% of the value of the existing assets of Kay Plc, determine the expected return and the standard deviation of Kay Plc after the investment. (4 Marks)
(iii) What effect will the adoption of the project have on the beta of Kay? (4 Marks)
(Ignore all taxes)
- c. Explain why an asset can have negative beta. (4 Marks)

(Total 20 Marks)

QUESTION 3

The remuneration committee of FL Plc is discussing the remuneration package that might be offered to the company's new managing director. Members of the committee have expressed different opinions. These include:

- (i) It is essential to offer a salary linked to revenue;
- (ii) The managing director should be offered share options, exercisable in one year's time, on at least 3,000,000 shares, at an exercise price of 25% below the current market price of 120 kobo; and
- (iii) Remuneration should be a basic salary plus a proportion of the economic value added (EVA) of the company. 1.5% per year was the suggested proportion.

In the ensuing debate, one committee member stated that a friend had recently bought one year European style put options on the company's shares at a price of 35 kobo. The options to be granted to the new managing director would therefore be worth several millions naira. Such generosity would not be well received given recent newspaper commentary about the excessive remuneration of senior managers in some companies.

Relevant company and market data is shown below:

	Year ended 31 March 2024	₦ million
Revenue		546
Cost of sales		(369)
Depreciation		(52)
Advertising		(10)
Net Interest		<u>(26)</u>
Profit before tax		89
Taxation		<u>(27)</u>
Available to shareholders		<u>62</u>

	31 March 2023	31 March 2024
Capital employed	₦420 million	₦458 million

Notes

- (1) Accounting depreciation is approximately equal to economic depreciation.
- (2) Advertising has been ₦10 million per year for the last four years.
- (3) The company's cost of equity is 12%
- (4) The company's weighted average cost of capital is 9.5%.
- (5) The risk free rate is 4%.
- (6) The corporate tax rate is 30%.

Required:

a. Discuss the relative merits of each of the three suggestions. (6 Marks)
b. Some committee members have expressed concern about how much some of the suggestions might cost the company.

For both the share option and EVA suggestions, estimate the potential cost to the company, and comment on your findings. The EVA estimate should be based upon the most recent relevant published data. (9 Marks)

c. Briefly describe the possible areas of conflict between the shareholders and the managers of the business. Outline possible strategies available to resolve such conflicts. (5 Marks)

(Total 20 Marks)

QUESTION 4

You are the newly appointed Head of Risk and Compliance at GreenHarvest Nigeria Ltd, a large agricultural export company based in Kaduna State.

GreenHarvest is a major exporter of sesame seeds, shea butter, and dried hibiscus flowers to Europe and Asia.

The company has marketed itself heavily to foreign buyers as a leader in sustainable agriculture and fair-trades practices in Nigeria.

GreenHarvest even claims compliance with major international standards such as Fair trade International and (the professional guidelines of) Rainforest Alliance certifications.

Recently, GreenHarvest secured a contract worth \$8 million with a major German food processing company, conditional upon continued certification of its sustainability and labour practices.

Situation

During a site visit to some partners farms in Nasarawa and Benue States, you discovered serious breaches:

- Several farms use child labour, with children as young as 10 years old working long hours during harvest season;
- Some farms extensively use illegal chemical pesticides banned under European Union regulations; and
- Internal company audits in the past deliberately omitted these farms from reporting samples to certifying bodies to maintain the "clean" image.

You also found that GreenHarvest's chief operating officer (COO) is aware of the situation but believes it is "standard practice in rural Nigeria" and insists it is "better not to rock the boat" just before the first major shipment under the German contract. He told you quietly:

"If we lose this contract, hundreds of local workers could suffer. Sometimes we have to choose the lesser evil."

You realise that disclosing the breaches could cause GreenHarvest to:

- Lose its certifications;
- Face contract cancellations; and
- Damage its international reputation.

But if you stay silent, the company would be misrepresenting its practices to investors, customers, and regulators.

Required:

- a. Identify and discuss the key ethical and corporate responsibility issues involved in this scenario. (10 Marks)
- b. Recommend the appropriate actions you should take as Head of Risk and Compliance, justifying your decisions. (10 Marks)

(Total 20 Marks)

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

QUESTION 5

The JL's share price is currently ₦95, and its book value per share was ₦100 at the end of last year. The Research Department at Eko Asset Management (EKO) has published an investment opinion on JL's stock, forecasting a return on equity (ROE) of 10% and a payout ratio of 30% into perpetuity. The risk-free rate is 3%, the stock market risk premium 7% and JL's estimated beta is 1.1.

Assumptions used in the JL investment opinion are:

Return on shareholders' equity (ROE)	10%
Payout ratio	30%
Book value per share (BVPS) at the end of last year	₦100
Risk-free rate	3%
Stock market risk premium	7%
JL's beta	1.1
JL's share price	₦95

- a. Based on the forecasts from the Eko Research Department, calculate the expected rate of return (implied return) on JL's shares at the current share price, by using the constant growth dividend model. Then, discuss whether JL's shares are trading at a discount or at a premium if the CAPM holds. (4 Marks)
- b. Mr Kola, an analyst at Eko, uses residual income model to calculate theoretical share price. Using a single-stage residual income model, calculate the theoretical share price of JL. Then, discuss whether JL's shares are trading at a discount or at a premium. (5 Marks)
- c. Under what conditions would a financial analyst consider the use of residual income model (RIM) in valuing equity shares, appropriate? (6 Marks)

(Total 15 Marks)

QUESTION 6

- a. A Nigerian firm needs to pay a supplier in Eastland, with a currency of E\$, in three months' time. The foreign amount payable is E\$20,000,000. The relevant exchange rates are:

Spot rate ₦1 = E\$2.67
 3-month expected rate ₦1 = E\$2.65
 Deposit interest rate in Nigeria is 10% p.a.

The firm is considering either of the following two options:

- (i) Investing naira today so that the naira holding grows to the amount needed to buy E\$20,000,000 at the expected 3 – month rate; or
- (ii) Converting naira to E\$ today and investing the E\$ so it becomes E\$20,000,000 in 3 months.

Required:

What must the Eastland interest rate be for the firm to be indifferent between these two options? (9 Marks)

- b. The Central Bank of Nigeria (CBN) plays a pivotal role in influencing interest rates in the Nigerian economy.

Required:

Identify and discuss **FIVE** actions that the CBN can take to influence interest rates in Nigeria. Illustrate your answer with relevant examples where possible.

(6 Marks)

(Total 15 Marks)

QUESTION 7

Barista Beverages Plc, a Nigerian-listed company producing bottled drinks, has maintained a constant dividend of ₦1.50 per share over the last five years. Recently, the company experienced an increase in profits due to expansion into West African markets and favourable foreign exchange movements.

However, Barista is now facing several strategic decisions:

- It plans to launch a new line of health drinks, requiring a capital investment of ₦2.5 billion over the next 18 months.
- Its debt-to-equity ratio has increased to 80%, raising concerns among investors and creditors.
- Inflation in Nigeria is running at 17%, and investors are becoming more focused on real returns.
- The Central Bank of Nigeria has introduced tighter guidelines for dividend distributions among companies with high leverage.
- Some shareholders are demanding a higher payout to reflect the company's improved profitability.

Required:

As part of a team of strategic finance analysts, prepare a report for the Board of Barista Beverages Plc advising on the formulation of an appropriate dividend policy, taking into account the company's circumstances.

Your report should:

- (i) Identify and discuss the main factors relevant to the dividend policy decision. (5 Marks)
- (ii) Advise whether the company should increase, maintain, or reduce its dividend with justifications. (5 Marks)
- (iii) Comment on any alternatives to cash dividends the company could consider. (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

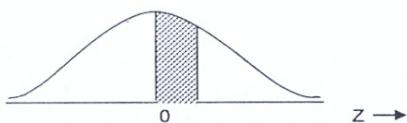
Discount rate (r)

Periods

(n)	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%	
1	0.990	0.980	0.971	0.962	0.952	0.943	0.935	0.926	0.917	0.909	1
2	1.970	1.942	1.913	1.886	1.859	1.833	1.808	1.783	1.759	1.736	2
3	2.941	2.884	2.829	2.775	2.723	2.673	2.624	2.577	2.531	2.487	3
4	3.902	3.808	3.717	3.630	3.546	3.465	3.387	3.312	3.240	3.170	4
5	4.853	4.713	4.580	4.452	4.329	4.212	4.100	3.993	3.890	3.791	5
6	5.795	5.601	5.417	5.242	5.076	4.917	4.767	4.623	4.486	4.355	6
7	6.728	6.472	6.230	6.002	5.786	5.582	5.389	5.206	5.033	4.868	7
8	7.652	7.325	7.020	6.733	6.463	6.210	5.971	5.747	5.535	5.335	8
9	8.566	8.162	7.786	7.435	7.108	6.802	6.515	6.247	5.995	5.759	9
10	9.471	8.983	8.530	8.111	7.722	7.360	7.024	6.710	6.418	6.145	10
11	10.368	9.787	9.253	8.760	8.306	7.887	7.499	7.139	6.805	6.495	11
12	11.255	10.575	9.954	9.385	8.863	8.384	7.943	7.536	7.161	6.814	12
13	12.134	11.348	10.635	9.986	9.394	8.853	8.358	7.904	7.487	7.103	13
14	13.004	12.106	11.296	10.563	9.899	9.295	8.745	8.244	7.786	7.367	14
15	13.865	12.849	11.938	11.118	10.380	9.712	9.108	8.559	8.061	7.606	15
(n)	11%	12%	13%	14%	15%	16%	17%	18%	19%	20%	
1	0.901	0.893	0.885	0.877	0.870	0.862	0.855	0.847	0.840	0.833	1
2	1.713	1.690	1.668	1.647	1.626	1.605	1.585	1.566	1.547	1.528	2
3	2.444	2.402	2.361	2.322	2.283	2.246	2.210	2.174	2.140	2.106	3
4	3.102	3.037	2.974	2.914	2.855	2.798	2.743	2.690	2.639	2.589	4
5	3.696	3.605	3.517	3.433	3.352	3.274	3.199	3.127	3.058	2.991	5
6	4.231	4.111	3.998	3.889	3.784	3.685	3.589	3.498	3.410	3.326	6
7	4.712	4.564	4.423	4.288	4.160	4.039	3.922	3.812	3.706	3.605	7
8	5.146	4.968	4.799	4.639	4.487	4.344	4.207	4.078	3.954	3.837	8
9	5.537	5.328	5.132	4.946	4.772	4.607	4.451	4.303	4.163	4.031	9
10	5.889	5.650	5.426	5.216	5.019	4.833	4.659	4.494	4.339	4.192	10
11	6.207	5.938	5.687	5.453	5.234	5.029	4.836	4.656	4.486	4.327	11
12	6.492	6.194	5.918	5.660	5.421	5.197	4.988	4.793	4.611	4.439	12
13	6.750	6.424	6.122	5.842	5.583	5.342	5.118	4.910	4.715	4.533	13
14	6.982	6.628	6.302	6.002	5.724	5.468	5.229	5.008	4.802	4.611	14
15	7.191	6.811	6.462	6.142	5.847	5.575	5.324	5.092	4.876	4.675	15

NORMAL DISTRIBUTION

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



$Z = \frac{(x - \mu)}{\sigma}$	0.00	0.01	0.02	0.03	0.04	0.05	0.06	0.07	0.08	0.09
0.0	.0000	.0040	.0080	.0120	.0159	.0199	.0239	.0279	.0319	.0359
0.1	.0398	.0438	.0478	.0517	.0557	.0596	.0636	.0675	.0714	.0753
0.2	.0793	.0832	.0871	.0910	.0948	.0987	.1026	.1064	.1103	.1141
0.3	.1179	.1217	.1255	.1293	.1331	.1368	.1406	.1443	.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									

SECTION A

SOLUTION 1

a)

- **Cost synergies:**
 - **Operational efficiencies:** JJ can reduce per-unit costs by leveraging KN Ltd's workshops and skilled maintenance staff, eliminating the need to outsource vehicle repairs in northern Nigeria.
 - **Resource sharing:** JJ can utilise KN Ltd's bus stations and motels, reducing the need to establish its own facilities. This will lead to reduced capital expenditures and operational costs.
- **Revenue synergies:**
 - **Market expansion:** JJ can use KN Ltd's established routes and brand reputation in the north to expand its customer base, offering combined routes that appeal to travelers throughout Nigeria and even to cross-border destinations in Chad and Niger.
 - **Service diversification:** JJ could leverage KN Ltd's motels to offer bundled services (e.g., travel plus accommodation), attracting long-haul customers and increasing customer spending per trip.
- **Financial synergies:**
 - **Lower financing costs:** With a stronger, nationwide presence, the combined company may benefit from lower financing costs due to increased market confidence and potentially improved credit ratings.
 - **Asset utilisation:** JJ can optimize its vehicle deployment, using KN Ltd's facilities to enhance fleet management efficiency, particularly in the northern region where it previously faced high costs.
- **Strategic synergies:**
 - **Enhanced brand value:** Acquiring KN Ltd allows JJ to position itself as a truly national transport leader, potentially gaining a stronger competitive edge over rivals with a more limited geographic reach.
 - **Regulatory benefits:** By acquiring a company with established local relationships, JJ can gain smoother access to permits and regulatory compliance in northern Nigeria and the broader ECOWAS region.

B (i) Calculation of free cash flow to the firm (FCFF)

	₦m
EBIT (1 – t) = 918 (1 – 0.3)	642.60
Add depreciation	220.00
Less purchase of non-current asset (W2)	(361.00)
Less increase in working capital (W1)	<u>(132.00)</u>
FCFF	<u>369.60</u>

Working notes

1. Changes in working capital *

	₦m
Inventory 1039 – 1,271	(232)
Receivables 490 – 536	(46)
Payables 1,542 – 1,396	<u>146</u>
	<u>(132)</u>

* This calculation must exclude cash and cash equivalents. In addition, short term loans are also excluded because they represent financing items.

2. Purchase of non-current assets

	₦m
Closing balance of NBV	3,112
Add: Depreciation	220
Less: Opening balance of NBV	<u>(2,971)</u>
Purchase of non-current assets	<u>361</u>

Alternative calculation

	₦m
Profit after tax	527.00
Add interest, net of tax = 165 (1 – 0.30)	115.50
Add depreciation	220.00
Less purchase of non-current assets	(361.00)
Less increase in working capital	<u>(132.00)</u>
FCFF	<u>369.60</u>

(Note: several other methods are available and allowed)

ii) The total value of the company is first computed as the PV of the FCFF.
First 5 years, when $g = 15\%$ and $r = 10\%$

		₦m
Year 1	$369.60 \times 1.15 \times 1.10^{-1}$	386.40
2	$369.60 \times 1.15^2 \times 1.10^{-2}$	403.96
3	$369.60 \times 1.15^3 \times 1.10^{-3}$	422.33
4	$369.60 \times 1.15^4 \times 1.10^{-4}$	441.52
5	$369.60 \times 1.15^5 \times 1.10^{-5}$	<u>461.59</u>
		<u>2,115.80</u>

Alternative method – using growing annuity

$$PV = \frac{FCFF_1}{r - g} \left[1 - \left(\frac{1 + g}{1 + r} \right)^n \right]$$

$$= \frac{369.60(1.15)}{0.10 - 0.15} \left[1 - \left(\frac{1.15}{1.10} \right)^5 \right] = 2,115$$

Years 6 – infinity

Growth rate 4%

Cost of capital 12%

	₦m
$FCFF_6 = 369.60 (1.15)^5 \times 1.04$	<u>773.1335</u>
$PV = \frac{773.1335}{0.12 - 0.04} \times \frac{1}{1.10^5}$	= 6,001.00
Total value of the company = 2,115 + 6,001	= 8,116
Less total value of debt	<u>2,324*</u>
Total value of equity	<u>5,792</u>
Number of shares	96.20m
$VPS = 5,792 / 96.20$	₦60.21

Thus the current value per share is approximately ₦60

* Calculation of market value of debt

Cost of debt = Risk-free rate of return plus the credit spread

$$= 4.3\% + 0.7\% = 5\%$$

Current value of a ₦1,000 bond:

$$\frac{80}{1.05} + \frac{80}{1.05^2} + \frac{80}{1.05^3} + \frac{80}{1.05^4} + \frac{1080}{1.05^5} = ₦1,129.89$$

Total value of non-current liabilities: ₦m

$$\left(\frac{1,200}{1,000} \right) \times 1,129.89 \quad 1,356$$

Add short-term loan 968*

Total value of debt 2,324

* In the absence of additional information we assume that the market value of the short-term loans and the book value are the same.

c) Cash offer

$$\text{Percentage premium} = \left(\frac{75}{60} - 1 \right) \times 100 = 25\%$$

Shares Offer

$$\text{Current EPS} = \frac{VPS}{P/E} = ₦90/12 \quad 7.5$$

Number of shares 250m

Total current profit after tax (₦m) 1,875

Add current profit after tax for KN Ltd (₦m) 527

2402

Expected P/E ratio 14

Post-acquisition value (₦m) (2402 x 14) 33,628

Existing share in JJ 250

Shares issued to KN Ltd:

$$96.20 \times \frac{4}{5} \quad 76.96$$

Revised number of shares in JJ Plc 326.96

Revised VPS in JJ Plc:

$$₦33628/326.96 = ₦102.85$$

Purchase consideration per existing share in KN Ltd:

$$₦102.85 \times 4/5 = ₦82.28$$

$$\text{Percentage premium } \left(\frac{82.28}{60} - 1 \right) \times 100 = 37.13\%$$

Comments

Cash Offer

The cash offer provides a premium of 25% to the shareholders of KN Ltd but this is below the required premium of 30%

Share Offer

The share offer gives significant premium of 37% and this is considered very attractive. However, it carries a greater risk because the shareholders are exposed to the possibility of a fall in the share price of JJ if the market fails to respond favourably and /or the potential synergistic benefits are not realised.

(Other relevant points will be rewarded).

Examiner's report

This is a standard question on business valuation using free cash flow to the firm (FCFF) model. Part (a) tests candidates' knowledge of various types of synergies arising from an acquisition. Part (b)(i) requires candidates to estimate FCFF from the given data. Part (b)(ii) requires candidates to estimate the value per share, using the given FCFF. In part (c), candidates are expected to calculate percentage premium per share in KN Ltd.

Being a compulsory question, almost all the candidates attempted the question.

Part (a) is reasonably straight forward and it is very disappointing that many candidates failed to gain more than average marks.

A number of them struggled to identify the relevant synergies in the given scenario.

Most of the given answers are generic in nature and achieved very little marks.

In part (b), most candidates lost considerable marks due to the following facts:

- i) Inability to correctly calculate the required FCFF;
- ii) Inability to correctly handle, in the process of discounting, the change in cost of capital;

- iii) Wrong use of the given growth rates; and
- iv) Failure to correctly calculate and apply the market value of debt.

In part (c), almost of all the candidates could not provide any meaningful answer and therefore earned little or no marks.

In all, candidates' performance in the question was extremely poor.

Success in this examination demands total dedication and complete coverage of the syllabus.

Marking guide

	Marks
1(a) Advise on types of synergistic benefits	6
(b) Calculate the free cashflow to the firm	6
(b) Determine value per share of the firm	10
(c) Calculate the percentage premium per share under each acquisition method	8
Total:	<u>30</u>

SOLUTION 2

a) Undertaking a greenfield-site investment in a foreign country presents significant opportunities for Kay Plc, but it also exposes the company to a wide range of strategic, financial, operational, and environmental risks as discussed below:

i. **Political and legal risk**

These are risks associated with the government policies, regulations, and political stability of the host country.

- Expropriation or nationalisation of assets.
- Sudden changes in foreign investment laws, taxes, or labour regulations.
- Trade restrictions, tariffs or import/export bans.
- Risk of civil unrest, coups, or war.
- Bureaucratic delays or corruption.

Example: A change in government might lead to restrictions on foreign ownership or repatriation of profit

ii. **Economic and currency risk**

- Exchange rate volatility can affect the value of repatriated profits
- Currency inconvertibility may prevent moving capital or earnings out of the country.
- Inflation risk, especially if input costs rise rapidly while price increases are restricted.
- Interest rate differentials may increase financing costs in the host country.

iii. **Cultural and human resource risk**

- Cultural differences may affect management practices, workplace dynamics, or marketing strategies.
- Language barriers could affect training, negotiations, and employee relations. Difficulty in hiring skilled local labour or complying with local labour laws and customs.

Example: Hiring experts might be costly or restricted, while local workers may require significant training.

iv. **Legal and regulatory compliance risk**

- Differences in accounting, environmental, tax, and safety standards.
- Difficulty in navigating licensing, permits, and land acquisition. Exposure to legal disputes in unfamiliar judicial systems.

For example, failure to comply with local environmental standards might result in fines or project delays.

v. **Operational risk**

- Building a factory from scratch involves risk of cost overruns, construction delays, or substandard infrastructure.
- Supply chain disruption risk due to poor transport systems or weak logistics networks.
- Risk of low capacity utilisation if market demand is overestimated.

vi. **Repatriation and profitability risk**

- The host country might impose capital controls, restricting dividend remittance or return of invested capital.
- Local tax policies may erode profit margins, e.g., withholding taxes on dividends.
- Risk of double taxation if tax treaties are not favourable.

vii. **Environmental and social risk**

- Opposition from local communities or NGOs due to perceived environmental or social impact.
- Need for environmental impact assessments (EIA) before approval.
- Risk of damage to corporate reputation if social or environmental issues are not handled properly.

viii. **Competitive risk**

- Entry into a new market may trigger retaliatory actions by local competitors.
- Risk of intellectual property (IP) theft in countries with weak IP laws.
- Risk of underestimating existing local competition or their brand loyalty.

