



**THE INSTITUTE OF CHARTERED
ACCOUNTANTS OF NIGERIA**

PATHFINDER

**MAY 2018 DIET
SKILLS LEVEL EXAMINATIONS**

Question Papers

Suggested Solutions

Examiner's Reports

Plus

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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THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA
SKILLS LEVEL EXAMINATION - MAY 2018

FINANCIAL REPORTING

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

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

SECTION A: COMPULSORY QUESTION (30 MARKS)

QUESTION 1

- a. Adanna Plc. has a subsidiary, Ebuka Limited. The statement of profit or loss and other comprehensive income of the companies are as follows:

Statement of Profit or Loss and Other Comprehensive Income for the year ended December 31, 2017

	Adanna Plc	Ebuka Limited
	₦'000	₦'000
Revenue	986,546	614,206
Cost of sales	<u>(593,204)</u>	<u>(365,903)</u>
Gross profit	393,342	248,303
Other income	57,850	12,420
Distribution costs	(69,496)	(40,562)
Administrative expenses	(158,624)	(95,036)
Other expenses	(32,108)	(15,814)
Finance costs	<u>(20,600)</u>	<u>(10,220)</u>
Profit before tax	170,364	99,091
Income tax expense	<u>(51,110)</u>	<u>(26,727)</u>
Profit for the year	119,254	72,364
Other comprehensive income:		
Gain on revaluation of property	<u>68,166</u>	<u>29,202</u>
Total comprehensive income	<u>187,420</u>	<u>101,566</u>

Additional Information

- (i) Adanna Plc. acquired 75% of the issued equity shares of Ebuka limited three years ago. Goodwill on acquisition was ₦280 million. The recoverable amount of goodwill at the year-end was estimated to be

~~₦~~268 million and this was the first time that the recoverable amount of goodwill had fallen below the amount at initial recognition.

- (ii) During the year, Ebuka Limited invoiced goods worth ~~₦~~300 million to Adanna Plc. A quarter of these goods are included in the inventory of Adanna Plc. at year end. It is the policy of Ebuka Limited to invoice goods at cost plus 25%.
- (iii) The distribution costs of Ebuka Limited include depreciation of an asset which had been subject to a fair value increase of ~~₦~~155 million on acquisition. The asset is being written off on a straight line basis over ten years.
- (iv) The other income in Adanna Plc.'s statement of profit or loss and other comprehensive income includes an inter-company management charge of ~~₦~~10 million to Ebuka Limited and Ebuka Limited has recognised this in administrative expenses.

Required:

Prepare the Consolidated Statement of Profit or Loss and other Comprehensive Income of Adanna Plc's group for the year ended December 31, 2017. (20 Marks)

- b. A parent acquired 600,000 equity shares of its subsidiary three years ago for ~~₦~~1,200,000. The subsidiary's issued equity share capital on that date was ~~₦~~250,000 denominated at 25 kobo per share. Other components of the subsidiary's net asset at the acquisition date were share premium ~~₦~~550,000 and retained earnings of ~~₦~~680,000. The subsidiary's shares were quoted at the stock exchange at ~~₦~~1.80k per share at the date the parent took control.

Required:

Calculate the goodwill on acquisition if it is the policy of the parent to measure non-controlling interest at its fair value. (4 Marks)

- c. IFRS 10 states that, with certain exceptions, a parent must present consolidated financial statements in which it consolidates its investments in subsidiaries.

Required:

State **FOUR** exceptions to the rule.

(6 Marks)

(Total 30 Marks)

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

QUESTION 2

- a. Discuss the importance of the statement that transactions should be recorded in the financial statements based on their substance over form. Explain the features that may show that substance of a transaction may differ from its legal form. (6 Marks)
- b. Yo-Yo Products Nigeria Limited manufactures a chemical product which takes a long time before it matures and ready for sale. This product had a cost of ₦30 million as at April 1, 2017 with a fair value of ₦42 million and it cannot be ready for sale until March 31, 2020. On April 1, 2017, the company had an agreement with Abeokuta Nigeria Limited to sell the product to the company for ₦36 million. Under the agreement, Yo-Yo Products Limited has the right to repurchase the product on or before March 31, 2020 at a price of ₦47,916,000. On this date Yo-Yo Products Limited can sell the product for ₦60 million. Yo-Yo Products Limited had a loan of ₦36 million on which it will pay a compound interest for the three-year-loan as follows:

	₦
Year 1	3,600,000
Year 2	3,960,000
Year 3	4,356,000

The compound interest rate is the same as the required return by Abeokuta Nigeria Limited.