(Note: Only five are required)

b) i)

- Expected return = $\bar{R} = (0.6 \times 10\%) + (0.4 \times 20\%) = 14\%$
- Calculation of standard deviation

Return (R)	Probability (P)	Exp. value (R)(P)	Deviation R - \bar{R}	Variance $P \times (R - \bar{R})^2$
10%	0.6	6%	-4%	9.6
20%	0.4	<u>8%</u>	6%	14.4
\bar{R}		= <u>14%</u>		<u>24</u>

$$\text{Standard deviation} = \sqrt{24} = 4.9\%$$

ii) Summary of facts

Existing activities (call it K)

New project (call it L)

Combined activities (call it Z)

	K	L	Z
Expected return (%)	30	14	Note 2
Standard deviation (%)	14	4.9	Note 3
Weight (%) = Note 1	80	20	100

Notes

		Overall weight
1. Existing assets (say)	100	$100/125 = 80\%$
New project (25% of 100)	<u>25</u>	$25/125 = \underline{20\%}$
	<u>125</u>	<u>100%</u>
2. Expected return of the enlarged company = $R = (80\% \times 30\%) + (20\% \times 14\%) = 26.8\%$		
3. Standard deviation of the enlarged company	$= \sigma = [(0.8)^2(14)^2 + (0.2)^2(4.9)^2 + 2(0.8)(0.2)(-0.36)(14)(4.9)]^{1/2}$	
	$= (118.49)^{1/2} = 10.89\%$	

iii)

- Present beta = $\beta_K = 1.20$

- Beta of project (β)

$$\beta_L = \frac{\text{Cor}(L, M) \times \sigma_L}{\sigma_m}$$

What is the standard deviation of market?

Rearranging the above formula of beta and using the given information on present beta.

$$\sigma_m = \frac{\text{Cor}(L, M) \times \sigma_L}{\beta_L}$$

$$= \frac{0.8 \times 14}{1.2} = 9.33$$

$$\text{Project beta} = \beta_L = \frac{(-0.1)(4.9)}{9.33} = -0.05$$

New beta of the company is the weighted average of the existing beta of the company (1.2) and the beta of the new project (-0.05):

$$\text{New beta} = (0.8 \times 1.20) + (0.2 \times -0.05) = 0.95$$

Therefore, the new project lowers the company's beta.

c) The key reasons for negative beta are:

- i) **Flight to safety:** During market downturns, investors shift capital from risky assets (like stocks) to safer assets (like government bonds). This increased demand raises bond prices, leading to higher returns when equity markets are falling. For example, during the 2008 financial crisis, investors moved heavily into U.S. Treasury bonds, driving up their prices while stock markets crashed.
- ii) **Counter-cyclical nature:** Government bonds, especially those issued by stable economies, perform well when the economy is weak. This is because central banks often cut interest rates in economic downturns, which increases bond prices. For example, the Nigerian government issues bonds that become more attractive during economic recessions when business profits decline.
- iii) **Lower default risk compared to stocks:** Unlike stocks, which depend on corporate earnings, government bonds are backed by the full faith and credit of the government. This perceived lower risk makes them attractive when stocks become volatile. For example, investors buy U.S. Treasury bonds or Nigerian FGN bonds when stock markets are shaky, expecting reliable returns.
- iv) **Central bank influence (monetary policy):** When markets fall, central banks lower interest rates to stimulate the economy. Since bond prices move inversely to interest rates, falling rates make government bonds more attractive. For example, if the Central Bank of Nigeria (CBN) cuts interest rates, Nigerian government bond yields decrease, making their prices rise.
- v) **Deflationary expectations in market crashes:** Stock market declines are often linked to deflationary risks (falling prices, lower wages, and reduced consumer demand). Deflation increases the real return of

government bonds, making them more attractive relative to stocks. For example, in a severe recession, investors prefer the fixed income from bonds over stocks, whose earnings decline.

vi) **Inverse relationship with interest rate expectations:** Stock market booms often lead to higher interest rate expectations, which can reduce bond prices, leading to lower bond returns. Conversely, during downturns, expectations of lower rates push bond prices up. For example, if Nigeria's stock market is performing poorly and the CBN is expected to cut rates, Nigerian bond prices rise, reinforcing their negative beta.

Examiner's report

Essentially, the question tests candidates' knowledge of Capital Asset Pricing Model (CAPM). In part (a), candidates were expected to identify and discuss key risks associated with investment in a foreign country. In part (b), candidates were expected to do some basic calculations like expected returns, standard deviation of returns and to assess the diversification effect of the new project on the overall systematic risk (beta) of the project. In part (c), candidates were asked to provide possible reasons why an asset can have negative beta.

More than 80% of the candidates attempted the question but again, the level of performance was very poor.

The question exposes significant candidates' knowledge gap in this important area of the syllabus.

Students should note that with Financial Management now at the skill level of the examination, similar topics will be tested indept at the SFM level.

Marking guide

		Marks
2(a)	Identify and discuss major risks in foreign investments Estimate and the expected rate of return and standard	5
(bi)	deviation of the return from new project	3
(bii)	Determine the expected rate of return and standard deviation after the investment	4
(biii)	Explain the effect of the adoption of the project on the company's beta.	4
(c)	Explain why an asset can have a negative beta.	4
Total:		<u>20</u>

SOLUTION 3

a) i) Salary linked to revenue

Merits

- **Simplicity:** Revenue is a straightforward metric, easy to measure and verify.
- **Growth Incentive:** Encourages the managing director to drive sales and business expansion.

Drawbacks

- **No profitability link:** Revenue growth without cost control could destroy shareholder value (e.g., high sales but low or negative margins).
- **Risk of manipulation:** The managing director might push for aggressive revenue recognition or risky deals.
- **Short-termism:** Focus on top-line growth might undermine strategic initiatives that take time to yield results.

ii) Share options on 3,000,000 shares at 25% discount

Merits

- **Alignment with shareholder interests:** Options encourage long-term focus on share price growth, aligning the MD's interests with shareholders.
- **No immediate cash outflow:** Share options do not create immediate cash cost for the company.
- **Retention:** Options typically incentivise the MD to stay until the vesting period ends.

Drawbacks

- **Discount issue:** Offering at 25% below the current price creates an instant gain for the managing director, regardless of future performance. This could be seen as overly generous and may face shareholder resistance.
- **Short vesting period:** Exercisable in one year encourages short-term share price boosting rather than sustainable performance.
- **Dilution:** Issuing large volumes of options may dilute existing shareholders' equity.

iii) Salary plus 1.5% of EVA

Merits

- **Value creation focus:** EVA is a superior metric as it accounts for cost of capital, meaning the MD is incentivized to generate returns above the company's cost of funds.
- **Aligns with shareholder wealth:** Positive EVA correlates with wealth creation for investors.
- **Balances risk and reward:** Base salary provides security, while EVA-based bonus links to performance quality, not just quantity.

Drawbacks

- **Complexity:** EVA is harder to calculate and may require accounting adjustments, making it less transparent to all stakeholders.
- **Potential manipulation:** EVA can be influenced by accounting policies or short-term capital structure changes.
- **Volatility:** EVA-based bonuses might fluctuate significantly with external economic conditions beyond the MD's control.

b) Cost of the share option scheme

The suggestion is to offer the managing director call options at an exercise price of 25% below current market price, i.e $75\% \times 120\text{ kobo} = 90\text{ kobo}$.

A one year put option on the company's shares costs 35 kobo. We must assume in the absence of additional information that the exercise price for the put option is also 90 kobo.

The value of the managing director's options can be estimated using the put-call parity formula:

$$\begin{aligned} C &= P + S - Ke^{-rT} \\ &= 35 + 120 - (90 \times 2.718^{-(0.04)} \text{ (1)}) \\ &= 35 + 120 - (90 \times 0.9607) = 68.5\text{ kobo} \end{aligned}$$

The value of 3 million call options would therefore be $(3,000,000 \times \text{₦}0.685) = \text{₦}2,055\text{ million}$.

This is a very generous price and is in fact misguided. The exercise price of the options should be set at a price above current market price, not below it, so that when the options are issued they have only a small value and encourage the managing director to work to improve the share price to above the exercise price.

The one year period for the option is also too short to encourage long term strategies. A three to five year period would be better.

Cost of the EVA scheme

To estimate EVA, it is first necessary to compute net operating profit after tax (NOPAT) by adding back interest and advertising costs and recalculating the tax charge, as follows:

	₦m
Profit before tax	89.00
Add back:	
Advertising	10.00
Interest	<u>26.00</u>
	125.0
Taxation (30%)	<u>37.5</u>
NOPAT	<u>87.5</u>

Capital employed at the start of the year is ₦420 million. This is adjusted by adding three years worth (say) of advertising investment: ₦420m + (₦10m × 3) = ₦450 million.

The expected NOPAT for the company would be capital employed × WACC = ₦450m × 9.5% = ₦42.75m

Thus the EVA is the excess NOPAT: ₦87.5m – ₦42.75m = ₦44.75m.

If the managing director receives 1.5% of this, it amounts to approximately ₦670,000 per annum. As discussed above, the scheme would be better linked to the increase in EVA after the new managing director has been appointed.

c) The fact that managers of a company are not necessarily the owners of the company leaves open the possibility that managers may not act in the interests of the owners of the company.

Possible areas of conflict are:

- i) The short term drive to cut costs and increase profits thereby increasing share price and hence managerial reward at the expense of the long-term investment which would jeopardise the long-term prospects of the company.
- ii) Managers may pursue policies which seek to maximise benefits to themselves rather than to shareholders. An example of one such policy is to focus on the sales of a company but not on its profits.
- iii) Managers may not be acting in the interests of the shareholders when evaluating takeovers or mergers. Thus, their decision may be to protect their own interests rather than to maximise shareholder wealth.
- iv) The pursuit of short-term cost reduction may lead to the company taking decisions which adversely affect its relationship with stakeholders. Possible examples are making employees redundant or reducing the products line available to customers etc. In the long term the affected stakeholders will move to other companies and thereby impact the long term performance of the company.

There are a number of strategies which are available for resolution of conflict between shareholders and managers. All such strategies seek to promote goal congruence. Goal congruence is accordance between the objectives of agents acting within an organisation and the objectives of the organisation as a whole.

Goal congruence may be better achieved by devising remuneration strategies which are related to the overall profitability of the company or its share price. Examples of such incentives are profit related bonuses, employee share schemes or executive share option plans.

An alternative approach is attempt to monitor manager's behaviour through the adoption of a corporate framework of decision making that restricts the powers of managers and increases the role of independent procedures or by introducing additional reporting requirements.

Examiner's report

This question tests candidates' knowledge of the key characteristics and merits of different remuneration packages for executive management.

More than 90% of the candidates attempted the question with performance far below average.

In part (a), most of the candidates scored average marks. In part (b) however, most of the candidates could not provide any reasonable solution. They could not handle the elementary put-call parity needed to evaluate the remuneration package. They also failed to make any reasonable impact on the calculations and evaluation of EVA.

In part (c), some very good solutions came from a number of the candidates and, therefore, scored a good proportion of the allocated marks.

Future candidates are reminded that success in this examination requires adequate coverage of the entire syllabus and effective revision.

Marking guide

	Marks
3(a) Discuss the relative merits of each of the suggestions	6
(b) Explain the potential cost of the share option and EVA estimates to the company	9
(c) Discuss the areas of conflict between shareholders, managers and how to resolve them.	5
Total:	<u>20</u>

SOLUTION 4

a) Ethical and corporate responsibility issues

i. Violation of human rights and labour standards

- The use of child labour breaches international human rights laws (e.g., ILO Conventions) and Nigeria's Child Rights Act.
- Ethical companies must actively prevent exploitative labour practices, especially when certified under "fair-trade" labels.

ii. Environmental and public health risks

- The use of banned pesticides can contaminate food products and endanger ecosystems, violating environmental protection principles.
- Exporting contaminated products could lead to recalls, lawsuits, and import bans.

- iii. **Fraudulent misrepresentation**
 - Omitting certain farms from internal audits amounts to deliberate misrepresentation to certifying bodies, buyers, and regulators.
 - This undermines investor trust and breaches contractual warranties.
- iv. **Corporate social responsibility betrayal**
 - GreenHarvest markets itself as sustainable and ethical. The reality contradicts these claims, creating reputational risk and potential accusations of "greenwashing."
- v. **Personal and professional integrity risk**
 - As Head of Risk and Compliance, I am responsible for identifying and reporting compliance failures.
 - Silence could implicate me in unethical conduct, risk my career, and expose me to legal liability if the breaches are discovered later.

b) **Recommended actions**

- i. **Internal escalation to executive management and board**
 - Report the full findings to the CEO and Board of Directors, documenting all concerns and evidence.
 - Advise urgent high-level action to avoid compounding the risks.
- ii. **Immediate suspension of affected suppliers**
 - Recommend suspending purchases from non-compliant farms pending corrective action.
 - Begin an emergency audit of all farm operations supplying under the German contract.
- iii. **Engage certifying bodies and buyers transparently**
 - Notify the relevant certification organisations and the German buyer of the situation.
 - Propose a remediation plan (e.g., farm worker training, supplier code of conduct enforcement) to retain partial business where possible.
- iv. **Implement corrective measures rapidly**
 - Introduce strict compliance protocols across all farms:
 - Ban child labor immediately;
 - Replace banned pesticides with approved alternatives; and
 - Conduct surprise inspections.
 - Partner with local NGOs to support educational alternatives for affected children.

v. **Public communication strategy**

- Prepare a proactive communication plan acknowledging the problem, detailing the corrective actions being taken, and reaffirming GreenHarvest's commitment to ethical practices.
- Framing it as a learning and reform opportunity can protect long-term brand equity.

vi. **Whistleblower protections and personal safeguards**

- If management refuses to act ethically, escalate through external channels (e.g., regulators, Fairtrade governing bodies).
- Maintain secure documentation trail to protect professional standing.

Conclusion

While the short-term consequences of disclosure may seem damaging, covering up human rights violations and environmental breaches would pose far greater long-term risks.

Examiner's report

The question tests candidates' knowledge of ethical and corporate responsibility issues.

In part (a), candidates were expected to identify and discuss ethical issues in the given scenario. In part (b), candidates were expected to provide appropriate remedial actions.

The question was attempted by almost all the candidates. Performance was generally average.

Candidates lost marks in the question primarily because they produced generic solutions.

It is recommended that students preparing for this examination should carryout adequate revision of past questions.

Marking guide

		Marks
4(a)	identify and discuss key ethical and corporate issues	10
(b)	Recommend the appropriate actions to take	10
Total:		<u>20</u>

SOLUTION 5

a) Expected EPS in year 1 = $EPS_1 = (BVPS_0) \times ROE = ₦100 \times 10\% = ₦10.00$
 Expected DPS in year 1 = $D_1 = EPS_1 \times \text{payout ratio} = ₦10 \times 0.30 = ₦3.00$
 Sustainable growth rate = $g = (ROE)(1 - \text{payout ratio}) = (10\%)(1 - 0.3) = 7\%$
 Implied $K_E = (D_1/V_0) + g$
 $= (3/95) + 0.07 = 10.15\%$

Required return under CAPM = $K_E = R_f + \beta (R_m - R_f) = 3 + 1.1 (7) = 10.70\%$
 The implied return of 10.15% is less than the required return of 10.70% under the CAPM, so JL's shares are at a premium.

b) We can make use of the following formula provided in the study text:

$$P_0 = B_0 + \left(\frac{ROE - r}{r - g} \right) \times B_0, \text{ where}$$

P_0 = theoretical stock price, using residual model
 B_0 = current book value per share = ₦100
 ROE = current return on equity = 10%
 r = required return on equity = 10.70%
 g = sustainable growth = 7%

Applying the formula:

$$P_0 = 100 + \left(\left(\frac{0.10 - 0.107}{0.107 - 0.07} \right) \times 100 \right) = ₦81.08$$

The theoretical price for JL's shares is thus ₦81.08, and the current price of ₦95 is at premium – overvalued.

With this approach, one obtains the same result as with the constant growth dividend model:

$$P_0 = D_1 / (K_E - g)$$

$$= 3 / (0.107 - 0.07) = ₦81.08$$

c) Financial analyst would consider the Residual Income Model (RIM) appropriate for valuing equity shares when the following conditions are met:

i. **The company does not pay dividends, or dividends are irregular**

- RIM is useful when the Dividend Discount Model (DDM) is difficult to apply because the firm pays no dividends, pays them inconsistently, or retains most of its earnings.
- Since RIM focuses on book value and residual earnings, it avoids the need for stable dividend assumptions.

- ii. **The company's free cash flows are negative or volatile**
 - For firms in early growth phases or undergoing heavy capital investment, Free Cash Flow to Equity (FCFE) models may produce negative or highly variable cashflows.
 - RIM is less affected because it values equity based on accounting earnings adjusted for the cost of capital.
- iii. **Reliable accounting information is available**
 - RIM requires accurate and consistent book value of equity and earnings figures.
 - If a company has audited, transparent, and credible financial statements, RIM is more dependable.
- iv. **The analyst believes accounting earnings are a good proxy for economic profitability**
 - If management uses clean surplus accounting (changes in book value = net income – dividends + other capital changes) and accounting profits reflect true economic returns, RIM can yield meaningful results.
- v. **Forecast horizon is reasonably short**
 - RIM is more reliable when future abnormal earnings can be forecast over a finite period, after which the firm is assumed to earn its cost of equity.
 - This is useful for firms in competitive markets where excess returns fade.
- vi. **The firm has stable and predictable return on equity (ROE)**
 - If ROE can be estimated with reasonable confidence, and excess ROE above the cost of equity is expected to continue for a while, RIM will produce a more accurate valuation.
- vii. **The company's market value is expected to be closely tied to its bookvalue**
 - RIM works best when a significant portion of the firm's value comes from net assets in place and the premium (or discount) relates to future abnormal earnings.
 - This is common in financial institutions, asset-heavy firms, or businesses where book value meaningfully represents replacement cost.

Examiner's report

A significant proportion of this question is on equity valuation, using dividend valuation model and more importantly, on residual income valuation model (RIM). Part (a) deals with dividend valuation model and part (b) requires candidates to make use of RIM to determine the theoretical value of equity. In part (c), candidates were required to identify the conditions needed for the use of RIM in equity valuation.

A number of candidates performed reasonably well in part (a) of the question but the performance in (b) and (c) was far below average. It is apparent that most of the candidates met RIM for the first time in the examination!

Once again, it is recommended that candidates cover the entire syllabus before presenting themselves for the institute's examinations.

Marking guide

	Marks
5(a) Calculate and explain the expected rate of return using the constant growth model.	4
(b) Calculate and discuss the theoretical share price using a single-stage residual income model..	5
(c) Explain the conditions when to use the residual income model (RIM) in valuing a company	6
Total:	<u>15</u>

SOLUTION 6

a) To be indifferent, the current naira cost of each method must be the same. In each case, the company will invest slightly less than the final required amount, as the principal will accumulate interest over the deposit period.

Method A – Investing in naira

If the predicted exchange rate is correct, the final naira amount required will be:

$$20,000,000/2.65 = ₦7,547,170$$

$$3\text{-month interest rate (on pro-rata)} = 10\%/4 = 2.5\%$$

Therefore the amount which must be invested is ₦7,547,170/1.025 = ₦7,363,093

Method B – Investing in Eastland dollars (E\$)

Let the E\$ interest rate be $x\%$ pa. The E\$ deposit will earn $x\%/4 = 0.25x\%$ interest over the period. Therefore the E\$ amount which must be invested is:

$$\frac{20,000,000}{1 + 0.0025x}$$

The current naira cost of this is:

$$\frac{1}{2.67} \times \frac{20,000,000}{1 + 0.0025x}$$

For indifference, this must equal ₦7,363,093.

$$\frac{20,000,000}{1 + 0.0025x} = 2.67 \times 7,363,093 (= 19,659,458)$$

$$(1 + 0.0025x) (19,659,458) = 20,000,000$$

$$1 + 0.0025x = \frac{20,000,000}{19,659,458}$$

$$1 + 0.0025x = 1.017322$$

$$0.0025x = 0.017322$$

$$x = 6.93\%$$

b) To influence interest rates, the CBN relies on both direct monetary policy tools and indirect market interventions. Key actions include:

i. **Adjusting the Monetary Policy Rate (MPR)**

- The MPR is the benchmark interest rate at which the CBN lends to commercial banks.
- Raising the MPR increases borrowing costs, leading to higher lending and deposit rates across the economy, helping to curb inflation.
- Lowering the MPR reduces costs of borrowing, encourages credit creation, and lowers market interest rates, stimulating economic activity.
- Example: In periods of double-digit inflation, CBN has raised the MPR to above 18% to rein in excess liquidity.

ii. **Open Market Operations (OMO)**

- Involves buying and selling of government securities in the open market to manage system liquidity.
- Selling OMO bills absorbs liquidity, creating scarcity of funds and driving up interbank and lending rates.
- Buying back OMO bills injects liquidity, reducing rates.
- Example: CBN has used OMO aggressively to mop up excess liquidity and maintain positive real interest rates to attract foreign investors.

iii. **Cash Reserve Ratio (CRR) adjustments**

- Proportion of customer deposits that commercial banks must hold with the CBN as reserves.

- Increasing CRR withdraws funds from banks, reducing capacity to lend and raising market interest rates.
- Decreasing CRR frees up funds, increasing liquidity and reducing lending rates.
- Example: At times, CBN has maintained CRR above 30%, directly squeezing bank liquidity.

iv. Liquidity Ratio (LR) requirements

- The ratio of liquid assets (cash, treasury bills, etc.) banks must maintain relative to their deposits.
- Higher LR restricts banks' ability to lend, putting upward pressure on interest rates.
- Lower LR allows more lending, easing rates.
- Though less frequently adjusted than CRR, it remains an important statutory tool.

v. Foreign Exchange (FX) interventions

- By intervening in the FX market, the CBN can indirectly influence interest rates.
- Selling USD to support the Naira withdraws Naira liquidity, often raising short-term rates.
- Conversely, easing FX restrictions or supplying more FX can stabilise liquidity and reduce pressure on interest rates.
- Example: CBN has frequently adjusted FX supply strategies (e.g. I&E window) alongside MPR hikes to attract foreign inflows.

Conclusion

The CBN influences Nigerian interest rates through a mix of policy rate adjustments, liquidity management (OMO, CRR, LR), and FX interventions. Together, these tools enable the Bank to control inflation, stabilise the currency, and shape credit conditions in the economy.

Examiner's report

Part (a) of the question essentially deals with Interest Rate Parity (IRP). The question requires candidates to calculate the foreign interest rate from the given data – using IRP. Part (b) of the question asks candidates to identify and discuss the actions of CBN that determine interest rates in Nigeria.

Almost all the candidates attempted the question. In part (a), the performance was very poor as many of the candidates could not produce any meaningful solution. They lost marks largely because they could not identify the appropriate formula to use. In part (b), a good number of the candidates scored well above average marks.

For better performance in future examinations, candidates are advised to carry out extensive revision covering all aspects of the syllabus, working with past questions.

Marking guide

		Marks
6(a)	Determine the interest rate that will make the firm to be indifferent.	9
(b)	identify and discuss the actions a central bank can use to influence interest rate.	6
Total:		<u>15</u>

SOLUTION 7

Executive Summary

This report provides a strategic analysis of the factors that Barista Beverages Plc should consider in formulating its dividend policy, evaluates whether the current payout level should be increased, maintained, or reduced, and explores viable alternatives to cash dividends in light of the company's financial and macroeconomic context.

Section 1: Key factors relevant to dividend policy

a. Profitability and recent performance

- Barista has recorded an increase in profits due to market expansion and FX gains.
- However, such gains may not be sustainable (especially if FX gains are non-operational). The dividend policy should not be based solely on temporary performance improvements.

b. Capital investment needs

- The proposed ₦2.5 billion investment in the health drink line indicates a strong need for internal financing.
- High dividend payouts could reduce retained earnings, forcing the company to either take on additional debt or delay expansion — both of which may harm long-term value.

v. Financial leverage and solvency

- A debt-to-equity ratio of 80% is relatively high, especially for a consumer goods company.
- High leverage increases financial risk and may breach debt covenants. Creditors may view increased dividend payouts negatively, particularly in light of CBN guidelines on payout restrictions for highly leveraged firms.

d. Macroeconomic and inflationary environment

- Nigeria's 17% inflation rate erodes the real value of dividends.
- Investors may demand higher nominal returns, but a prudent company may instead focus on real capital growth through retained earnings and reinvestment.

e. Shareholder expectations and market signaling

- Some shareholders are demanding higher dividends to reflect profitability.
- While meeting shareholder expectations is important, a sharp dividend increase might signal confidence but sets a precedent that may be hard to sustain.
- Alternatively, stable dividends with clear communication about the use of retained earnings for growth could maintain investor confidence.

f. Legal and regulatory constraints

- CBN's tighter regulatory stance may limit the capacity to distribute dividends for companies with high leverage.
- The Board must ensure compliance with regulatory limits and company law (e.g., dividends only out of distributable profits).

g. Access to external finance

- If capital markets are not conducive (e.g., high interest rates or weak equity market appetite), the company will be more reliant on retained earnings for funding.

h. Peer comparison and industry practice

- If other listed consumer goods firms are conserving cash amid macroeconomic uncertainty, a prudent stance will keep Barista competitive and avoid market punishment.

Section 2: Recommendation on dividend action

Recommended policy: maintain current dividend or consider a slight reduction

Justification:

- Although profitability has improved, the company faces significant capital expenditure needs and a high gearing ratio.
- Retaining earnings supports long-term value creation and financial flexibility.
- A dividend increase may send the wrong signal to creditors and regulators, and worsen the financial risk profile.
- A modest reduction (e.g., from ₦1.50 to ₦1.20) could free up capital while signaling prudence.
- Alternatively, maintain ₦1.50 and commit to future review after funding clarity is achieved.

Communication strategy:

- Explain to investors that retained earnings are needed for growth and debt management.
- Emphasise the company's commitment to sustainable shareholder value — not just short-term income.

Section 3: Alternatives to cash dividends

To balance shareholder interests and capital retention, Barista may consider:

a. **Scrip dividends (stock dividends)**

- Shareholders receive additional shares instead of cash.
- Conserves cash while still rewarding shareholders.
- May be particularly attractive in illiquid market conditions.

b. **Share buybacks**

- Barista can repurchase its own shares, increasing earnings per share (EPS).
- Buybacks are flexible and do not create a recurring obligation.
- May enhance market value, especially if the share is undervalued.
- However, may not be appropriate if liquidity is tight or if gearing is already high.

Examiner's report

This question tests candidates' knowledge of dividend policy. In part (a), candidates were asked to identify and discuss the key factors relevant to the given company's dividend policy. In part (b), candidates were asked to advise whether the company should increase, maintain or reduce its current level of dividend, of course, based on the given scenario. In part (c), candidates were asked to comment on alternatives to cash dividends.

Almost all the candidates attempted the question but sadly and contrary to expectation, candidates performed below average in the question.

Candidates lost valuable marks because the facts in the question were ignored and generic solutions provided!

The reason for providing specific facts and figures in the question is for candidates to make use of them in arriving at a professional advice. Reproduction of textbook solution at this level of the examination is certainly unacceptable!

Marking guide

	Marks
7(a) Identify and discuss the main factors relevant to dividend policy decisions.	5
(b) Advise whether the company should increase, maintain or reduce its dividend and justify	5
(c) Comment on any alternatives to cash dividend	5
Total:	15

INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA



PROFESSIONAL LEVEL EXAMINATION – NOVEMBER 2025

ADVANCED TAXATION

EXAMINATION INSTRUCTIONS

PLEASE READ THESE INSTRUCTIONS BEFORE THE COMMENCEMENT OF THE PAPER

1. Check your pockets, purse, mathematical set, etc. to ensure that you do not have prohibited items such as telephone handset, electronic storage device, programmable devices, wristwatches or any form of written material on you in the examination hall. You will be stopped from continuing with the examination and liable to further disciplinary actions including cancellation of examination result if caught.
2. Write your **EXAMINATION NUMBER** in the space provided above.
3. Do **NOT** write anything on your question paper **EXCEPT** your Examination number.
4. Do **NOT** write anything on your docket.
5. Read all instructions in each section of the question paper carefully before answering the questions.
6. Do **NOT** answer more than the number of questions required in each section, otherwise, you will be penalised.
7. All solutions should be written in **BLUE** or **BLACK INK**. Any solution written in **PENCIL** or any other **COLOUR OF INK** will not be marked.
8. Cross out **ALL UNUSED SPACES ON ALL PAGES** of the Answer Booklet.
9. Tax and Capital Allowances rates are provided with this examination paper
10. You are required to attempt **Question ONE (Compulsory)**, any **TWO Questions in Section B** and any **TWO Questions in Section C**.
11. Check that you have collected the correct question paper for the examination you are writing.

TUESDAY, NOVEMBER 18, 2025

DO NOT TURN OVER UNTIL YOU ARE TOLD TO DO SO

INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA
PROFESSIONAL LEVEL EXAMINATION – NOVEMBER 2025

ADVANCED TAXATION

Time Allowed: $3\frac{1}{4}$ hours (including 15 minutes reading time)

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

SECTION A: COMPULSORY QUESTION (30 MARKS)

QUESTION 1

Relazer Company Limited is a Nigerian company incorporated in 2014. The company commenced business in 2015 as a major distributor of hair relaxers for women of all ages. The company's accounting year runs from January 1 to December 31 of every year.

On June 3, 2025, the company submitted its 2024 financial statements and relevant tax returns to the tax authority (TA) on TaxPro Max. During the desk review of the tax returns, Tax Manager 1 (TM1) of the TA discovered some anomalies in the tax returns, so these were considered incomplete. The company was asked to provide additional documents and also offer some explanations in respect of the gaps noticed in the returns vide a letter Reference TA/DR/MTO/2025/61/TIN 0001 of June 28, 2025. The company failed to offer timely response on the request of the TA, which prompted the tax audit department to send a notice to conduct an audit exercise to the Chief Executive Officer of Relazer Company Limited. The letter of intent for the tax audit, Reference No TA/MTO/2025/67/TIN 0001, was dated July 29, 2025. The TA pleaded for the cooperation of the management and staff of the company on the audit exercise to be carried out in the taxpayer's premises between August 21 and September 4, 2025.

The field audit work indicated a material overstatement of expenses and capital allowances claimed over the years. This understatement of total profits have resulted in a shortfall in the tax payable of over ₦50 million for three years. These findings were communicated to the company's management, followed by a request for additional documents. The response from the company revealed that the understatement of profit had been on for many years, so an investigation into the affairs of Relazer Company Limited was initiated vide a letter Reference No. TA/INV/2025/TIN 0001, addressed to the Chief Executive Officer by TA on October 2, 2025. The tax investigation was fixed for October 30 to November 15, 2025.

The Chief Executive Officer of Relazer Company Limited recently appointed your firm – Babs & Co. (Chartered Accountants) as the new tax consultant and handed over to you all the correspondences received from TA and financial documents that may be of assistance in discharging your duties. The Chief Executive Officer does not understand the enormous task ahead and what tax audit and investigation entail, he merely thought the tax officials can be persuaded and "talked to". His intention was to take the TA to court, if they refused to accede to the company's requests.

Whilst reviewing the financial records and tax returns of the company, the following information came to limelight:

Year ended December 31:	2022 ₦'000	2023 ₦'000	2024 ₦'000
Gross turnover	<u>460,000</u>	<u>520,000</u>	<u>644,000</u>
Operating profit before tax	<u>160,600</u>	<u>195,800</u>	<u>260,400</u>
After deducting:			
Depreciation and amortisation	42,000	62,000	63,000
Donations to social clubs	2,600	1,900	4,800
Provision for assets impairment	4,200	3,200	1,900
Stamp duties on increase in share capital	-	-	3,600
Rent – long lease	-	-	16,800
Unrealised losses on foreign exchange transactions	2,200	-	1,500
Realised losses on foreign exchange transactions	2,750	3,952	4,610
Travelling expenses incurred for the director's relatives	9,800	12,000	12,500
Investment allowance on motor vehicles			5,960

Other information made available from the company's prior year capital allowances computation and assets register were:

(i) **TWDV of existing assets**

Assets	Plants and machinery	Motor vehicles	Office/solar equipment	Furniture and fittings
	₦	₦	₦	₦
TWDV b/fwd to 2023 YOA	10	1,640,000	525,000	480,000
No of years remaining	0	2	3	4
No of items	1	1	4	10

(ii) **Additions during the accounting years**

Assets Acquired	Plants and machinery	Motor vehicles	Office/solar equipment	Furniture and fittings
	₦	₦	₦	₦
March 31, 2022	-	10,600,000	-	-
July 31, 2023	-	-	5,960,000	-
February 30, 2024	-	9,500,000	-	720,000
September 30, 2024	-	-	3,160,000	-

Required:

Write a report to your client and advise the company on the following:

- a. The revised total profit and taxes payable for the relevant years of assessment (24 Marks)
- b. (i) The objectives of tax audit (3 Marks)
- (ii) Distinction between tax audit and tax investigation (3 Marks)

(Total 30 Marks)

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

QUESTION 2

The Managing Partner of Sanya Consults just passed to you, as the Tax Manager of the firm, an invitation to attend a workshop on transfer pricing, organised by the Transfer Pricing Department of the Federal Inland Revenue Service (FIRS).

The workshop is organised to create awareness on the requirements and compliance with provisions of the Income Tax (Transfer Pricing) Regulations, 2018.

At the conclusion of the workshop, you briefed the Managing Partner of Sanya Consults on what transpired during the three-hour session, which was attended by many professional accountants, captains of industry, tax practitioners, and other stakeholders.

Required:

Develop a summary of the underlisted issues discussed at the workshop for the benefit of other staff who could not attend the programme.

- a. Purpose, objectives and scope of Transfer Pricing Regulations, 2018 (6 Marks)
- b. The expectations of the FIRS on taxpayers' compliance with "arm's length principle". (3 Marks)
- c. Transfer pricing methods and evaluation of the taxpayers' controlled transaction. (5 Marks)
- d. Contents and mandatory transfer pricing documents and relevant information to be submitted to the FIRS by taxpayers. (4 Marks)
- e. The various penalties introduced by Transfer Pricing Regulations for various offences/acts on non-compliance with transfer pricing rules. (2 Marks)

(Total 20 Marks)

QUESTION 3

Westpoint Foods Limited was incorporated as a Nigerian company in 1972. It was registered for the processing of essential food items for citizens in the State and environs. It has two indigenous directors and one foreigner from a West African country.

The state government was desirous of promoting its food abundance policy, hence provided a vast land to the company on a leasehold term of 50 years. The leasehold agreement is renewable at the end of the first term.

A factory building was completed on the leased land in 1973 at a total cost of ₦1,800,500. Depreciation of the factory building and other assets were charged to operating statements to align with the 50 years lease term, which eventually expired in 2022. Unfortunately, the company could not continue in business due to exorbitant cost of input. Apart from that, the foreign director in charge of technical operations relocated to another country. The company decided to cease operations for a while, effective December 31, 2022. A letter of notification for the temporary cessation of business was forwarded to the Federal Inland Revenue Service (FIRS) immediately.

In January 2023, a meeting of the Board of Directors resolved to approach the state government for the renewal of the lease for another term of 50 years. This request was granted after the payment of ₦181,500,000 for another 50 years lease. This was raised by the old and newly appointed directors.

In their own wisdom, the directors refurbished the old factory for ₦24,260,000 towards the end of January 2023. In an attempt to mitigate the company's losses, the directors rented out the factory building to a third party and received a sum of ₦16,000,000 in that year.

The results of the commencement of operations for the year ended December 31, 2023 were as follows:

	₦
Rental income	16,000,000
Other income	<u>2,500,000</u>
	<u>18,500,000</u>
Expenses:	
Long lease renewal expenses	1,500,000
Salaries and wages	5,250,000
Audit and consultancy services	925,000
Repairs and maintenance	950,000
Depreciation	635,200
Electricity and solar energy consumed	250,000
Security levy	80,000
Income tax of the directors	<u>325,000</u>
	<u>9,915,200</u>
Operating profit	<u>8,584,800</u>

Additional notes on 2023 operations:

- (i) Capital allowance was agreed on the old and new factory building at ₦4,169,300
- (ii) Repairs and maintenance of ₦55,000 relates to the house of an in-law of a director
- (iii) There was no VAT charged on the rental income
- (iv) The tenants failed to deduct or remit any withholding tax on rent paid
- (v) Dividend paid to the directors in 2023 was ₦5 million

In February, 2024, the leased property together with the refurbished factory thereon were sold to a new investor for a lump sum of ₦650,000,000. Governor's consent for this transaction was obtained, so the interest in the leasehold property was transferred to the new investor for the rest of the remaining lease period.

The relevant expenses attributable to the disposal of the leasehold property include:

- Agency commission	3% of the sales value
- Solicitors' fees	5% of the sales value
- Adverts and other allowable expenses	₦6,500,000
- Gifts to neighbouring landlords	₦720,000

The directors of Westpoint Foods Ltd were desirous of paying relevant taxes and would not like to wait until the tax officials are aware of the whole deal. They are confused on the best way to handle this, and therefore, asked your firm to provide professional advice in determining all taxes payable for the relevant years of assessments.

Required:

Prepare a comprehensive report to the directors of Westpoint Foods Ltd, showing:

- a. The company's adjusted profit, total profit, income tax payable for the relevant assessment years (9 Marks)
- b. The relevant provision of the Finance Act 2019 when dividend payable exceeds profit or there is no total profit. Justify your position using the dividend paid in 2023 (3 Marks)
- c. Capital gains tax payable for the relevant year of assessment, (if any) (8 Marks)

(Total 20 Marks)

QUESTION 4

In April 2024, the Federal Government of Nigeria in a bid to unlock new investments in the petroleum industry, issued the Oil and Gas Companies (Tax Incentives, Exemptions, Remission, etc) Order 2024. This Order grants several incentives, one of which is 25% gas utilisation investment allowance (GUIA) applicable to qualifying expenditure on plant and equipment incurred by gas utilisation companies in the midstream oil and gas industry.

PSOK Petroleum Company Limited operates in the onshore and shallow water areas in the western part of the Niger Delta region for over thirty years. The company, at the expiration of its operating oil mining lease (OML) licence on December 31, 2021, opted for automatic conversion on January 1, 2022, to the petroleum mining lease (PML). This was consistent with the provisions of the Petroleum Industry Act, 2021.

The company has a subsidiary, Obuseh Gas Investment Limited, which was licenced in 2015 to engage in midstream gas utilisation activities.

The following information was extracted from the financial statements of PSOK Petroleum Limited for the year ended December 31, 2024:

Revenue Description	Type	Quantity	Actual price USA \$	Fiscal price USA \$
Crude oil sold	Bonny light	4 million barrels	75	74
Condensate from associated gas sold	Opobo P2 condensate	1.5 million MMBtu	56	56
Gas liquid from associated gas sold	Oloibiri Q5 liquid	1.2 million MMBtu	50	52
Expenses				
Production cost				₦'million
Drilling cost				205344
Royalties incurred and paid				51,000
Repairs and maintenance				102,671
Terminaling cost				2,200
Concession rentals				180
First two appraisal wells cost			(ii)	25,660
Depreciation of plant, machinery and fixtures				4,800
Cost of gas reinjection wells				2,500
Host community fund				1,300
Environmental remediation fund				1,900
Niger Delta Development Commission charge				30
Donations and subscriptions			(iii)	350
Finance costs			(iv)	230
Administrative expenses			(v)	95
General expenses			(vi)	1,360
				260

Additional information:

- (i) The company made other income of ₦195 million during the course of the year.
- (ii) 65% of the first two appraisal wells cost consisted of tangible costs.
- (iii) Donations and subscriptions included books, journals and laboratory equipment worth ₦150 million given to the State University as part of the company's corporate social responsibility activities.
- (iv) **Finance costs:**

	₦'million
Bank charges	42
Interest on borrowings	<u>53</u>
	<u>95</u>

- (v) **Administrative expenses:**

	₦'million
Salaries and other personnel costs	950
Power cost	254
Transport and traveling	122
Production bonuses fee paid	<u>34</u>
	<u>1,360</u>

- (vi) **General expenses:**

	₦'million
Stamp duties	33
Gas flare levy	60
Customs duties on essentials	17
State government land use charges	<u>150</u>
	<u>260</u>

- (vii) Agreed capital allowances for the year was ₦2,750 million.

- (viii) Production allowances:

	₦'million
Onshore operations	1,850
Shallow water operations	<u>2,100</u>
	<u>3,950</u>

- (ix) Assume that the exchange rate averaged ₦1,150 to US \$1 during the year and tax liabilities will be paid in domestic currency (Naira).

Required:

- a. Compute the company's hydrocarbon tax payable for the relevant assessment year. (17 Marks)
- a. Comment on the conditions that must be met before a gas utilisation company can enjoy the GUIA on qualifying plant and equipment expenditure. (3 Marks)

(Total 20 Marks)

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

QUESTION 5

The current wave of globalisation and technological revolution has had a tremendous effect on international taxation. The financial economic liberalisation has brought such sophistication and complexity into business practices that Nigerian tax administrators and practitioners are required to be up-to-date with information on emerging tax issues.

Required:

Discuss your understanding of the underlisted initiatives in international taxation:

- a. Tax inspectors without borders (6 Marks)
- b. Cooperative compliance (4 Marks)
- c. Simultaneous tax examination (5 Marks)

(Total 15 Marks)

QUESTION 6

Tax planning is a right that taxpayers (both corporate and individuals) should exercise to reduce tax liability and improve profitability, while fully complying with the relevant legislations to avoid penalties and further risks. From available data across the world, some taxpayers are seen to employ thin capitalisation and treaty shopping strategies to reduce tax revenue due to various governments, and others, such as the multinational companies, adopted base erosion and profit shifting methods.

Required:

- a. Discuss the concept of, and tax implications on:
 - (i) Thin capitalisation (4 Marks)
 - (ii) Treaty shopping (4 Marks)
- b. Explain **SEVEN** strategies being used by the Organisation for Economic Cooperation and Development in mitigating the use of aggressive base erosion and profit shifting by taxpayers. (7 Marks)

(Total 15 Marks)

QUESTION 7

You attended a workshop on Mining Revenue and Digital Economy organised by the Department of Mining under a Nigerian Ministry, where you represented your firm as tax consultant. Also in attendance at the workshop were tax officials together with five foreigners who were desirous of investing in the mining industry in Nigeria, if the environment is conducive enough to do so.

One of the foreigners, who sat beside you and introduced himself as Jefferson, observed that you were very attentive and also took notes throughout the workshop. He became interested in engaging your firm, but would like to have an understanding of some key items or issues before executing a letter of engagement. He is specifically interested in types of mineral resources available in Nigeria, fees payable to Mining Cadastre Office, mining incentives, objections and appeals procedures, if there are disputes between the company and the relevant tax authorities.

Required:

Provide a response in form of memorandum to the foreigner, explaining the following:

- a. Fees payable and failure to pay to mining cadastre office (2 Marks)
- b. Priority of using land for mining (2 Marks)
- c. The key incentives available to companies engaged in mining operation in Nigeria in line with Companies Income Tax Act 2004 (as amended) (4 Marks)
- d. The objections and appeal procedures relating to dispute with a relevant tax authority (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

BABS & Co.
(Chartered Accountants)

Date:

The Chief Executive Officer
Relazer Company Limited

Dear Sir,

RE: Tax Investigation by the Federal Inland Revenue Service (FIRS)

We refer to our appointment as tax consultants to Relazer Company Limited for the purpose of providing professional advice in respect of the tax investigation on your company by FIRS. Our comments are as follows:

(a) The revised computations of total profit and income tax payable for 2023 to 2025 years of assessment

YOA	2023	2024	2025
	₦	₦	₦
Total profit	<u>213,660</u>	<u>268,735</u>	<u>359,894</u>
Companies income tax	64,098.00	80,620.50	107,968.20
Tertiary education tax	<u>6,642.00</u>	<u>8,247.00</u>	<u>11,113.80</u>
Total tax	<u>70,740.00</u>	<u>88,867.50</u>	<u>119,082.00</u>
Minimum tax	<u>2,300</u>	<u>2,600</u>	<u>3,220</u>

The companies income tax for the relevant years of assessment are based on normal profits since the minimum tax computed above are lower.

Please see appendix 1 for details.

(b) i. The objectives of tax audit

The primary objectives of tax audit are to enable the tax auditors determine whether or not:

- adequate accounting books and records exist for the purpose of determining the total profit or loss of the taxpayer and the related tax payable;
- the tax computations submitted to the tax authority by the taxpayer agree with the underlying records; and
- all applicable tax legislations have been complied with.

The secondary objectives are to:

- provide for an avenue to educate taxpayers on various provisions of the tax laws;
- discourage tax evasion;
- detect and correct accounting and / or arithmetic errors in tax returns;
- provide feedback to the management on various provisions of the law and recommend possible changes;
- identify cases involving tax fraud and recommend them for investigation;
- forestall taxable persons' failure to render tax returns;
- forestall taxable person's rendering incomplete or inaccurate returns; and
- encourage voluntary compliance by taxpayers.

ii. **Distinction between tax investigation and tax audit**

- Tax investigation is called for when there are problems in, for example, an organisation, either affecting the whole or segment of the organisation. Such could be required when a large fraud is suspected.
- In an investigation, the scope of work is wider than that of a tax audit. The details of checking and depth of the work will also likely be more than what is required for an audit exercise.
- Tax investigation is like any other form of investigation. It is not carried out on routine basis as that of an audit.
- Tax investigation would be carried out when a taxpayer is suspected to have committed fraud. Suspected cases of tax evasion could lead to investigation.
- Tax investigation is conducted by tax inspectors who have special training and competence in investigation techniques. They can request for assistance of police investigators and enforces, if necessary. These are not required for tax audit.
- The principal aim of investigation is to expose all the circumstances of fraud or tax evasion and to obtain evidence for possible prosecution. Tax investigators have been given greater power than tax auditors. They can seal up a business premises to facilitate their work and obtain all the documents needed to substantiate the evidence of tax evasion and fraud.
- Tax audit is legally required periodically, to confirm the accuracy of the self-assessment of a taxpayer. Tax investigation may not be required for same taxpayer for several years.

Please feel free to contact us if you need further clarification on any of the above.

Yours sincerely,
For: Babs & Co. (Chartered Accountants)

Romoke Atanda
Audit Partner

Appendix 1: Revised total profit and companies income tax payable for the relevant years of assessment

YOA	2023 ₦'000	2024 ₦'000	2025 ₦'000
Gross turnover	<u>460,000</u>	<u>520,000</u>	<u>644,000</u>
Operating profit before tax	160,600	195,800	260,400
Add:			
Depreciation and amortisation	42,000	62,000	63,000
Donations to social clubs	2,600	1,900	4,800
Stamp duties on increase in share capital	-	-	3,600
Rent - long term lease	-	-	16,800
Private travelling expenses	9,800	12,000	12,500
Provision for assets impairment	4,200	3,200	1,900
Investment allowance on motor vehicle	-	-	5,960
Unrealised loss on exchange transactions	<u>2,200</u>	<u>-</u>	<u>1,500</u>
Adjusted profit/ assessable profit	221,400	274,900	370,460
Deduct:			
Capital allowance (w1)	<u>(7,740)</u>	<u>(6,165)</u>	<u>(10,566)</u>
Total profit	<u>213,660</u>	<u>268,735</u>	<u>359,894</u>
Companies income tax @ 30%	64,098.00	80,620.50	107,968.20
Tertiary education tax @ 3% of assessable profit	<u>6,642.00</u>	<u>8,247.00</u>	<u>11,113.80</u>
Total tax	<u>70,740.00</u>	<u>88,867.50</u>	<u>119,082.00</u>
Minimum tax @ 0.5% of turnover less franked investment income	<u>2,300</u>	<u>2,600</u>	<u>3,220</u>

(W1) Computation of capital allowances

	Plant and machinery	Motor vehicles	Office / solar equipment	Furniture and fittings	Total
I. A.	50	50	50	25	
A.A.	<u>25</u>	<u>25</u>	<u>25</u>	<u>20</u>	
	₦'000	₦'000	₦'000	₦'000	₦'000
2023 YOA					
TWDV b/fwd	10	1,640	525	480	
Additions	-	<u>10,600</u>	-	-	
	10	12,240	525	480	
I. A.	-	(5,300)	-	-	5,300
A.A.	-	w2(2,145)	w2(175)	w2(120)	<u>2,440</u>
					<u>7,740</u>
2024 YOA					
TWDV b/fwd	10	4,795	350	360	
Additions	-	-	<u>5,960</u>	-	
	10	4,795	6,310	360	
I. A.	-	-	(2,980)	-	2,980
A.A.	-	w2(2,145)	w2(920)	w2(120)	<u>3,185</u>
					<u>6,165</u>
2025 YOA					
TWDV b/fwd	10	2,650	2,410	240	
Additions	-	<u>9,500</u>	<u>3,160</u>	<u>720</u>	
	10	12,150	5,570	960	
I. A.	-	(4,750)	(1,580)	(180)	6,510
A.A.	-	w2 (2,513)	w2(1,315)	w2(228)	<u>4,056</u>
					<u>10,566</u>
TWDV c/fwd	<u>10</u>	<u>4,887</u>	<u>2,675</u>	<u>552</u>	

(W2) Annual allowances (A.A) on old and new assets

(i) Motor vehicle

2023 YOA ₦

Old motor vehicle: ₦1,640,000 2 = 820,000

New motor vehicle:

I.A. = ₦10,600,000 x 50%

= ₦5,300,000

A.A. = ₦10,600,000 - 5,300,000

4
= ₦5,300,000

1,325,000

Total

2,145,000

2024 YOA

A.A. on old assets	<u>2,145,000</u>
--------------------	------------------

2025 YOA

A.A. on old assets	<u>₦</u> 1,325,000
--------------------	-----------------------

New assets:

additions	=	₦9,500,000 x 50%
-----------	---	------------------

I.A.	=	<u>₦4,750,000</u>
------	---	-------------------

=	<u>₦9,500,000 – 4,750,000</u>
	4

₦4,750,000	=	<u>1,187,500</u>
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Total		<u>2,512,500</u>
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(ii) Office equipment**2023 YOA**

I.A.	=	<u>₦525,000</u>	<u>₦</u>	
		3	=	<u>175,000</u>

2024 YOA

Old assets	<u>₦525,000</u>	<u>₦</u>	
	3	=	175,000

New assets:

additions	
-----------	--

I.A.	=	₦5,960,000 x 50%
------	---	------------------

<u>₦2,980,000</u>

A.A.	=	<u>₦5,960,000 – 2,980,000</u>
		4

=	<u>₦2,980,000</u>	=	<u>745,000</u>
	4		<u>920,000</u>

2025 YOA

Old assets A.A.	<u>₦</u> 920,000
-----------------	---------------------

New assets:

additions	
-----------	--

I.A.	=	₦3,160,000 x 50%
------	---	------------------

<u>₦1,580,000</u>

A.A.	=	<u>₦3,160,000 – 1,580,000</u>
		4

=	<u>₦1,580,000</u>	=	<u>395,000</u>
	4		

Total		<u>1,315,000</u>
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(iii) Furniture and fittings

2023 YOA			₦
A.A. old assets =	<u>₦480,000</u>		
	4	=	<u>120,000</u>
2024 YOA			₦
A.A. on old assets	<u>₦360,000</u>		
	3	=	<u>120,000</u>
2025 YOA			₦
A.A. on old assets	<u>₦240,000</u>		
	2	=	120,000
New assets:			
additions			
I.A. =	<u>₦720,000 x 25%</u>		
	<u>₦180,000</u>		
A.A. =	<u>₦720,000 – 180,000</u>		
	5		
=	<u>₦540,000</u>		
	5		
		=	<u>108,000</u>
Total			<u>228,000</u>

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 total profit and tax liabilities. The second part tests the candidates' knowledge of audit and investigation.

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 total 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, the CITA 2004 (as amended), and relevant Finance Acts when preparing for future examination.

Marking Guide

		Marks	Marks
a.	Computations of revised total profit and taxes payable for the relevant assessment years		
	Body of the letter:		
	Addressee and heading	$\frac{1}{2}$	
	Opening paragraph	$\frac{1}{2}$	
	Identification of 2023 – 2025 YOA	$\frac{1}{2}$	
	Total profit ($\frac{1}{2} \times 3$)	$1\frac{1}{2}$	
	Total tax ($\frac{1}{2} \times 3$)	$1\frac{1}{2}$	
	Minimum tax ($\frac{1}{2} \times 3$)	$1\frac{1}{2}$	
	Appendix 1:		
	Depreciation and amortisation ($\frac{1}{4} \times 3$)	$\frac{3}{4}$	
	Donation to social clubs ($\frac{1}{4} \times 3$)	$\frac{3}{4}$	
	Stamp Duties	$\frac{1}{4}$	
	Rent – long term lease	$\frac{1}{4}$	
	Private traveling expenses ($\frac{1}{4} \times 3$)	$\frac{3}{4}$	
	Provision for impairment ($\frac{1}{4} \times 3$)	$\frac{3}{4}$	
	Investment allowance	$\frac{1}{4}$	
	Unrealised loss on Exchange ($\frac{1}{4} \times 2$)	$\frac{1}{2}$	
	Adjusted profit ($\frac{1}{2} \times 3$)	$1\frac{1}{2}$	
	Capital allowance ($\frac{1}{4} \times 3$)	$\frac{3}{4}$	
	Total profit ($\frac{1}{4} \times 3$)	$\frac{3}{4}$	
	Income tax ($\frac{1}{4} \times 3$)	$\frac{3}{4}$	
	Tertiary education tax ($\frac{1}{4} \times 3$)	$\frac{3}{4}$	
	W1 computation of capital allowances:		
	2023 YOA		
	TWDV B/fwd ($\frac{1}{4} \times 4$)	1	
	Additions to motor vehicle	$\frac{1}{4}$	
	I.A. (motor vehicle)	$\frac{1}{4}$	
	A.A. ($\frac{1}{4} \times 3$)	$\frac{3}{4}$	
	Total of capital allowances	$\frac{1}{4}$	
	2024 YOA		
	TWDV B/fwd ($\frac{1}{4} \times 4$)	1	
	Additions to office solar	$\frac{1}{4}$	
	I.A. of office solar	$\frac{1}{4}$	
	A.A. ($\frac{1}{4} \times 3$)	$\frac{3}{4}$	
	Total of capital allowances	$\frac{1}{4}$	
	2025 YOA TWDV B/fwd ($\frac{1}{4} \times 3$)		$\frac{3}{4}$
	Additions ($\frac{1}{4} \times 3$)	$\frac{3}{4}$	
	I.A. ($\frac{1}{4} \times 3$)	$\frac{3}{4}$	
	A.A. ($\frac{1}{4} \times 3$)	$\frac{3}{4}$	
	Total of capital allowances	$\frac{1}{4}$	
	TWDV ($\frac{1}{4} \times 4$)	1	24

bi.	Objectives of tax audit 1/2 mark for each objective of tax audit, subject to a maximum of 6 points	3
bii.	Distinction between tax investigation and tax audit 1/2 mark for each distinction, subject to a maximum of 6 points	<u>3</u>
	Total	<u>30</u>

SOLUTION 2

Date:

From: Tax Manager

To: Managing Partner, Sanya Consult

Re: Highlights of Workshop on Transfer Pricing Organised by the Federal Inland Revenue Service

(a) Purpose, objectives, and scope of transfer pricing regulations

Purpose

The purpose of the Transfer Pricing Regulations, 2018 is to give effect to the provisions of certain or specific tax legislations, such as the Personal Income Tax Act, Companies Income Tax Act, Value Added Tax Act, Petroleum Industries Act, and Capital Gains Tax Act.

Objectives

The objectives of the regulations are to:

- i. ensure that Nigeria is able to tax on an appropriate taxable basis corresponding to the economic activities deployed by taxable persons in Nigeria, including their transactions and dealings with associated enterprises;
- ii. provide the Nigerian authorities with the tools to fight tax evasion through over or under-pricing of controlled transactions amongst associated enterprises;
- iii. enforce compliance with arm's length principles;
- iv. provide a level playing field amongst multinational enterprises and independent enterprises doing business in Nigeria; and
- v. provide taxable persons with certainty of transfer pricing treatment in Nigeria.

Scope

The regulations shall apply to transactions amongst connected taxable persons carried on in a manner not consistent with the arm's length principle and include:

- i. sale and purchase of goods and services;
- ii. sales, purchase or lease of tangible assets;
- iii. transfer, purchase, licence or use of intangible assets;
- iv. provision of services;
- v. lending or borrowing of money;
- vi. manufacturing arrangement; and
- vii. any transaction which may affect profit and loss or any other matter incidental to, connected with, or pertaining to the transactions referred to in the regulations.

b. The expectations of FIRS on taxpayers compliance with arm's length principle

Every taxpayer is expected to comply with arm's length principle in dealing with transactions between their related entities. The regulation provides that:

- i. where a connected taxable person has entered into a transaction or a series of transactions to which these Regulations apply, the person shall ensure that the taxable profits resulting from the transactions is in a manner that is consistent with the arm's length principle; and
- ii. where a connected taxable person fails to comply with the provisions of this regulation, the FIRS shall make adjustments where necessary if it considers that the conditions imposed by connected taxable persons in controlled transactions are not in accordance or consistent with the "arm's length principle".

c. Transfer pricing methods as recommended by OECD

The following transfer pricing methods shall be applied as recommended in the guidelines issued by Organisation for Economic Co-operation and Development (OECD):

i. Comparable uncontrolled price method (CUPM)

The comparable uncontrolled price method compares the price charged for transactions between associated enterprises (related parties) with prices charged for similar transactions between independent enterprises (unrelated parties) in comparable circumstances. If there is any difference between the two prices, this might be an indication that the transactions amongst the associated enterprises are not made at arm's length.

However, in applying the CUPM, it should be noted that prices for the same product may differ not necessarily because of being sold to associated or independent enterprises, but because the product is not

sold under similar terms and circumstances in comparable quantities and markets. Therefore, it may be necessary to make a reasonable comparability adjustment for such differences.

ii. **Resale price method (RPM)**

The resale price method begins with the resale price to an independent enterprise of a product purchased from an associated enterprise and a gross margin is then deducted from this resale price.

iii. **Cost-plus method (CPM)**

Under this approach, the costs incurred by the supplier in making the product transferred or services provided to an associated enterprise are ascertained and marked-up. An appropriate mark-up may be determined by reference to other enterprise in similar independent supplier earns in comparable transactions (internal comparable), or by reference to the mark-up earned in comparable transactions by entirely independent enterprises (external comparable).

iv. **Profit split method (PSM)**

The first step is to determine the combined profit that arises from a business transaction in which the associated enterprises are engaged. This profit is then split between the associated enterprises in a manner that reflects the division of profit that would have been expected between independent enterprises. The combined profit or loss attributed to the transactions in which the associated enterprises participated is allocated to the associated enterprises in proportion to their respective contributions to that combined operating profit or loss.

v. **Transactional net margin method (TNMM)**

Under this method, the net profit margin that an enterprise earns from transactions with an associated enterprise is compared with the net profit margin earned in comparable transactions with an independent enterprise.

An appropriate net margin may be determined by reference to the net margin that the enterprise earns in comparable transactions with independent enterprises (internal comparable), or by reference to the net margin earned in comparable transactions by independent enterprises (external comparable). The transactional net margin method operates in a manner similar to the cost plus and resale price methods. However, the transactional net margin examines the net profits in relation to an appropriate base (e.g. costs, sales, assets) and not gross margin on resale or mark-up on costs.

(d) **Contents and mandatory transfer pricing documents and relevant information to be submitted to the Service by taxpayers**

Transfer pricing declaration form (contents of transfer pricing declaration form) contains the following:

- i. particulars of reporting company or entity;
- ii. particulars of immediate parent companies;
- iii. particulars of directors of reporting companies;
- iv. particulars of major shareholders of reporting companies and related parties;
- v. ownership, structure of reporting entity and related parties;
- vi. particulars of subsidiary and other connected persons;
- vii. particulars of external auditors of reporting entity;
- viii. particulars of tax consultant of the reporting entity;
- ix. particulars of company secretary of the reporting entity; and
- x. particulars of the person making the declaration.

Contents of transfer pricing disclosure form include:

- i. particulars of the reporting company or entity;
- ii. income from controlled transaction;
- iii. costs of controlled transactions;
- iv. summary of controlled transactions with connected persons;
- v. transfer pricing methods and documentation;
- vi. basic financial information for reporting entity and the group;
- vii. particulars of the person making the disclosure; and
- viii. declaration.

(e) **Transfer pricing offences and penalties**

S/N	Offences	Penalties
i.	Failure to file TP declaration form	₦10million for the first month of default, and ₦10,000 for every day the failure continues
ii.	Failure to file TP disclosure form and TP documentation	The higher of: ₦10million or 1% of the value of uncontrolled transaction(s) not disclosed, and ₦10,000 for every day the failure continues
iii.	Making an incorrect disclosure in the TP disclosure form	The higher of ₦10million or 1% of the value of controlled transactions incorrectly disclosed
iv.	Failure to provide the FIRS with information or document required within the time specified in a notice issued to the taxpayer	1% of the value of each controlled transaction for which the information or document was required, plus ₦10,000 for each day such failure continues
v.	Failure to submit updated TP declaration form	₦25,000 for every day the failure continues

Examiner's Report

The question tests candidates' understanding of the relevant provisions of the Income Tax (Transfer Pricing) Regulations, 2018, in respect of the purpose, objectives, and scope of the regulations; expectations of the FIRS on taxpayers' compliance with "arm's length principle; transfer pricing methods; contents and mandatory transfer pricing documents; and various offences and penalties on non-compliance with transfer pricing.

About 30% 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 the candidates was their inability to state correctly the various penalties introduced by the regulations for offences or acts on non-compliance with transfer pricing.

Candidates are advised to study extensively the Institute's Study Text, other relevant textbooks, and relevant sections of the Income Tax (Transfer Pricing) Regulations, 2018 for future examination.

Marking Guide

		Marks	Marks
a	Purpose, objectives, and scope of transfer pricing regulations 1 mark for correct discussion of the purpose of transfer pricing	1	
	1 mark each for discussion of objectives of TP, subject to a maximum of 3 points	3	
	1 mark each for discussion of scope of TP, subject to a maximum of 2 points	2	6
b.	Expectations of FIRS on taxpayers' compliance with arm's length principle 1½ marks each for discussion of the expectation of FIRS on taxpayers' compliance with arm's length principle, subject to a maximum of 2 points		3
c.	Transfer pricing methods ½ mark for identification of the method and ½ mark for discussion of each method, subject to a maximum of 5 methods		5
d.	Contents of TP documentation and relevant information to be submitted to FIRS ½ mark for each content of transfer pricing declaration form, subject to a maximum of 4 points	2	

$\frac{1}{2}$ mark for each content of transfer pricing disclosure form, subject to a maximum of 4 points	<u>2</u>	4
e. Offences and penalties 1 mark each for stating both the offence and corresponding penalty, subject to a maximum of 2 points	<u>2</u>	
Total	<u>20</u>	

SOLUTION 3

WESTPOINT FOODS LIMITED

The Managing Director
Westpoint Foods Limited
Lagos.

Dear Sir,

Re: Adjusted Profit, Total Profit, and Income Tax Payable for the Relevant Assessment Years and Other Related Matters

We write to accept your offer to prepare adjusted profit, total profit, and income tax payable for the relevant assessment years, as well as other tax related matters. Our comments are as follows:

a. **Computation of adjusted profit, total profit and income tax payable for the relevant assessment years**

As shown in Appendix 1, the adjusted profit of the company for the year ended December 31, 2023 (2024 assessment year) was ₦11,100,000. The total profit was ₦6,930,700.

Since the annual gross turnover of the company, for the period under review, was ₦18,500,000, which is within the threshold of ₦25 million and below, the company, in line with the provisions of Finance Act, 2019, is deemed to be a small company. It, therefore, implies that for the 2024 assessment year, the companies income tax rate of 0% shall apply. The company will also not be liable to pay tertiary education tax, and exempted from minimum tax provisions.

b. **Dividend basis (Section 19 of CITA 2004 (amended by Section 7 of Finance Act, 2019**

Section 19 (1) CITA Cap C21 LFN 2004, provides that total dividends (proposed or paid) distributed out of profits of any year of assessment on which no income tax has been computed and paid shall replace total or taxable profit and be taxed at the appropriate rate in that tax year if the

dividend deduction resulted to any of the following situations in the same year of assessment under consideration:

- Where there is no total or assessable profits, or
- Where the total or assessable profit is less than the total dividend

The effect of this provision is that where a company pays dividend from its accounting profits while declaring that it had no total profit or total profit is less than the dividend paid out, the tax authority will treat the dividend paid out as the profit of the company and subject it to the appropriate companies income tax (in line with the Finance Act, 2019).

In the case of Westpoint Foods Limited, total profit computed in (a) above for 2024 assessment year was ₦6,930,700 as against the dividend of ₦5,000,000 paid out. The dividend of ₦5,000,000, therefore, will not be subjected to tax.

c. **Capital gains tax for 2024 assessment year**

As shown in appendix 2, the capital gains tax payable by the company for 2024 assessment year was ₦38,393,950.

Thank you.

Yours faithfully,

For: XYZ & Co.

Bamiji Abiloro
Audit Partner

Appendix 1: Computation of adjusted profit, total profit and income tax payable for the 2024 assessment year

	₦	₦
Operating profit		8,584,800
Add back:		
Long lease renewal	1,500,000	
Depreciation	635,200	
Income tax – Directors	325,000	
Repairs and maintenance	<u>55,000</u>	<u>2,515,200</u>
Adjusted profit		11,100,000
Deduct capital allowances		(4,169,300)
Assessable profit/ total profit		<u>6,930,700</u>
Companies income tax thereon @ 0%		<u>Nil</u>
Tertiary education tax (exempted)		<u>Nil</u>
Total tax payable		<u>Nil</u>

Appendix 2: Computation of capital gains tax for 2024 assessment year

	₦	₦
Sales proceeds		650,000,000
Less:		
Initial cost of factory building in 1973	1,800,500	
Renewal of long lease in 2023	181,500,000	
Refurbishment cost	24,260,000	
Agency fees (3% of ₦650m)	19,500,000	
Solicitors fees (5% of ₦650m)	32,500,000	
Adverts	<u>6,500,000</u>	
		<u>266,060,500</u>
Capital gains		<u>383,939,500</u>
Capital gains tax @ 10% of ₦383,939,500		<u>38,393,950</u>

Examiner's Report

The question is divided into three parts. The first part tests candidates' knowledge of computations of adjusted profit, total profit, and income tax liabilities in line with the provisions of CITA 2004 (as amended). The second part tests candidates' understanding of the provisions of the Finance Act, 2019 when dividend payable by a company exceeds profit or there is no total profit. The third part tests candidates' knowledge of computations of capital gains tax of a company in line with the provisions of Capital Gains Tax Act Cap C1 LFN 2004 (as amended).

About 80% of the candidates attempted the question. Candidates showed a good understanding of the requirements of the question and their performance was above average.

The commonest pitfall was the inability of some candidates to explain correctly the provisions of the Finance Act 2019 in respect of assessment of companies income tax liability when dividend payable exceeds profit or there is no total profit.

Candidates are advised to read the Institute's Study Text, the Finance Act, 2019, and other relevant textbooks, as this would go a long way in assisting them to pass future examination.

Marking Guide

	Marks	Marks
a. Computations of adjusted profit, total profit, and income tax payable		
Addressee	1/2	
Opening paragraph	1/2	
Body of the letter (stating that the company is exempted from paying income tax and tertiary education tax	1	
Appendix 1		
Heading (2024 assessment year)	1/2	
Opening profit	1/2	

Long lease renewal	$\frac{1}{2}$
Depreciation	$\frac{1}{2}$
Income tax for directors	$\frac{1}{2}$
Repairs and maintenance	$\frac{1}{2}$
Adjusted profit	1
Capital allowances	$\frac{1}{2}$
Assessable / total profit	1
Income tax @ 0%	$\frac{1}{2}$
Tertiary education tax	$\frac{1}{2}$
Total tax payable	$\frac{1}{2}$

9

b. **Relevant provisions of the Finance Act, 2019 in respect of dividend paid exceeding profit or when there is no profit**

1 mark for each provision of the Finance Act, subject to a maximum of 3 points

3

c. **Capital gains tax computation**

Heading (2024 assessment year)	$\frac{1}{2}$
Sales proceeds	1
Initial cost in 1973	1
Renewal of lease in 2023	1
Refurbished cost	1
Agency fees	$\frac{1}{2}$
Solicitors' fees	$\frac{1}{2}$
Adverts	$\frac{1}{2}$
Capital gains	1
Capital gains tax	$\frac{1}{2}$

8
20

SOLUTION 4

(a)

PSOK Petroleum Company Limited
Computation of hydrocarbon tax
For 2024 year of assessment

	₦'million	₦'million
Revenue		
Value of crude oil sold (\$75 x 4 million barrels x ₦1,150)	345,000	
Value of condensates from associated gas sold (\$56 x 1.5 million MMBtu x ₦1,150)	96,600	
Value of gas liquid from associated gas (\$52 x 1.2 million MMBtu x ₦1,150)	<u>71,760</u>	
Gross revenue	513,360	
Allowable deductions (Section 263):		
Production cost	205,344	
Drilling cost	51,000	
Royalties paid	102,671	
Repairs and maintenance	2,200	
Terminating cost	180	
Concession rentals	25,660	
First two appraisal wells cost	4,800	
Cost of gas reinjection wells	1,300	
Host community fund	1,900	
Environmental remediation fund	30	
NDDC charge	350	
Administrative expenses:		
- Salaries and other personnel costs	950	
- Power costs	254	
- Transport and traveling	122	
General expenses- Stamp duties	33	
General expenses- State government land use charges	150	
Total allowable cost	396,944	
Total costs subject to CPR limit (W1)	<u>(396,944)</u>	(396,944)
Excess allowable cost carried forward	Nil	
Adjusted profit	116,416	
Less: Loss relief	<u>Nil</u>	
Assessable profit	116,416	
Less: Section 266 and 6th schedule deductions:		
Capital allowance	<u>2,750</u>	
	113,666	
Production allowance:		
Onshore operations	1,850	
Shallow water operations	<u>2,100</u>	<u>3,950</u>
Chargeable profit	<u>109,716</u>	
/Hydrocarbon tax @ 30% of ₦109,716 million		<u>32,914.8</u>

(1) Cost-price-ratio (CPR) limit

	₦'million	₦'million
Gross revenue		<u>513,360</u>
i. Maximum allowable @ 65% of Gross revenue of ₦513,360		<u>333,684</u>
Total operating cost	396,944	
Capital allowances	2,750	
Total eligible costs	399,694	
Less: Exempted cost incurred (Section 263):		
Royalties paid	102,671	
Concession rentals	25,660	
Host community fund	1,900	
Environmental remediation fund	30	
NDDC charge	<u>350</u>	<u>130,611</u>
ii. Net total costs to be subject to CPR		<u>269,083</u>

Maximum allowable cost is the lower of (i) and (ii), which is ₦269,083 million.

Total allowable cost (in line with the practice of FIRS) = Total exempted cost + CPR restricted cost = ₦130,611 million + ₦269,083 million = ₦399,694 million.

Allowable expenses is however restricted to actual amount incurred of ₦396,944 million.

b. Conditions that must be met before a gas utilisation company can enjoy the GUIA on qualifying plant and equipment expenditure are:

- i. the cost of the qualifying plant and equipment must have been incurred by the company;
- ii. the cost must have been incurred fro the commencement date of this incentive Order;
- iii. proof of ownership of qualifying plant and equipment; and
- iv. evidence of direct use of plant and equipment for gas processing and transportation in midstream gas operations.

Examiner's Report

The question is divided into two parts. The first part 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. The second part tests candidates' knowledge of the conditions that must be met before a gas utilisation company can enjoy the gas utilisation investment allowance applicable to qualifying expenditure on plant and equipment.

About 90% 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 the candidates was their inability to identify correctly the conditions that must be met before a gas utilisation company can enjoy the gas utilisation investment allowance applicable to qualifying expenditure on plant and equipment.

Candidates are advised to study extensively the relevant sections of the Petroleum Industry Act, 2021 and the Oil and Gas Companies (Tax Incentives, Exemptions, Remission, etc) Order 2024, when preparing for future examination.

Marking Guide

	Marks	Marks
(a) Computation of hydrocarbon tax		
Value of crude oil sold	$\frac{1}{2}$	
Value of condensate from associated gas sold	$\frac{1}{2}$	
Value of gas liquid from associated gas	$\frac{1}{2}$	
Gross revenue	$\frac{1}{2}$	
Production cost	$\frac{1}{2}$	
Drilling cost	$\frac{1}{2}$	
Royalties paid	$\frac{1}{2}$	
Repairs and maintenance	$\frac{1}{2}$	
Terminaling cost	$\frac{1}{2}$	
Concession rentals	$\frac{1}{2}$	
First two appraisal wells cost	$\frac{1}{2}$	
Cost of gas reinjection wells	$\frac{1}{2}$	
Host community fund	$\frac{1}{2}$	
Environmental remediation fund	$\frac{1}{2}$	
NDDC charge	$\frac{1}{2}$	
Administrative expenses- Salaries	$\frac{1}{2}$	
Administrative expenses- power costs	$\frac{1}{2}$	
Administrative expenses- transport and traveling	$\frac{1}{2}$	
Stamp duties	$\frac{1}{2}$	
State government land use charges	$\frac{1}{2}$	
Total allowable costs	$\frac{1}{2}$	
Total costs subject to CPR limit (W1)	$\frac{1}{2}$	
Adjusted profit	$\frac{1}{2}$	
Assessable profit	$\frac{1}{2}$	
Capital allowance	$\frac{1}{2}$	
Production allowance	$\frac{1}{2}$	
Chargeable profit	$\frac{1}{2}$	
Hydrocarbon tax	$\frac{1}{2}$	

Workings (CPR limit)	
Maximum allowable @ 65% of gross revenue	$\frac{1}{4}$
Total operating cost	$\frac{1}{4}$
Capital allowances	$\frac{1}{4}$
Royalties paid	$\frac{1}{4}$
Concession rentals	$\frac{1}{4}$
Host community fund	$\frac{1}{4}$
Environmental remediation fund	$\frac{1}{4}$
NDDC charge	$\frac{1}{4}$
Net total costs to be subject to CPR	$\frac{1}{4}$
Maximum allowable cost (lower of i and ii)	$\frac{1}{4}$
Total allowable cost in line with FIRS	$\frac{1}{4}$
Restriction of allowable cost to actual amount	$\frac{1}{4}$
	17
b. Conditions that must be met before a gas utilisation company can enjoy the GUIA on qualifying plant and equipment expenditure	
1 mark for each condition, subject to a maximum of 3 points	
Total	$\frac{3}{20}$

SOLUTION 5

a. **Tax inspectors without borders (TIWB)**

- This is a joint new initiative of the Organisation for Economic Cooperation and Development (OECD) and the United Nations Development Programme (UNDP) for delivering assistance needed to build tax audit capacity in developing countries, bridging the gap between theory and practice.
- It also complements efforts from the international development community to help with a range of broader domestic resource mobilisation (DRM) issues. As such, TIWB can make a significant contribution to DRM efforts by developing countries.
- TIWB facilitates targeted tax audit assistance programmes in developing countries across the globe. Under TIWB, tax audit experts work alongside local officials of developing country tax administrations on current direct and indirect tax audits and related issues concerning international tax matters and sharing general audit practices for specific cases.
- TIWB programmes can include pre-audit risk assessment and case selection, investigatory techniques, audit cases involving transfer pricing issues, anti-avoidance rules, or sector-specific issues, relating for example to natural resources, e-commerce, financial services or telecommunications.

v. The host administrations of developing countries are the lead partners in TIWB programmes, clearly specifying their needs and scope of work. TIWB assistance is delivered by current or recently retired tax audit experts. Audit experts work with the host administration under a programme agreement which covers all the legal and practical safeguards and provisions. The experts are not intended to act as a substitution of local audit staff or to carry out audit work where no local audit personnel would otherwise exist.

b. **Cooperative compliance**

- i. Cooperative compliance is a tax planning strategy that is in a form of relationship between the revenue authority and a taxpayer with the objective of agreeing actions that ensure that taxpayers is tax compliant in an uncertain and controversial tax situation.
- ii. The aim of cooperative compliance is to ensure that a business is fully tax compliant through a preventive dialogue with tax authorities.
- iii. In recent years, a growing number of tax authorities have shifted their strategies towards large organisations to include forms of so-called cooperative compliance programmes.
- iv. Cooperative compliance programmes require large organisations to have internal (or tax) control frameworks in place that assure that they can comply with their tax obligations and can also detect uncertain tax positions and disclose these to the tax authority. In exchange, the tax authority sees to it that tax matters are resolved quickly, quietly, fairly, and with finality.
- v. Cooperative compliance programmes have, therefore, been characterised as “transparency in exchange for certainty”.

c. **Simultaneous tax examination**

A simultaneous tax examination is an arrangement amongst two or more countries to examine the tax affairs of a person or entity simultaneously, but independently, in each country.

This approach allows tax authorities to:

- i. exchange information and coordinate efforts to ensure accurate taxation;
- ii. minimise the risk of double taxation and tax disputes; and
- iii. streamline tax audits and examinations.

Simultaneous tax examination has the following benefits as it:

- i. encourages taxpayers to comply with tax laws and regulations;
- ii. helps detect and prevent tax evasion and avoidance schemes; and
- iii. fosters cooperation and collaboration between tax authorities.

Examiner's Report

The question tests the candidates' knowledge of selected initiatives in international taxation, specifically, tax inspectors without borders, cooperative compliance, and simultaneous tax examination.

About 60% of the candidates attempted the question and they exhibited a lack of understanding of its requirements. The performance was below average.

The commonest pitfall was the inability of some candidates to explain correctly the cooperative compliance.

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

Marking Guide

	Marks	Marks
a. Tax inspectors without borders (TIWB) 1½ marks for each correct discussion of TIWB subject to a maximum of 4 points	6	
b. Cooperative compliance 1 mark for each correct discussion of cooperative compliance, subject to a maximum of 4 points	4	
c. Simultaneous tax examination 1 mark for description of simultaneous tax examination 1 mark for each approach that simultaneous tax examination allows tax authorities to do, subject to a maximum of 2 points	1	
	2	
1 mark for each benefit of simultaneous tax examination, subject to a maximum of 2 points	2	5
Total		<u>15</u>

SOLUTION 6

(a) i. **Concept and tax implications of thin capitalisation**
Concept of thin capitalisation

A company is said to be thinly capitalised when its capital is made up of a much greater proportion of debt than equity, that is, its gearing, or leverage, is too high.

This is perceived to create problems for two classes of people-creditors and tax authorities.

Tax issues on thin capitalisation

Even where countries' corporate laws permit companies to be thinly capitalised, tax authorities in those countries will often limit the amount that a company can claim as a tax deduction on interest, particularly when it receives loans at non-commercial rates (for example, from connected parties). However, some countries simply disallow interest deductions above a certain level from all sources when the company is considered to be too highly geared under applicable tax regulations.

Some tax authorities limit the applicability of thin capitalisation rules to corporate groups with foreign entities to avoid "tax leakage" to other jurisdictions. The United States "earnings stripping" rules are examples. Hong Kong protects tax revenue by prohibiting taxpayers from claiming tax deductions for interest paid to foreign entities, thus eliminating the possibility of using thin capitalisation to shift income to a lower-tax jurisdiction.

Prior to the commencement of Finance Act, 2019, there were no thin capitalisation rules in Nigeria. However, in practice, FIRS sometimes seeks to disallow interest deductions considered excessive, which in most cases are usually done arbitrarily.

The Finance Act, 2019, now introduces a specific benchmark of thirty percent (30%) of earnings before interest, taxes, depreciation and amortisation (EBITDA) in a year as the limit for interest deduction on loans by a foreign 'connected person'.

Where there is excess interest, such is considered as a disallowable deduction in that year.

ii. Concept and tax implications on treaty shopping

Concept of treaty shopping

Treaty shopping is a situation where a person, who is resident in one country (say the "home" country) and who earns income or capital gains from another country (say the "source" country), is able to benefit from a tax treaty between the source country and yet another country (say the "third" country). This situation often arises where a person is resident in the home country but the home country does not have a tax treaty with the source country.

Tax implication on treaty shopping

Treaty shopping is an analysis of tax treaty provision by non-treaty party to structure an international transaction or operation so as to gain or take advantage of a particular treaty benefit. This practice consists in a resident of a state that is not a party to the double taxation treaty establishing an entity within a state that is party to the treaty in order to take advantage of its provision.

The problem of treaty shopping could be tackled through anti-treaty shopping provisions despite the fact that it is one of the most complex international tax rules. Some countries have also tackled the problem of treaty shopping by including in their tax treaties specific provision referred to as “limitation on benefit” or “LOB”. These provisions limit the benefit under the treaties in certain circumstances. Therefore, companies which are not bona fide residents of the treaty countries or which are set up for treaty shopping purpose may be denied the treaty benefits.

b. **The OECD has issued 15 action items to address the main areas where they feel companies have been most aggressively accomplishing this shifting of profit. The action items are as follows:**

- i. **Address the tax challenges of the digital economy:** Identify the main difficulties that the digital economy poses for the application of existing international tax rules and develop detailed options to address these difficulties, taking a holistic approach and considering both direct and indirect taxation. Issues to be examined include, but are not limited to, the ability of a company to have a significant digital presence in the economy of another country without being liable to taxation due to the lack of nexus under current international rules, the attribution of value created from the generation of marketable location-relevant data through the use of digital products and services, the characterisation income derived from new business models, the application of related source rules, and how to ensure the effective collection of value a tax or goods and services tax with respect to the cross-border supply of digital goods and services.
- ii. **Neutralise the effects of hybrid mismatch arrangements:** Develop model treaty provisions and recommendations regarding the design of domestic rules to neutralise the effect (for example, double non-taxation, double deduction, long-term deferral) of hybrid instruments and entities. This may include:
 - changes to the OECD Model Tax Convention to ensure that hybrid instruments and entities (as well as dual resident entities) are not used to obtain the benefits of treaties unduly;
 - domestic law provisions that prevent exemption or non-recognition for payments that are deductible by the payer;
 - domestic law provisions that deny a deduction for a payment that is not includable in income by the recipient (and is not subject to taxation under controlled foreign company (CFC) or similar rules);
 - domestic law provisions that deny a deduction for a payment that is also deductible in another jurisdiction; and

- where necessary, guidance on co-ordination or tie-breaker rules if more than one country seeks to apply such rules to a transaction or structure. Special attention should be given to the interaction between possible changes to domestic law and the provisions of the OECD Model Tax Convention. This work will be coordinated with the work on interest expense deduction limitations, the work on CFC rules, and the work on treaty shopping.

iii. **Strengthen controlled foreign company (CFC) rules:** Develop recommendations regarding the design of controlled foreign company rules. This work will be coordinated with other work as necessary.

iv. **Limit base erosion via interest deductions and other financial payments:** Develop recommendations regarding best practices in the design of rules to prevent base erosion through the use of interest expense, for example through the use of related-party and third-party debt to achieve excessive interest deductions or to finance the production of exempt or deferred income, and other financial payments that are economically equivalent to interest payments. The work will evaluate the effectiveness of different types of limitations. In connection with and in support of the foregoing work, transfer pricing guidance will also be developed regarding the pricing of related party financial transactions, including financial and performance guarantees, derivatives (including internal derivatives used in intra-bank dealings), and captive and other insurance arrangements. The work will be coordinated with the work on hybrids and CFC rules.

v. **Counter harmful tax practices more effectively, taking into account transparency and substance:** Revamp the work on harmful tax practices with a priority on improving transparency, including compulsory spontaneous exchange on rulings related to preferential regimes, and on requiring substantial activity for any preferential regime. It will take a holistic approach to evaluate preferential tax regimes in the BEPS context. It will engage with non-OECD members on the basis of the existing framework and consider revisions or additions to the existing framework.

vi. **Prevent treaty abuse:** Develop model treaty provisions and recommendations regarding the design of domestic rules to prevent the granting of treaty benefits in inappropriate circumstances. Work will also be done to clarify that tax treaties are not intended to be used to generate double non-taxation and to identify the tax policy considerations that, in general, countries should consider before deciding to enter into a tax treaty with another country. The work will be coordinated with the work on hybrids.

vii. **Prevent the artificial avoidance of PE status:** Develop changes to the definition of PE to prevent the artificial avoidance of PE status in relation to BEPS, including through the use of commissionaire

arrangements and the specific activity exemptions. Work on these issues will also address related profit attribution issues.

- viii. **Assure that transfer pricing outcomes are in line with value creation – intangibles:** Develop rules to prevent BEPS by moving intangibles among group members. This will involve:
 - adopting a broad and clearly delineated definition of intangibles;
 - ensuring that profits associated with the transfer and use of intangibles are appropriately allocated in accordance with (rather than divorced from) value creation; and
 - developing transfer pricing rules or special measures for transfers of hard-to-value intangibles; and updating the guidance on cost contribution arrangements.
- ix. **Assure that transfer pricing outcomes are in line with value creation – risk and capital:** Develop rules to prevent BEPS by transferring risks among, or allocating excessive capital to, group members. This will involve adopting transfer pricing rules or special measures to ensure that inappropriate returns will not accrue to an entity solely because it has contractually assumed risks or has provided capital. The rules to be developed will also require alignment of returns with value creation. This work will be coordinated with the work on interest expense deductions and other financial payments.
- x. **Assure that transfer pricing outcomes are in line with value creation – other high risk transactions:** Develop rules to prevent BEPS by engaging in transactions which would not, or would only very rarely, occur between third parties. This will involve adopting transfer pricing rules or special measures to:
 - clarify the circumstances in which transactions can be recharacterised;
 - clarify the application of transfer pricing methods, in particular profit splits, in the context of global value chains; and
 - provide protection against common types of base eroding payments, such as management fees and head office expenses.
- xi. **Establish methodologies to collect and analyse data on BEPS and the actions to address it:** Develop recommendations regarding indicators of the scale and economic impact of BEPS and ensure that tools are available to monitor and evaluate the effectiveness and economic impact of the actions taken to address BEPS on an ongoing basis. This will involve developing an economic analysis of the scale and impact of BEPS (including spillover effects across countries) and actions to address it. The work will also involve assessing a range of existing data sources, identifying new types of data that should be collected, and developing methodologies based on both aggregate (for example, FDI and balance of payments data) and micro-level data (for example,

from financial statements and tax returns), taking into consideration the need to respect taxpayer confidentiality and the administrative costs for tax administrations and businesses.

- xii. **Require taxpayers to disclose their aggressive tax planning arrangements:** Develop recommendations regarding the design of mandatory disclosure rules for aggressive or abusive transactions, arrangements, or structures, taking into consideration the administrative costs for tax administrations and businesses and drawing on experiences of the increasing number of countries that have such rules. The work will use a modular design allowing for maximum consistency but allowing for country specific needs and risks. One focus will be international tax schemes, where the work will explore using a wide definition of "tax benefit" in order to capture such transactions. The work will be coordinated with the work on co-operative compliance. It will also involve designing and putting in place enhanced models of information sharing for international tax schemes between tax administrations.
- xiii. **Re-examine transfer pricing documentation:** Develop rules regarding transfer pricing documentation to enhance transparency for tax administration, taking into consideration the compliance costs for business. The rules to be developed will include a requirement that multinational enterprises (MNE's) provide all relevant governments with needed information on their global allocation of the income, economic activity and taxes paid among countries according to a common template.
- xiv. **Make dispute resolution mechanisms more effective:** Develop solutions to address obstacles that prevent countries from solving treaty-related disputes under Mutual Agreement Procedure (MAP), including the absence of arbitration provisions in most treaties and the fact that access to MAP and arbitration may be denied in certain cases.
- xv. **Develop a multilateral instrument:** Analyse the tax and public international law issues related to the development of a multilateral instrument to enable jurisdictions that wish to do so to implement measures developed in the course of the work on BEPS and amend bilateral tax treaties. On the basis of this analysis, interested parties will develop a multilateral instrument designed to provide an innovative approach to international tax matters, reflecting the rapidly evolving nature of the global economy and the need to adapt quickly to this evolution.

Examiner's Report

The question is divided into two parts. The first part tests candidates' understanding of the concepts and tax implications of thin capitalisation and treaty shopping. The second part tests candidates' knowledge of strategies used by the organisation for Economic Cooperation and Development (OECD) in mitigating the use of aggressive base erosion and profit shifting by taxpayers.

About 60% of the candidates attempted the question. Candidates showed a fair understanding of the requirements of the question and their performance was average.

The commonest pitfall was the inability of some candidates to explain correctly the strategies used by the OECD in mitigating the use of aggressive base erosion and profit shifting by taxpayers.

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 examination.

Marking Guide

		Marks	Marks
ai.	Concept of, and tax implications on thin capitalisation 1 mark for each correct discussion of the concept of thin capitalisation, subject to a maximum of 2 points		2
	 1 mark for each correct discussion of the tax implications on thin capitalisation, subject to a maximum of 2 points	2	4
aii.	Concept of, and tax implications on treaty shopping 1 mark for each correct discussion of the concept of treaty shopping, subject to a maximum of 2 points	2	
	 1 mark for each correct discussion of the tax implications on treaty shopping, subject to a maximum of 2 points	2	4
b.	Strategies being used by OECD in mitigating the use of aggressive base erosion and profit shifting by taxpayers 1 mark for each correct discussion of the mitigating strategy being used by OECD, subject to a maximum of 7 points	7	
	Total		<u>15</u>

SOLUTION 7

MEMORANDUM

Date:

To: Jefferson
From: The Tax Consultant

Subject: **Re: Mining Revenue, Incentives, and Digital Economy**

Please find below for your perusal, my response on the above subject matter.

a. Fees payable to the Mining Cadastre Office and consequence of failure to pay fees

The Mining Cadastre Office shall collect:

- i. a fee for processing of applications for mineral titles;
- ii. an annual service fee established at a fixed rate per square cadastral unit for administrative and management services rendered by the Cadastre Office; and
- iii. a mineral title shall become liable to revocation where the holder thereof has failed to pay the prescribed fees.

b. Priority for use of land for mining

- i. The use of land for mining operations shall have a priority over other uses of land and be considered for the purposes of access, use and occupation of land for mining operations as constituting an overriding public interest within the meaning of the Land Use Act.
- ii. In the event that a mining lease, a small-scale mining lease or a quarry lease is granted over land subject to an existing and valid statutory or customary right of occupancy, the Governor of the state within which such rights are granted shall within sixty days of such grant or declaration revoke such right of occupancy in accordance with the provisions of section 28 of the Land Use Act.

c. The key incentives available to companies engaged in mining operation in Nigeria in line with Companies Income Tax Act, 2004 (as amended)

- i. Tax holiday for an initial period of 3 years from commencement of operations renewable for additional 2 years. Any dividend recorded during the tax holiday periods will not be subject to withholding tax upon distribution to shareholders.
- ii. Exporters of mineral products may be permitted to retain part of their foreign exchange earning in a domiciliary account for the purpose of acquiring spare parts and other mining inputs.
- iii. Exemption from customs and import duties in respect of plant, machinery equipment and accessories imported exclusively for mining

operations. However, the plant and equipment can only be disposed of locally upon payment of the applicable customs and import duties.

- iv. Free transferability of foreign currency through the Central Bank of Nigeria (CBN) for the following:
 - payment for servicing of certified foreign loan; and
 - remittance of foreign capital in event of sale or liquidation of the business.
- v. Grant of personal remittance quota for expatriate personnel free from any tax imposed by any enactment for the transfer of external currency out of Nigeria;
- vi. Accelerated capital allowance on mining expenditure (95% initial allowance and retention of 5% until asset is disposed of);
- vii. Grant of investment allowance of 10% on qualifying plant and machinery;
- viii. All infrastructure cost provided by the mining company and approved by the MCO to be capitalised and capital allowance claimed at 95% in the first year of operation;
- ix. A company may also be entitled to claim an additional rural investment allowance on its infrastructure cost, depending on the location of the company and the type of infrastructure provided;
- x. Annual indexation of unutilised capital allowance carried forward by 5% for mines that commenced production within five (5) years from the date of enactment of the Act. Whilst the period for new companies to enjoy this incentive lapsed in 2012, new producers may apply to the Minister of Finance, through the Minister of Mines and Steel Development, to enjoy this incentive. Such application may be considered on a case-by-case basis;
- xi. The Minister may grant a concession for the royalty payable on any mineral to be deferred for a number of years, subject to the approval of the Federal Executive Council; and
- xii. Actual amount incurred out of reserves made for environmental protection, mine rehabilitation, reclamation and mine closure cost shall be tax deductible, subject to certification by an independent.

d. **The objections and appeal procedures relating to dispute with a relevant tax authority**

(i) **Notice of objection**

If any taxpayer disputes a tax assessment raised by the tax authority, it may give a notice of objection to the tax authority seeking a review of assessment, the objection must be valid. For a notice of objection to be valid, the following are applicable:

- The objection must be in writing;
- Timely submission: The objection must be submitted within the stipulated time frame (30 days) to be considered valid;

- It must contain clear grounds for objection: The objection must specify in detail the grounds upon which it is made, including facts and reasons for objecting to each issue;
- Supporting documents: The taxpayer must provide evidence and supporting documents to substantiate their objection; and
- Payment of non-disputed tax: The taxpayer must pay all tax not in dispute as well as 50% of the amount of tax in dispute (for Value Added Tax objections).

(ii) **Amendment of assessment and refusal to amend**

- Upon the receipt of the valid notice of objection, the relevant tax authority will examine the grounds of objection to determine its validity. Where the grounds are found to be valid, the tax computation would be reviewed and a revised or amended assessment raised. Payment would be based on the revised amendment within the statutory time limit of sixty days from the date of receipt of the revised assessment by the taxpayer.
- Where the relevant tax authority believes that there is no merit in the notice of objection, then a notice of refusal to amend (NORA) would be sent to the taxpayer.
- The taxpayer, if aggrieved by the notice of refusal to amend, may file a notice of appeal to the Tax Appeal Tribunal within 30 days of the receipt of the notice of refusal to amend.

(iii) **Appeal to the Tax Appeal Tribunal (TAT)**

If the taxpayer is dissatisfied with the response to his objection, he can appeal to the TAT within 30 days of receiving the notice of refusal to amend (NORA).

(iv) **Appeal to Federal High Court**

- If a party is aggrieved by the final decision of the TAT, it can appeal to the Federal High Court within 30 days of receiving the TAT's decision.
- It is essential to note that these limits are crucial and failure to adhere to them result in the assessment becoming final and conclusive.

Examiner's Report

The question tests the candidates' understanding of the provisions of the Nigerian Minerals and Mining Act, 2007 (as amended) in respect of fees payable and failure to pay to mining cadastre office; priority of using land for mining; key incentives available to mining companies in line with the provisions of CITA 2004 (as amended); and the objections and appeal procedures relating to dispute between a taxpayer and a relevant tax authority.

About 30% 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 provisions of the Nigerian Minerals and Mining Act, 2007 (as amended) in respect of using land for mining.

Candidates are advised to read the Institute's Study Text, Nigerian Minerals and Mining Act, 2007 (as amended), and other relevant textbooks when preparing for future examination.

Marking Guide

	Marks	Marks
a. Fees payable and failure to pay to mining cadastre office 1 mark for each discussion of fees payable and failure to pay to mining cadastre office, subject to a maximum of 2 points	2	
a. Priority of using land for mining 1 mark for each discussion of priority of using, land for mining, subject to a maximum of 2 points	2	
b. Mining incentives in line with CITA 2004 (as amended) ½ mark each for discussion of mining incentives, subject to a maximum of 8 points	4	
c. Objections and appeal procedures 1 mark for each discussion of notice of objection, subject to a maximum of 3 points 1 mark for each discussion of amendment of assessment or refusal to amend, subject to a maximum of 2 points 1 mark for discussion of appeal to Tax Appeal Tribunal, subject to a maximum of 1 point 1 mark for discussion of appeal to Federal High Court, subject to a maximum of 1 point	3 2 1 1	7 <u>15</u>
Total		

INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA



PROFESSIONAL LEVEL EXAMINATION – NOVEMBER 2025

CASE STUDY

EXAMINATION INSTRUCTIONS

PLEASE READ THESE INSTRUCTIONS BEFORE THE COMMENCEMENT OF THE PAPER

1. Check your pockets, purse, mathematical set, etc. to ensure that you do not have prohibited items such as telephone handset, electronic storage device, programmable devices, wristwatches or any form of written material on you in the examination hall. You will be stopped from continuing with the examination and liable to further disciplinary actions including cancellation of examination result, if caught.
2. Write your **EXAMINATION NUMBER** in the space provided above.
3. Do **NOT** write anything on your question paper **EXCEPT** your Examination number.
4. Do **NOT** write anything on your docket.
5. Read all instructions in the question paper carefully before answering the questions.
6. All solutions should be written in **BLUE** or **BLACK INK**. Any solution written in **PENCIL** or **any other COLOUR OF INK** will not be marked.
7. Check that you have collected the correct question paper for the examination you are writing.
8. Cross out **ALL UNUSED SPACES ON ALL PAGES** of the Answer Booklet.

THURSDAY, NOVEMBER 20, 2025

DO NOT TURN OVER UNTIL YOU ARE TOLD TO DO SO

INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA
PROFESSIONAL LEVEL EXAMINATION – NOVEMBER 2025

CASE STUDY

Time Allowed: 4 hours (including reading time)

INSTRUCTION: **YOU ARE TO USE CASE STUDY ANSWER BOOKLET FOR THIS PAPER**

PRE-SEEN

This material is circulated 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.

You **MUST NOT** bring this material with you to the Examination Hall. Upon receipt of the material, you are to spend the next 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 analyse 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 all 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 sections which include the questions to be answered. 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 provided	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%

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 competence. 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: Folak Motors Nigeria Limited (Folak Motors)

List of exhibits

Exhibit 1: About you (Sylvester Chukwudi) and your employer, Bagudu, Ademola & Co. (Chartered Accountants)

Exhibit 2: The Nigerian economy and the services sector

Exhibit 3: Analysis of motor vehicle sales and distribution business in Nigeria: 2022–2025

Exhibit 4: Analysis of motor repairs, service centres, and spare parts sales in Nigeria

Exhibit 5: Folak Motors: Unaudited summarised 2023 – 2024 financial statements

About you (Sylvester Chukwudi) and your employer, Bagudu, Ademola & Co. (Chartered Accountants)

You are **Sylvester Chukwudi**, an accounting graduate, writing the Professional level of ICAN examination. You are employed as a Trainee in the firm of Bagudu, Ademola & Co (Chartered Accountants) reporting directly to Dauda Bagudu, a Partner in the firm. Your position requires a proactive approach to client services 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. This involves 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:** Assess various operational and strategic business proposals, evaluating how each aligns with the client's objectives. Additionally, 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:** Provide 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 line report'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 at national and international levels. This commitment to continuous learning ensures that your work reflects current best practice and supports the firm's clients in achieving their objectives.

The Nigerian economy and the services sector

Introduction

The Nigerian economy, one of Africa's largest by GDP, is driven by a diverse array of sectors, with the Services sector accounting for a significant share of national output. The motor repairs business stands out as vital sub-sector, supporting the country's extensive road transportation system, by ensuring the functionality and increase in the life span of vehicles used by millions of Nigerians.

The structure of the services sector in Nigeria

Nigeria's services sector has experienced significant growth over the past decade. According to the National Bureau of Statistics, the sector contributes over 50 percent to Nigeria's GDP, outpacing agriculture and oil in recent years. Its components include trade, transport, real estate, finance, information technology, professional services, and personal services.

The motor repairs services sub-sector

Motor repairs, while often grouped under trade and personal services, represent a critical link in Nigeria's transportation value chain. As the country's urban centres expand and vehicle ownership rises, the demand for reliable, professional motor repair services has surged, creating opportunities for entrepreneurs and skilled technicians alike.

Key features affecting motor repairs

The following are the key features of the motor repairs sub-sector in Nigeria:

- **Informal versus Formal Enterprises:** The majority of motor repairs businesses operate within Nigeria's vast informal sector, characterised by small-scale workshops, roadside mechanics, and family-run garages. Formal enterprises, often branded service centres, represent a smaller, but growing segment, typically catering for newer vehicles and clients seeking higher standard of services.
- **Skills and training:** Technical expertise is mostly acquired through informal apprenticeships rather than structured vocational education, leading to variable service quality and innovation. The services sector's increasing sophistication has begun to drive demand for higher standards and technical certifications.
- **Access to infrastructure:** The efficiency of motor repairs businesses depends on access to reliable electric power, good road networks, and modern diagnostic equipment, all of which are shaped by wider services sector investments.
- **Supply chains:** Access to spare parts and technical information is strongly influenced by trade regulations, import policies, and logistics infrastructure within the services sector.

Economic impact of motor repairs within the services sector

Motor repairs businesses contribute meaningfully to job creation, skills transfer, and local economic development. By supporting the road transport system, which moves over 90 percent of Nigeria's goods and people, they help sustain the productivity of other services sub-sectors, such as retail and logistics.

Economic benefits of the motor repairs sub-sector

- **Employment generation:** The motor repairs business absorb thousands of apprentices and skilled workers, offering a pathway for youth employment in an economy where formal jobs are scarce;
- **Entrepreneurship:** The low barriers to entry in the sector enable the proliferation of micro and small enterprises, thus fostering economic inclusion; and
- **Complementary service:** Successful motor repairs businesses often evolve into broader service providers, including auto-electrics, car wash, sales of spare parts, and accessory installation, further deepening their economic footprint.

Challenges facing motor repairs businesses in the Nigeria services sector

Despite its importance, the motor repairs sub-sector faces considerable challenges arising from both the broader services environment and its own internal dynamics.

- **Infrastructure constraints:** Power supply remains low and erratic, forcing many businesses to rely on generators, which increases operational costs. Poor road conditions complicate access to clients and the movement of supplies. Inadequate workshop facilities and outdated equipment also limit the competitiveness of local businesses.
- **Regulatory and policy constraints:** The absence of formal regulation for many informal motor repairs businesses results in inconsistent service standards and customer trust issues. Where regulation exists, compliance can be expensive and complex, particularly for small businesses.
- **Access to finance:** Limited access to affordable finance restricts business expansion, investment in modern tools, and capacity building. Financial institutions often prefer lending to well-established businesses with formal documentation and collateral, leaving smaller workshops at a disadvantage.
- **Technical skill gaps:** Reliance on informal training limits the sector's ability to adapt to evolving automotive technologies, such as hybrid and electric vehicles. Limited availability of structured vocational programmes and certifications impede workers mobility and overall sector professionalism.
- **Supply chain and spare parts quality:** Motor repairs businesses are frequently affected by counterfeit or substandard spare parts, which undermine service quality and vehicle safety. Trade policies affecting the importation of genuine spare parts can also disrupt supply chains.

- **Digitalisation and technology adoption:** Nigeria's services sector is increasingly shaped by technological advances, yet most motor repairs businesses remain outside the digital economy. Limited access to digital diagnostic tools, online marketing platforms, and management software restrict their ability to scale and serve a modern clientele.

Opportunities for growth and transformation

Amidst these challenges, the evolving services sector offers several pathways for enhancing the performance and prospects of motor repairs businesses. These include:

- **Vocational training and certification:** Investment in formal technical education and certification can improve service standards, foster innovation, and enhance consumer confidence. Partnerships between government, private sector, and international organisations can help deliver targeted training programmes. The current government policy on technical and vocational education is expected to improve the availability of trained technicians in the sub-sector.
- **Access to finance:** Tailored financial products for small businesses, such as micro-loans and equipment leasing, can help entrepreneurs invest in modern tools, workshop upgrades, and staff development.
- **Infrastructure upgrades:** Improvements in the services sector's physical infrastructure, power, roads, and logistics, will have direct positive effects on motor repairs businesses, enabling greater efficiency and customer satisfaction.
- **Regulatory reform:** Streamlining registration and compliance processes, and encouraging self-regulation through industry associations, can help raise standards, while enabling smaller businesses to access broader markets.
- **Digitalisation:** Adoption of digital tools for diagnostics, inventory management, and customer engagement can revolutionise service delivery. E-commerce platforms for spare parts and services also offer new growth avenues.
- **Quality assurance:** Collaborations with reputable suppliers and distributors, and the enforcement of standards for spare parts, can help combat counterfeiting and ensure safety.
- **Local production capacity:** The volume of cars sold by dealerships in Nigeria and the demand for high quality service and repair workshops is an indication that the opportunity for expansion of capacity for parts production and for certification of technicians exist.

The roles of government and stakeholders

The government of Nigeria, in collaboration with industry stakeholders, have pivotal roles to play in shaping the future of motor repairs within the services sector. The roles of the government include:

- **Policy formulation:** Development of clear, supportive policies for motor repairs businesses can unlock their potentials for job creation and economic growth.
- **Public-private partnerships:** Joint initiatives amongst government, private sector, and development agencies can deliver infrastructure upgrades, promote skills training, and encourage best practice.
- **Industry associations:** Strengthening associations for motor repairs businesses can provide a platform for advocacy, skills development, and regulatory self-enforcement.

The services sector is a significant part of the Nigerian economy, providing employment, fostering innovation, and supporting social mobility. Motor repairs businesses, a vital sub-sector, is both a beneficiary and contributor to this dynamic environment.

Strategic investments in education, infrastructure, finance, and digitalisation, combined with regulatory reforms and industry collaboration can help motor repairs businesses thrive within Nigeria's evolving services sector. The financial success of the sub-sector will sustain the nation's mobility, drive its economic productivity, and empower the aspirations of its people.

Exhibit 3

Analysis of motor vehicle sales and distribution business in Nigeria: 2022–2025

Introduction

The Nigerian motor vehicle sales and distribution sector is a critical portion of the economy. As one of the continent's most populous nations, Nigeria's automotive industry reflects the broader economic, infrastructural, and regulatory trends that shape its commercial landscape. Since 2022, the sector has undergone substantial shifts, faced economic headwinds, evolving consumer preferences, and policy-driven reforms that collectively reshape the terrain for manufacturers, importers, and distributors.

Market overview: 2022–2025

Nigeria's automotive sector is predominantly import-driven, with a vast majority of vehicles, both new and used, sourced from Asia, Europe, and North America. Despite efforts to foster local assembly, the market remains reliant on imports due to cost advantages, limited manufacturing capacity, and consumer demand for affordable vehicles.

Size and growth

Since 2022, Nigeria's motor vehicle market has experienced both moderate growth and volatility. In 2022, total annual vehicle sales, made up of both new and used vehicles, were estimated at around 280,000 units. The market was dominated by used vehicles, constituting more than 80% of sales. The new vehicle segment, severely impacted by scarcity of foreign exchange and high import duties, accounted for 10 - 15% of total sales.

By 2023, a slight uptick in economic activities and modest improvements in infrastructure spurred a minor rebound. Nonetheless, the industry faced challenges such as persistent inflation, a depreciating naira, and increasing costs of finance for consumers and businesses. By 2024 and into 2025, the market's trajectory remained uncertain, but demonstrated resilience, with projections estimating total annual sales growing to around 320,000 units by the end of 2025, assuming gradual economic stabilisation.

Key segments and distribution channels

- a. **Used vehicles ("Tokunbo"):** These make up the largest segment. Imported mainly from the United States of America, Europe, and Asia, used cars are distributed through a network of dealers, independent resellers, and auto marts concentrated in major cities like Lagos, Abuja, and Port Harcourt.
- b. **New vehicles:** With international brands such as Changan, Geely, Kia, Honda, Hyundai, Mercedes Benz, Toyota, Volkswagen, etc, the new vehicle segment is mainly served through authorised dealerships. However, high prices and limited access to credit confine their customer base to government agencies, corporates, and a small affluent consumer class.
- c. **Local assembly:** Despite policy incentives, locally assembled vehicles still account for a minor fraction of total sales due to limited production capacity and high input costs.

Distribution structure

- a. **Authorised dealerships:** Typically located in urban centres, these outlets represent international automakers and provide sales, financing, after-sales services, and warranties. They rely heavily on brand reputation and long-term relationships with corporate clients.
- b. **Independent dealers:** These actors dominate the used vehicle market, importing in bulk and reselling directly to consumers or through auto marts.
- c. **Online platforms:** The digitalisation of commerce has seen the emergence of online marketplaces where consumers can browse, negotiate, and purchase vehicles with increased transparency and convenience.

Key market drivers

- a. **Population growth and urbanisation:** Nigeria's population exceeds 237 million with a rapidly growing urban middle class. The need for mobility in expanding cities drives consistent demand for both personal and commercial vehicles.
- b. **Infrastructural development:** While public transit remains inadequate, investments in road infrastructure, especially in Lagos and Abuja, have encouraged private vehicle ownership. The improvement of expressways and urban roads has a direct impact on vehicle sales figures.
- c. **Government policy and regulation:** The Nigerian Automotive Industry Development Plan (NAIDP) introduced incentives for local assembly and placed higher tariffs on fully-built imports to stimulate domestic manufacturing. However, inconsistent enforcement and policy reversals have hindered the Plan's effectiveness.
- d. **Access to Finance:** Microfinance institutions and emerging automotive finance products are making vehicle ownership more accessible to consumers, though high interest rates and economic volatility remain barriers for many.

Challenges facing the sector

- a. **Foreign exchange constraints:** The Naira's depreciation and foreign currency shortages have significantly increased import costs, impacting both new and used vehicle prices. The exchange rate remain volatile, creating uncertainty for businesses reliant on imports.
- b. **High import duties and tariffs:** To protect domestic assemblers, the government imposed high tariffs (up to 70% on some segments) on fully-built imported vehicles. While this was intended to boost local production, it resulted in higher vehicle prices and increased the influx of low-quality used vehicles.
- c. **Weak manufacturing base:** Despite policy incentives, local assembly plants face high production costs, unreliable electricity, and limited economies of scale. Imported components and inconsistent supply chains further hamper their competitiveness.
- d. **Smuggling and informal markets:** Due to high tariffs and complex procedures, smuggling of vehicles through neighbouring countries remains rife, undermining formal businesses and depriving the government of revenue.
- e. **Poor infrastructure and insecurity:** Underdeveloped transport infrastructure and security challenges restrict distribution networks and increase logistical costs for distributors and dealers.

Trends and opportunities (2022–2025)

- a. **Digital transformation:** Online sales platforms, digital financing solutions, and data-driven inventory management are reshaping vehicle distribution. The COVID-19 pandemic accelerated this trend, with consumers increasingly relying on online research and virtual showrooms.
- b. **Local assembly and value addition:** Ongoing investments are gradually increasing the share of locally assembled vehicles. Government procurement policies favouring locally produced vehicles offer a growth opportunity, though significant scale-up is needed to compete with imports.
- c. **Electric and Alternative Fuel Vehicles:** Though still in early stages, there is growing interest in electric vehicles (EVs) and hybrid technologies, particularly for commercial fleets. Pilot projects and public awareness campaigns are underway, but infrastructure such as availability of charging stations and reliable electricity pose major hurdles.
- d. **After-sales market and value chain expansion:** The growth of the Nigerian auto sector is driving demand for spare parts, servicing, and maintenance. There are significant opportunities for businesses offering genuine parts, quality repair services, and complementary products such as insurance and fleet management solutions.

Competitive landscape

The key players in the motor vehicle sales and distribution in Nigeria can be classified into indigenous and foreign based companies. The market is further segmented into dealers in new vehicles, dealers in used vehicles and dealers in both new and used vehicles.

Folak Motors is one of the indigenous businesses selling both new and used vehicles in the sector.

Projections and future outlook: 2025 and beyond

The Nigerian motor vehicle sales and distribution business is projected to see cautious growth through 2025, with annual sales potentially reaching 320,000 units. Key drivers will include gradual economic recovery, policy reforms aimed at encouraging local manufacturing, and the continued rise of digital sales and financing platforms.

However, significant risks remain. Currency volatility, inflation, and potential policy reversals could impact market stability. To unlock the sector's full potential, stakeholders are calling for:

- Consistent automotive policy implementation;
- Expansion of auto financing solutions;
- Investment in infrastructure and security; and
- Capacity building and skills development for local assembly

Analysis of motor repairs, service centres, and spare parts sales in Nigeria

Introduction

Nigeria has a rapidly expanding automotive sector. The growing demand for personal and commercial transportation has led to the proliferation of motor repairs, service centres, and spare parts sales retailers across the nation.

Overview of the automotive after sales market in Nigeria

The automotive after sales market in Nigeria encompasses a wide array of services, including vehicle repairs, routine maintenance, and the sale of spare parts. The sector is largely driven by the aging vehicle population, importation of used vehicles, and challenging road and environmental conditions that accelerate vehicle wear and tear. Most vehicles in Nigeria are imported, with a significant portion being used cars, further intensifying the demand for maintenance and replacement parts.

Motor repairs

Motor repair workshops range from informal roadside mechanics to formalised, branded service centres. Informal operators dominate the market, offering cost-effective solutions but often lacking advanced diagnostic tools and standardised practices. Formal workshops, typically affiliated with car manufacturers or franchises, are concentrated in major urban centres. These centres provide higher quality service, access to genuine parts, and better-trained personnel, but their services are often more expensive.

Service centres

Service centres in Nigeria are evolving, with more dealerships and manufacturers establishing authorised service facilities. These centres offer comprehensive maintenance packages, warranty services, and customer support. However, their reach is limited, and many vehicle owners still rely on independent workshops for routine maintenance due to cost and accessibility. There is a growing trend towards digitisation, with some service centres adopting online booking, customer relationship management, and telematics to enhance service delivery.

Spare parts sales

The spare parts market in Nigeria is extensive and fragmented. It includes both genuine original equipment manufacturer (OEM) parts and after sales market (non-OEM) alternatives. The prevalence of counterfeit and substandard parts is a persistent challenge, often resulting in compromised safety and vehicle performance. Major spare parts markets serve as hubs for distribution. The rise of e-commerce platforms is gradually transforming the sector, making it easier for customers to access a wider range of products, compare prices, and verify authenticity.

Key challenges

The major challenges in the subsector include:

- a. **Counterfeit parts:** The influx of fake and substandard parts undermines consumer trust and vehicle safety.
- b. **Skills gap:** Many mechanics lack formal training, leading to inconsistent service quality.
- c. **Infrastructure:** Poor road conditions and inadequate workshop facilities hamper efficient service delivery.
- d. **Import dependency:** Heavy reliance on imported vehicles and parts exposes the sector to currency fluctuations and supply chain disruptions.
- e. **Regulatory oversight:** Weak enforcement of standards and regulations exacerbates the proliferation of counterfeit goods and unqualified service providers.

Opportunities

The subsector presents the following opportunities:

- a. **Training and certification:** Investment in skills development and certification programs can improve service quality and industry reputation.
- b. **Digital platforms:** E-commerce and digital service management tools offer new avenues for growth and customer engagement.
- c. **Localisation:** Encouraging local manufacturing and assembly of spare parts can reduce import dependency and create jobs.
- d. **Partnerships:** Collaborations between manufacturers, service centres, and training institutes can drive industry standards and innovations.

Future outlook

The motor repairs, service centre, and spare parts sales sector in Nigeria is poised for growth, driven by increased vehicle ownership and urbanisation. However, realising the sector's full potentials requires addressing the challenges of counterfeit parts, skills infrastructure gaps, and regulatory enforcement. The integration of technology and investment in quality assurance will be critical in shaping a sustainable and competitive automotive after-sales market in Nigeria.

New entrants into the motor repairs, service centre and spare part sales could potentially be companies that buy and sell new and used vehicles, such as Folak Motors.

Exhibit 5

Folak Motors: Unaudited summarised 2023 – 2024 financial statements Income statement: 2023 – 2024

	2023 ₦000	2024 ₦000
Revenue	1,761,910	1,849,920
Cost of sales	1,505,500	1,584,340
Selling, administrative, and other expenses	<u>201,830</u>	<u>213,390</u>
Total costs and expenses	<u>1,707,330</u>	<u>1,797,730</u>
Operating income	54,580	52,190
Interest expense	(13,020)	-11,150
Other income/(loss)	<u>(1,890)</u>	<u>31,290</u>
Income before income tax	39,670	72,330
Benefit from/(Provisions for) income taxes	<u>3,620</u>	<u>(13,390)</u>
Net income	<u>43,290</u>	<u>58,940</u>

Statement of financial position

	2023 ₦000	2024 ₦000
Assets		
Current assets		
Cash and cash equivalents	248,620	229,350
Marketable securities	153,090	154,130
Trade and other receivables	620,260	665,730
Inventories	156,510	149,510
Other assets	<u>36,330</u>	<u>46,020</u>
Total current assets	1,214,810	1,244,740
Non-current assets		
Property, plant and equipment	1,234,030	1,314,820
Deferred income taxes	169,850	163,750
Other assets	<u>114,410</u>	<u>128,650</u>
Total assets	<u>1,518,290</u>	<u>1,607,220</u>
	<u>2,733,100</u>	<u>2,851,960</u>

Liabilities

Current liabilities

Payables	756,610	790,770
Other liabilities and deferred revenue	<u>258,700</u>	<u>277,820</u>
Total current liabilities	<u>1,015,310</u>	<u>1,068,590</u>

Long term liabilities		
Other liabilities and deferred revenue	284,140	288,320
Long-term debt	995,620	1,035,730
Deferred income taxes	10,050	10,740
	<u>1,289,810</u>	<u>1,334,790</u>
Total liabilities	2,305,120	2,403,380
Equity		
Share capital	420	420
Share premium	207,440	206,920
Retained earnings	220,120	241,240
Total equity	427,980	448,580
Total equity and liabilities	2,733,100	2,851,960

UNSEEN

Folak Motors Nigeria Limited (Folak Motors)

List of exhibits

The following exhibits are newly supplied and did not form part of the Pre-seen exhibits:

- Exhibit 6: Email from Dauda Bagudu to Sylvester Chukwudi
- Exhibit 7: Email from Taiwo Folajinmi (Finance Director, Folak Motors) to Dauda Bagudu
- Exhibit 8: Additional information on the 2024 financial statements
- Exhibit 9: Information on planned expansion into motor repairs and spare parts sales from Folak

Folak Motors Nigeria Limited: Case Study requirement

You are **Sylvester Chukwudi**, an accounting graduate, writing the Professional level of ICAN examination. You are employed as a Trainee in the firm of Bagudu, Ademola & Co (Chartered Accountants). You are reporting to Dauda Bagudu, a Partner in the firm.

Requirement

You are required to prepare a draft report, as set out in the email dated October 2, 2025, from Dauda Bangudu 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 provided	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. Failure to address any requirement, including not submitting an executive summary will affect your chances of success. In addition, as indicated above, all four skills areas will be assessed under each of the 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.

Exhibit 6

Email from Dauda Bagudu to Sylvester Chukwudi

From: Dauda Bagudu
To: Sylvester Chukwudi
Date: October 2, 2025
Subject: Folak Motors Nigeria Limited

Background and strategic objective

Folak Motors Nigeria Limited is pursuing a strategic objective to expand its operations within Nigeria. As part of this plan, the company proposes to establish modern vehicle repair garages in Lagos, Abuja and Port Harcourt. This initiative aims to capitalise on the opportunities present in the Nigerian vehicle repair market.

Please prepare a draft report for review, prior to submission to the Board of Folak Motors Limited, bearing in mind the required evaluations and specific tasks for the report.

Summary of Exhibits:

We have received the business environment Exhibits 2, 3, and 4 from our Research and Development unit, and Exhibits 5, 7, 8 and 9 from Folak Motors Nigeria Limited. Exhibit 5 is the financials of the organisation for 2023 and 2024 year; Exhibit 7 is the engagement email from Folak Motors Finance Director, Taiwo Folajinmi; Exhibit 8 is additional information on the 2024 financial statements and other issues, while Exhibit 9 is information on the proposed diversification strategy of Folak Motors.

Required evaluations

The company requests an evaluation of the summary financial statements for the year 2024, including a comparison with the 2023 figures. This analysis should consider any necessary corrections based on the additional information provided in Exhibit 8, as communicated by Folak's Motors Finance Director.

In addition, the directors seek an assessment of the financial details regarding the proposed modern motor vehicle repairs garage project. Information relevant to this project is attached as Exhibit 9. The board has indicated that they expect such a project to achieve a minimum internal rate of return (IRR) of 20% by the end of its first five years of full operation.

Specific tasks for the report

1. Provide an evaluation of the 2023 and 2024 financial statements, focusing on performance, financial position and future prospects, whilst identifying and addressing any potentially unethical practices in the information provided. Ensure that this assessment reflects all relevant information per Exhibits 5 and 8.
2. **With respect to the expansion plan:**
 - (a) (i) Evaluate the viability of the proposed modern vehicle repairs garages, using the financial information provided by Folak Motors. Determine whether the project is likely to meet the Board's expectation, specifically the required IRR (See Exhibit 7).
 - (ii) Evaluate the adequacy of Folak's current governance and management structure to effectively support its proposed diversification into repairs and spare part sales, highlighting any adjustments needed to ensure oversight and accountability.
 - (b) Explain in your advisory report how the company can utilise e-commerce or booking platforms to drive customers acquisition and retention for its proposed vehicle servicing and spare part business.

I look forward to receiving the draft reports.

Kind regards,

Dauda Bagudu.

Exhibit 7

Email from Taiwo Folajinmi (Finance Director, Folak Motors) to Dauda Bagudu

To: Dauda Bagudu
From: Taiwo Folajinmi
Date: September 30, 2025

Dear Dauda,

I hope this message finds you well.

As part of our ongoing strategic objective to broaden our operational footprint within Nigeria, the company is proposing the establishment of modern vehicle repair garages in three key cities: Lagos, Abuja, and Port Harcourt. This initiative is intended to leverage the significant opportunities currently available in the Nigeria vehicle repair market.

The board has requested a comprehensive evaluation of the summary financial statements for the year 2024, alongside a comparative analysis with the 2023 figures. This assessment should consider any adjustments that may be necessary, particularly

in light of the additional information on the 2024 financial statements that I have attached to this email.

In addition, the board would like you to conduct an evaluation of the proposed modern motor vehicle repairs garages project. Relevant details pertaining to this project have also been included in the attachments. The board expects that the project should deliver a minimum internal rate of return (IRR) of 20% within its first five years of full operation.

Ahead of the proposed expansion, the Board also requires your appraisal of Folak Motor's governance and management structure. This is to ensure that the current structure is sufficiently robust to support the proposed diversification.

I would appreciate receiving your report on these matters within the next month, as the board intends to review your findings at the upcoming board meeting scheduled for the first week of December. This meeting will also address the approval of the company's financial plan for 2026.

As always, I am confident in your ability to deliver within the stipulated time frame.

Best regards,

Taiwo

Exhibit 8

Additional information on the 2024 financial statements from Taiwo Folajinmi (Finance Director, Folak Motors)

To: Daudu Bagudu
From: Taiwo Folajinmi
Date: October 7, 2025

Board Dynamics

The Board of Folak Motors is composed mostly of family members. The organisation has a Board Chairman, a Chief Executive Officer, a Director of Finance, a Director of Admin and a Director of Sales. There are no independent Directors. Regional Managers report directly to the Chief Executive Officer with minimal checks.

Performance Targets

The performance targets are basically sales volume. Currently, quality control metrics are not part of performance targets.

Warranty Provision

The company offers a standard warranty period of six months on all vehicles sold. In previous financial years, management determined that the estimated costs associated with warranties were insignificant, and as such, no specific warranty provisions were recorded in the financial statements. However, during the audit of the 2024 financial statements, the auditor highlighted that the obligations arising from warranties have

now become material to the financial position of the company. As a result, management recognises the need to adjust the 2024 financial statements to include provisions for unexpired warranties.

The Sales Director has provided the following estimates regarding vehicles still covered under warranty:

The total value of vehicles currently under warranty is estimated at ₦500 million.

Based on historical trends and past experience, the company expects the pattern of warranty claims to be as follows:

- 80% of vehicles under warranty are expected to require no repairs or associated costs.
- 12% are anticipated to require minor repairs, with costs estimated at 30% of the respective sale price.
- 8% are anticipated to require major repairs, with costs estimated at 70% of the respective sale price.

Vehicle recall

In the course of 2024, approximately 10% of vehicles sold developed brake system malfunctions primarily due to extended periods spent in inventory prior to sale. To maintain the company's reputation and ensure customer safety, a recall programme was initiated for comprehensive repairs to the affected vehicles.

The financial implications of the recall are as follows:

- The sales value of all recalled vehicles is estimated at ₦450 million;
- Major repairs are required for vehicles with a sales value of ₦260 million, with repair costs estimated at 10% of the sales value;
- Minor repairs are required for vehicles with a sales value of ₦190 million, with repair costs estimated at 5% of the sales value; and
- Administrative costs related to the recall process are estimated at ₦5 million.

Provision for old model vehicles

The auditor has also identified a stock of old model vehicles in the company's inventory. These vehicles can no longer be sold at their original cost to the company. As such, a provision has been recommended to reflect their diminished value.

The original cost of these vehicles was ₦80 million when imported. However, the current estimated realisable value is now ₦45 million. The company will therefore recognise a provision to account for the difference between the original cost and the current value.

Management of Folak Motors attributed the loss in value of the old model vehicles to slow demand and depreciation. Records further reveal that delayed management decision on discount approvals, poor stock rotation policy and absence of board level monitoring of inventory aging as possible factors. Folak Motors currently has no early warning system for slow moving stock.

Payment to unregistered customer Agents

During the audit, a payment of ₦50 million was identified as being made to an individual who does not have any direct business dealings with the company. This transaction was brought into question by the auditor, given the absence of a clear connection between the recipient and the company's operations.

Upon further investigation, I clarified that the payment was intended as a public relations gesture to a customer's agent. This action was associated with the supply of 100 vehicles to a customer during the year. My explanation confirmed that, although the recipient was not directly involved in the company's transactions, the payment was linked to efforts to facilitate and maintain positive relationship with the customer in relation to this significant supply contract.

Internal audit findings: Odometer tampering

In September 2024, the company's internal audit revealed that certain regional managers had engaged in the practice of tampering with odometer readings on imported used vehicles held in inventory. This action was primarily motivated by the bonus system in place, which directly rewarded managers based on timely deliveries and achievement of volume targets.

The auditor concluded that this behaviour not only contravened established company policies, but also breached regulatory standards pertaining to vehicle safety and the transparency of business operations. The manipulation of odometer readings compromised the integrity of sales records and undermined consumer trust, raising significant concerns regarding compliance with extant policies within the organisation.

Please feel free to reach out with any further enquires that would facilitate the Board Report.

Best regards,

Taiwo

Exhibit 9

Information on planned expansion into motor repairs and spare parts sales from Folak

The management of Folak Motors has resolved to capitalise on opportunities within the motor repairs and spare parts sales sub-sector of the automotive industry. To this end, the company will establish modern, comprehensive automotive repair and service centres in Lagos, Abuja, and Port Harcourt. These centres are intended to deliver a full spectrum of vehicle maintenance and repair services, catering to a broad customer base and reinforcing Folak Motors' position in the market.

Service offerings

Each centre will provide an extensive range of services designed to address various vehicle needs:

- **Diagnostics and electrical:** This includes advanced diagnostics such as OBD-II scanning, troubleshooting of ABS and airbag systems, battery testing, and reference to wiring diagrams to ensure accurate fault identification and resolution.
- **Mechanical repairs:** Comprehensive mechanical services will be offered, covering engine servicing, transmission repairs, brake system maintenance, suspension work, and exhaust repairs.
- **Maintenance:** Routine maintenance services, such as oil changes, replacement of filters, scheduled inspections, and fluid level checks, will be available to keep vehicles running efficiently.
- **Body work and painting:** The centres will be equipped to handle all aspects of body repairs and painting to restore vehicles to their optimal condition.
- **Parts and accessories sale:** Customers will have access to an inventory comprising both Original Equipment Manufacturer (OEM) and reputable after-sales market parts, ensuring a variety of choices for replacement and upgrade needs.
- **Roadworthiness inspections/certification (Lagos):** Specialised roadworthiness inspections and certification services will be provided, particularly at the Lagos centre, in line with regulatory requirements.
- **Air conditioning service and repair:** The centres will offer dedicated services for diagnosing and repairing vehicle air conditioning systems.

Business unit structure

To ensure operational efficiency and service quality, the offerings will be organised under four distinct business units:

- Mechanical;
- Electrical/Diagnostics;
- Bodywork; and
- Spare parts sale.

Each unit will focus on its area of expertise, enabling Folak Motors to deliver specialised solutions and meet the diverse requirements of its clientele.

Target customers

The proposed motor repairs and spare parts sales services are tailored to meet the diverse needs of several key customer segments:

- **Individual customers:** Possibility of catering to private vehicle owners seeking routine maintenance services, repairs, and genuine parts for their personal vehicles;

- Small fleets: Possibility of offering regular servicing and parts supply on a contractual basis for small fleets, such as delivery vans and service vehicles;
- Spare parts customers: Possibility of providing a wide range of spare parts to customers, accommodating varying requirements for technical support; and
- Commercial accounts: Local businesses may potentially benefit from our ability to supply bulk parts, manage warranty work, and deliver service plans, designed for commercial operations.

Competitive landscape

The automotive service and parts market is characterised by a range of competitors:

- Local independent mechanic workshops: These businesses are highly competitive on price and offer personalised customer service;
- Authorised dealerships: While they typically charge higher prices for parts, they benefit from customer trust and the ability to handle warranty work;
- Tyre and quick-lube chains: Known for their speed and convenience, these chains also offer competitive pricing structures; and
- Online retailers: The availability of parts and aggressive pricing from online platforms present significant pressure in the marketplace.

Initial investment

Each of the Garages will require the following initial investment:

	₦m
Building-workshop and office building	100
Mechanical equipment	200
Hand tools	25
Power tools	10
Specialised automotive equipment	200
Bodywork and painting equipment	100
Spare parts and sales infrastructure	50
Lubrication and fluid service equipment	25
Cleaning and maintenance supplies	20
Safety and personal protective equipment (PPE)	20
Administrative and miscellaneous equipment	<u>50</u>
	<u>800</u>

Initial working capital

The initial working capital required for the business has been carefully estimated at ₦100 million per garage. This amount has been determined based on the anticipated operational needs at the startup phase, ensuring that all essential expenditures can be met efficiently. The allocation of this capital is intended to cover the various costs associated with inventory procurement, staffing, day-to-day operational expenses, and other necessary outlays that will enable the business to function seamlessly from inception.

Projected revenue

Market survey conducted estimated monthly revenue from each of the Garages as follows:

Business Unit	Demand	Probability (%)	Revenue (₦m)
1. Mechanical	High	35	52.5
	Medium	45	42.0
	Low	20	35.0
2. Electrical/Diagnostics	High	35	35.0
	Medium	45	28.0
	Low	20	21.0
3. Bodywork	High	35	35.0
	Medium	45	28.0
	Low	20	14.0
4. Spare parts sale	High	35	17.5
	Medium	45	14.0
	Low	20	10.5

Estimated costs

The following cost estimates have been developed, based on input from experienced engineers. These estimates provide a structured overview of the anticipated costs associated with different categories of work. The information reflects collective professional insights and is intended to support accurate budgeting and planning for the project.

Cost Estimates by Business Unit - See Note below:

Cost type	Mechanical (%)	Electrical/Diagnostics (%)	Bodywork (%)	Spare parts sale (%)
Parts	50	15	25	50
Labour	15	20	25	10
Overheads	5	25	10	5

Note:

Cost breakdown analysis

Each cost item is expressed as a percent of revenue for each business unit. This approach allows for a clear comparison of labour and overhead costs across different segments, highlighting how each unit allocates resources relative to its revenue. By presenting costs as percentages, it becomes easier to assess efficiency and identify areas where expenses may be disproportionately high or low in relation to earnings.

Additional overheads

The following annual additional overheads have been estimated for the project:

Advertising and sales promotion - ₦25m

Administrative - ₦180m

ICAN CASE STUDY NOVEMBER 2025

Folak Motors Nigeria Limited

First Marking

DATE		CANDIDATE NO.			
TIME		MARKER NUMBER			
	Exc Summary	Req 1	Req 2	Overall	TOTAL
SA					
CA					
BC					
NC					
V					
Total	5	8	8	4	25

Executive Summary: Folak Motors Nigeria Limited

1. General	4. Requirement 2: Conclusions
<ul style="list-style-type: none"> States the purpose of the report States the summary of the two requirements States the assumptions States reservations, e. g. scepticism 	<ul style="list-style-type: none"> The project has a positive contribution The project's IRR is 20%. The project has potentials, given the situation in the country. The project's IRR meets the board's expectation. Consider financing the project with equity.
2. Requirement 1: Conclusions	5. Requirement 2: Recommendations
<ul style="list-style-type: none"> Appropriate sanctions required for regional managers tampering with used vehicle odometer. Liquidity is poor, as seen from the working capital ratio. It takes approximately six months to settle suppliers. The company faces high financial risk. Giving money to government officials to facilitate contract is a breach of business ethics. 	<ul style="list-style-type: none"> The project is viable based on having a positive contribution. The project is viable based on the IRR of 20%. The project is viable because it has the potential of boosting the company's profitability. Use equity capital to finance the project to reduce the company's overall financial risk. The project's IRR meets the board's expectation; therefore, the company should go ahead with the project.

<p>3. Requirement 1: Recommendations</p> <ul style="list-style-type: none"> • Improve liquidity immediately. • Sanction the regional managers involved in tampering with used vehicles odometers. • Stop offering bribe to government officials to facilitate contracts. • Take immediate steps to inject equity capital to reduce the financial risk. • Improve on payments to suppliers. 	
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Folak Motors Nigeria Limited: Financial statement analysis

<p>1. USES DATA AND INFORMATION APPROPRIATELY</p> <ul style="list-style-type: none"> • Uses information on exhibit 2 - The Nigerian economy and the services sector. • Uses information on exhibit 3 - Analysis of motor vehicle sales and distribution business in Nigeria: 2022 - 2025. • Uses information on exhibit 4 - Analysis of motor repairs, service centres, and spare parts sales in Nigeria. • Uses information in exhibit 5 - Folak Motors: 2023 - 2024 summarised financial statements. • Uses information on exhibit 6 - Email from Dauda Bagudu. • Uses information on exhibit 7 - Email from Taiwo Folajinmi • Uses information on exhibit 8: Additional information on the 2024 financial statements. 	<p>2. USES PROFESSIONAL TOOLS AND KNOWLEDGE</p> <ul style="list-style-type: none"> • Calculates gross profit margin • Calculate operating profit margin • 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. • Calculate debt/equity + debt ratio. • Calculate Non-current assets turnover • Calculate total assets turnover • Calculates inventories turnover • Calculates receivables turnover • Calculate payable days • Calculates required provision for warranty. • Calculates required provision for repair of vehicle recalled. • Calculates the write down on the value of old inventory.
<p>3. USES ANALYTICAL SKILLS (material points) written report</p> <ul style="list-style-type: none"> • Discusses that gross margin reduced from 14.55% in 2023 to 7.79% in 2024, essentially due to provisions for 	<p>4. IDENTIFIES ISSUES AND OPTIONS</p> <ul style="list-style-type: none"> • Identifies that the provisions for warranty, repairs of vehicles recalled and write down of inventory turned profitability into negative in 2024.

<p>warranty, repairs of vehicle recalled and write down on the value of old inventory.</p> <ul style="list-style-type: none"> Discusses that operating profit margin reduced from a positive of 3.10% in 2023 to a negative of 3.75% in 2024. Discusses that net profit margin reduced from a positive of 5.21% in 2023 to a negative of 2.66% in 2024. Discusses that returns on capital employed reduced from a positive of 3.07% in 2023 to a negative of 2.29% in 2024. Discusses that working capital ratio was 1.2 in 2023 and 1.05 in 2024. This is very low and below the standard benchmark of 2.0. Discusses that Acid test ratio of 1.04 in 2023 and 0.095 in 2024 is considered to be within the standard benchmark of 1.0. Discusses that the total liabilities to total assets was 84.34% in 2023 and 88.39% in 2024. This is considered very high. Discusses that the debts to equity ratio in 2023 was 301.37% in 2023 and 408.09% in 2024. This is too high and risky. Discusses that non-current assets turnover was stable at 1.2 times. Discusses that total assets turnover was 0.6 times in 2023 and 0.7 times in 2024. Discusses that the inventory turnover was 9.6 times in 2023 and 14.9 times in 2024. 	<ul style="list-style-type: none"> Identifies that the Folak Motors is high geared and it is not good for the health of the company. Identifies that the company's investment in non-current assets is too high, relative to its revenue. Identifies that the payable days outstanding of 183 days in 2023 though reduced to 169 days in 2024 is not good for suppliers' relationship to thrive. Identifies that the company's working capital ratio is low. Identifies that the company may face reputation damage for altering used vehicles odometer. Identifies that there are no early warning signals about inventory movements, to enable the management take immediate decisions on slow moving stock. Identifies that Management is not taking proactive decisions to solve operational problems.
<p>5. APPLIES PROFESSIONAL SCEPTICISM AND ETHICS</p> <ul style="list-style-type: none"> Recognises that the payment of N50m 	<p>6. EVALUATIVE SKILLS AND JUDGEMENT</p> <ul style="list-style-type: none"> Recognises that there is no indication that the auditors have completed the audit of the 2024 financial statements.

<p>to facilitate government contract of supplying vehicles is a breach of business ethics.</p> <ul style="list-style-type: none"> • Recognises that the tampering of odometer to make sales of used vehicles is a breach of ethical duty to the company's customers. • Recognises that the company may face regulatory sanctions for changing used vehicles odometers. • Recognises that the company is carrying excessive non-current assets, relative to the nature of the company's business. 	<ul style="list-style-type: none"> • Recognises that the complete auditors' observations on the 2024 financial statement were not provided, there may be other issues not contained in the additional information provided in exhibit 8. • Recognises that the company faces high financial risk as a result of very worrisome leverage ratios. • Recognises that the company is taking more than or almost six months to pay its supplier, thereby using suppliers' money to run the company.
<p>7. CONCLUSIONS</p> <p>(Draws distinct conclusions under a heading)</p> <ul style="list-style-type: none"> • Concludes on need to sanction regional managers tampering with used vehicle odometer. • Concludes on liquidity problem. • Concludes on high payable days. • Concludes on leverage • Concludes on the ethics of giving bribe to facilitate 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 sanction the regional managers tampering with used vehicles odometers. • Recommends that the company should stop offering bribe to government officials to facilitate contract. • Recommends that the company should take immediate steps to inject equity so as to reduce its financial risk. • Recommends that the company must improve on payments to its suppliers, otherwise they may stop extending credit to the company.

REQUIREMENT 2 -Evaluation of proposed motor repair Garages

<p>1. USES DATA AND INFORMATION APPROPRIATELY</p> <ul style="list-style-type: none"> • Uses information on exhibit 2 - The Nigerian economy and the services sector. • Uses information on exhibit 3 - Analysis of motor vehicle sales and distribution business in Nigeria: 2022 - 2025. • Uses information on exhibit 4 - Analysis 	<p>3. USES ANALYTICAL SKILLS (written into report)</p> <ul style="list-style-type: none"> • Discusses that the project has a positive contribution. • Discusses that the IRR of the project is 20%. • Discusses that the project's IRR meets the directors' expectation. • Discusses the limitations of Folak Motors' current board and management structure.
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<p>of motor repairs, service centres, and spare parts sales in Nigeria.</p> <ul style="list-style-type: none"> • Uses information on exhibit 6 - Email from Dauda Bagudu. • Uses information on exhibit 7 - Email from Taiwo Folajinmi • Uses information on exhibit 9: Expansion into motor repairs and spare parts sales. 	
<p>2. USES PROFESSIONAL TOOLS AND KNOWLEDGE</p> <ul style="list-style-type: none"> • Calculates the total initial investment. • Calculates the expected monthly revenue. • Calculates the expected annual revenue. • Calculates the estimated annual operational costs. • Calculate the net annual contribution. • Calculates the IRR. 	<p>4. IDENTIFIES ISSUES AND OPTIONS</p> <ul style="list-style-type: none"> • Identifies that the best way to finance the project is equity, so as to reduce the company's overall financial risk. • Identifies that the project has a great potential, given the prevailing conditions in the economy. • Identifies that the project, when it comes on stream, will improve the company's profitability • Identifies that most cars in Nigeria are used "Tokunbo" cars which necessitates regular maintenance and change of parts. • Identifies the opportunities available to Folak Motors if it deploys e-commerce business model in the proposed Modern Motor Garage project. • Identifies that there is need to strengthen the company's governance structure. • Identifies that the performance targets did not include quality control metrics.
<p>5. APPLYING PROFESSIONAL SCEPTICISM AND ETHICS</p> <ul style="list-style-type: none"> • Discusses the need to employ certified motor engineers to manage each of the garages. • Discusses that qualified technicians only should be employed to work in the workshops. • Discusses that company should put in place ethical policies to guide the operation of each repair garage. 	<p>6. EVALUATIVE SKILLS AND JUDGEMENT (uses analytical headings)</p> <ul style="list-style-type: none"> • Recognises that the best way to finance the project is through equity, so as to reduce the company's exposure to financial risk. • Recognises that the company needs a strong internal control system to prevent pilferage and stealing of parts • Recognises that there is a need for developing operational policy and controls for the workshop operations.

<ul style="list-style-type: none"> Discusses that management should ensure that waste, parts and oil removed from repaired vehicles are disposed in such a way that they will not cause environmental problem. 	<ul style="list-style-type: none"> Recognises that the current arrangement where Regional Managers report directly to the CEO will not allow proper monitoring and control.
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<p>7. CONCLUSIONS (Draws distinct conclusions under a heading)</p> <ul style="list-style-type: none"> Concludes on the contribution of the project. Concludes on the IRR. Concludes that the project has potential given the situation in the country. Concludes that the project's IRR meets the board's expectation. Concludes on the method of financing the project. Concludes on the need to review the reporting line of Regional Managers. Concludes on the need to include quality control metrics in the performance targets. Concludes on the need to strengthen the company's governance structure. 	<p>8. RECOMMENDATIONS (commercial / relevant)</p> <ul style="list-style-type: none"> Recommends that the project is viable based on having a positive contribution. Recommends that the project is viable based on the IRR of 20%. Recommends that the project is viable because it has the potential of boosting the company's profitability. Recommends that the company should use equity capital to finance the project to reduce the company's overall financial risk. Recommends that Regional Managers should be reporting to the Sales Director, for effective supervision and control. Recommends that quality control metrics be included in the performance metrics. Though a private company, Folak Motors should consider appointing independent non-executive directors to strengthen the board.
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Overall

Appendices	Main Report
<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. 	<p>3. Report: Structure</p> <ul style="list-style-type: none"> Sufficient appropriate headings Appropriate use of paragraphs / sentences Legible/clear handwriting Correctly numbered pages

<ul style="list-style-type: none"> Shows inventories turnover. Shows receivables turnover. Shows Non-current assets turnover. Shows total assets turnover. Shows payable days. Shows revised financial statements for 2024, after all adjustments. Shows the journal entries required to adjust the 2024 financial statements Shows the calculations of the provision for warranty, repairs of vehicles recalled and inventory. 	
<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 monthly revenue. Shows expected annual revenue. Shows the calculation of the estimated annual operational costs. Shows the calculation of the net annual contribution. Shows the calculation of the IRR. 	<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

Appendix 1
Folak Motors Nigeria Limited
Financial statements analysis

Profitability	2023	2024
Gross profit margin (GP/Revenue X 100)	256,410/1,761,910 X 100 14.55%	144,080/1,849,920 X 100 7.79%
Operating profit margin (OP/Revenue X 100)	54,580/1,761,910 X 100 3.10%	(69,310)/1,849,920 X 100 -3.75%
Net profit margin (Profit before tax exp/Revenue X 100)	39,670/1,761,910 X 100 5.21%	(49,170)/1,849,920 X 100 -2.66%
Return on capital employed(ROCE) Operating Profit/Capital employed X100	52,690/1,717,790 X 100 3.07%	(38,020)/1,661,870 X 100 -2.29%

Liquidity

Current ratio

Current assets/Current liabilities	1,214,810/1,015,310	1,209,740/1,155,090
	1.2:1.0	1.05:1.0

Quick ratio - Acid test

CA - Inventories/Current liabilities	1,058,300/1,015,310	1,095,230/1,155,090
	1.04:1.0	0.95:1.0

Leverage

Total liabilities/Total assets	2,305,120/2,733,100 X 100	2,489,880/2,816,960 X 100
	84.34%	88.39%
Debts/Equity	1,289,810/427,980 X 100	1,334,790/327080 X 100
	301.37%	408.09%
Debt/Equity+ Debt	1,289,810/1,717,790 X 100	1,334,790/1,661,870 X 100
	75.09%	80.32%

Efficiency

Non-current assets turnover		
Revenue /Non-current assets	1,761,910/1,518,290	1,849,920/1,607,220
	1.2 times	1.2 times
Total assets turnover		
(Revenue/Total assets	1,761,910/2,733,100	1,849,920/2,816,960
	0.6 times	0.7 times
Inventories turnover		
Cost of sales ÷ Inventory	1,505,500/156,510	1,705,840/114,510
	9.6 times	14.9 times
Receivable turnover		
Revenue ÷ Receivables	1,761,910/620,260	1,849,960/665,730
	2.8 times	2.8 times
Payable days		
Payables/Cost of sales X 365	756,610/1,505,500 X 365	790,770/1,705,840 X 365
	183 days	169 days

Appendix 2

Folak Motors Nigeria Limited Adjusted 2024 Financial Statements Income statement

	2024 ₦000	Adjustment ₦000	Final ₦000
Revenues	1,849,920		1,849,920
Cost of sales	-1,584,340	-121,500	-1,705,840
Selling, administrative, and other expenses	-213,390	0	-213,390
Total costs and expenses	<u>-1,797,730</u>	<u>-121,500</u>	<u>-1,919,230</u>
Operating income	52,190	0	-69,310
Interest expense	-11,150	0	-11,150
Other income/(loss)	31,290	0	31,290
Income before income tax	72,330	0	-49,170
Provision for/(Benefit from) income taxes	-13,390	0	-13,390
Net income	58,940	-121,500	-62,560

Statement of financial position

	2024 ₦000	Adjustment ₦000	Final ₦000
Assets			
Current assets			
Cash and cash equivalents	229,350		229,350
Marketable securities	154,130		154,130
Trade and other receivables	665,730		665,730
Inventories	149,510	-35,000	114,510
Other assets	46,020		46,020
Total current assets	1,244,740	-35,000	1,209,740
Non-current assets			
Property, plant and equipment	1,314,820		1,314,820
Deferred income taxes	163,750		163,750
Other assets	128,650		128,650
	<u>1,607,220</u>		<u>1,607,220</u>
Total assets	<u>2,851,960</u>		<u>2,816,960</u>

Liabilities		
Current liabilities		
Payables	790,770	790,770
Other liabilities and deferred revenue	277,820	364,320
Total current liabilities	1,068,590	86,500
Long term liabilities		
Other liabilities and deferred revenue	288,320	288,320
Long-term debt	1,035,730	1,035,730
Deferred income taxes	10,740	10,740
Total liabilities	1,334,790	2,489,880
Equity		
Share capital	420	420
Share premium	206,920	206,920
Retained earnings	241,240	-121,500
Total equity	448,580	327,080
Total equity and liabilities	2,851,960	2,816,960
Journals	₦000	₦000
1. Dr Cost of sales	86,500	
Cr.Provision for warranty/ Veh Recall		86,500
Being provision for unexpired warranty & estimated repair cost for vehicle recalled.		
2. Dr. Cost of sales	35,000	
Cr. Inventory		35,000
Being write down on old inventory to net realisable value		
Workings	₦000	
• Provision for warranty:		
Minor repairs (500m X 12% X 30%)	18,000	
Major repairs (500m X 8% X 70%)	28,000	
• Prov. for repairs on vehicle recalled:		
Major repairs (260m X 10%)	26,000	
Minor repairs (190m X 5%)	9,500	
Administrative costs	5,000	
	86,500	

Appendix 3

Folak Motors Nigeria Limited Appraisal of proposed Motor repairs Garages

Initial investment:	₦m
Plant and equipment	800
Working capital	100
	<u><u>900</u></u>

Monthly revenue – Per Garage

Business Unit	Demand	Probability %	Revenue (₦m)	Expected revenue (₦m)
1. Mechanical	High	35	52.5	18.375
	Medium	45	42	18.9
	Low	20	35	7
2. Electrical/Diagnostics	High	35	35	12.25
	Medium	45	28	12.6
	Low	20	21	4.2
3. Bodywork	High	35	35	12.25
	Medium	45	28	12.6
	Low	20	14	2.8
4. Spare parts sale	High	35	17.5	6.125
	Medium	45	14	6.3
	Low	20	10.5	2.1
				<u><u>14.525</u></u>

Annual revenue	₦m
Mechanical	44.28
Electrical	29.05
Bodywork	27.65
Spare parts sale	14.53
	<u><u>115.50</u></u>
	<u><u>1,386.00</u></u>

Estimated costs

1. Mechanical	Parts	Labour	Overheads
531.3 X .5	265.65		
531.3 X.15		79.70	
531.3 X.05			26.57

2. Electrical/Diagnostics

348.6 X .15	52.29		
348.6 X .2		69.72	
348.6 X .25			87.15

3. Bodywork

331.8 X .25	82.95		
331.8 X .25		82.95	
338.8 X .10			33.18

4. Spare parts sale

174.3 X .5	87.15		
174.3 X .1		17.43	
174.3 X .05			8.72
	<u>488.04</u>	<u>249.80</u>	<u>155.61</u>

Contribution	₦m
Annual revenue	1,386.00
Less: Costs:	
Parts	488.04
Labour	249.80
Overheads	155.61
	(893.45)
	492.56
Additional expenses:	
Advertising and prom.	25.00
Administrative	180.00
Net annual contribution	<u>287.56</u>

Calculation of IRR

Using 20%

NPV	Year	Cash flow(₦m)	Present factor	PV(₦m)
Year 0	Initial Inv.	-900	1	-900
Year 1 – 5	Contribution	287.56	2.9905	859.94818
Year 5	Working cap	100	0.4019	40.19
			NPV	<u>0.13818</u>

The IRR is approximately 20%. The project meets the directors' expectation.

Examiner's report

The case scenario is on Folak Motors Limited, a company that is in the motor vehicle distribution and sales business. The Pre-seen case scenario includes: Details about the Nigerian economy and the service sector; Analysis of motor vehicle sales and distribution business in Nigeria: 2022 - 2025; Analysis of motor repairs, service centres, and spare parts sales in Nigeria and Unaudited summarised 2023 – 2024 financial statements. While the Unseen introduces Email from Dauda Bagudu to Sylester Chukwudi; Email from Taiwo Folajimi (Finance Director, Folak Motors) to Dauda Bagudu; Additional Information on the 2024 financial statements; and Information on planned expansion into motor repairs and spare parts sales from Folak Motors.

Candidates are required to address the following requirements:

- Provide an evaluation of the 2023 and 2024 financial statements, focusing on performance, financial position and future prospects, whilst identifying and addressing any potentially unethical practices in the information provided. They are to ensure that the assessment reflects all relevant information in exhibits 5 and 8;
- Evaluate the viability of the proposed modern vehicle repairs garages, using the financial information provided by Folak Motors. They were to determine whether the project is likely to meet the Board's expectation, specifically the required IRR;
- Evaluate the adequacy of Folak's current governance and management structures to effectively support its proposed diversification into repairs and spare part sales, highlighting any adjustments needed to ensure oversight and accountability; and
- Explain in their reports how the company can utilise e-commerce or booking platforms to drive customers' acquisition and retention for its proposed vehicle servicing and spare part business.

To perform very well in this Case Study, candidates must prepare the following appendices:

The following appendices are required:

Requirement 1:

Appendix 1: Adjustments to the 2024 draft financial statements; and

Appendix 2: Ratio analyses appraising the company's performance, financial position and future prospects; and

Requirement 2:

Appendix 3: Evaluation of the proposed modern vehicle repairs garages.

The candidates' performance was woeful, as only very few of them scored up to 50%.

The common pitfalls of the candidates are:

- Almost all the candidates did not carry out adjustments necessary on 2024 financial statements, as required by exhibit 8, before calculating ratios for 2024;
- 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 IRR 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.