- i. You are required to prepare extracts from the Yo-Yo Products Limited's projected statement of profit or loss for three years to March 31, 2020 using the above figures with separate calculation each for legal form and substance form of the transaction. (10 Marks)
- ii. Comment on the effects that these calculations will have on the performance of the company. (4 Marks)

(Total 20 Marks)

QUESTION 3

The statement of financial position of Abagana Plc. as at July 31, 2016 and 2017 is shown below

Statement of financial position as at July 31

	2017		2016	
	₦'000	₦'000	₦'000	₦'000
ASSETS:				
Non- current assets:				
Property, plant and equipment at cost	735		675	
Accumulated depreciation	<u>(555)</u>	180	<u>(495)</u>	180
Investment at cost		<u>28</u>		<u>66</u>
		<u>208</u>		<u>246</u>
Current assets:				
Inventories		434		264
Trade receivable	346		159	
Allowance for doubtful debt	<u>(39)</u>	307	<u>(6)</u>	153
Prepayments		19		18
Cash on 7 day deposit		-		75
Cash at bank and in hand		<u>-</u>		<u>88</u>
		<u>760</u>		<u>598</u>
		<u>968</u>		<u>844</u>
EQUITY and LIABILITIES				
Equity:				
Ordinary share capital		375		300
Share premium		45		-
Retained earnings		<u>237</u>		<u>319</u>
		657		619
Liabilities:				
Non-current liabilities:				
14% Loan notes		-		60
12% Loan notes		45		-
Current Liabilities:				
14% Loan notes	60			
Trade payables	90		83	
Accruals	13		12	

Other payables	30		-	
Tax payable	13		70	
Bank overdraft	<u>60</u>	<u>266</u>	<u>-</u>	<u>165</u>
		<u>968</u>		<u>844</u>

Additional Information

- (i) Equipment which had cost ₦45,000 during the year to July 31, 2014 was sold in February 2017 for ₦15,000. The company depreciates equipment at 20% per annum on cost with a full charge in the year of acquisition and none in the year of disposal.
- (ii) Non- current asset investments which had cost ₦38,000 some years ago was sold during the year for ₦31,500.
- (iii) Dividends received during the year were ₦7,500. Dividends totalling ₦150,000 were paid during the year.
- (iv) The 14% Loan notes were issued many years ago and are due to be redeemed in January 2017. A fresh issue of 12% Loan notes was made on July 31, 2017.
- (v) In January 2017 the company issued ₦75,000 ordinary shares at a premium of 60 kobo per share.
- (vi) The cash on 7-day deposit ranks as a cash equivalent.
- (vii) The net cash flow from operating activities using the indirect method is ₦187,000 deficit.

Required:

- a. Prepare a statement of cash flows for the year ended July 31, 2017 in accordance with the requirements of IAS 7 (using the indirect method).
(12 Marks)
- b. Reconcile the total cash and cash equivalents shown by the statement of cash flows to the equivalent figures shown in the opening and closing statements of financial position.
(5 Marks)
- c. Comment briefly on the significance of the information provided by the statement of cash flows.
(3 Marks)

(Total 20 Marks)

QUESTION 4

Ibadan Nigeria Limited would like to acquire a suitable private limited liability company.

The board of directors of Ibadan Limited engaged the service of a financial consultant to carry out a critical financial analysis of the two companies, Abuja Limited and Rivers Limited. Both companies operate in the same industry and their management have indicated that they would be receptive to the acquisition.

The draft financial statements of the two companies are as follows:

Statements of profit or loss

	Abuja Limited	Rivers Limited
	₦'000	₦'000
Revenue	3,980	2,240
Cost of Sales	<u>(2,640)</u>	<u>(1,588)</u>
Gross Profit	1,340	652
Operating expense	(496)	(300)
Interest expense	<u>(140)</u>	<u>(40)</u>
Profit before Taxation	704	312
Tax expense	<u>(260)</u>	<u>(100)</u>
Profit for the year	<u><u>444</u></u>	<u><u>212</u></u>

Statements of financial position

	Abuja Limited	Rivers Limited
	₦'000	₦'000
Non-current assets:		
Property, plant & equipment	<u>3,060</u>	<u>1,640</u>
Current assets:		
Inventory	620	560
Trade receivables	680	1,580
Bank	<u>200</u>	<u>180</u>
	<u>1,500</u>	<u>2,320</u>
Current liabilities:		
Trade payables	(940)	(1,200)
Other payables	<u>(520)</u>	<u>(500)</u>
	<u>(1,460)</u>	<u>(1,700)</u>
Net current assets:	<u>40</u>	<u>620</u>
Non-current liabilities:		
Loan notes	<u>(880)</u>	<u>(280)</u>
Net assets	<u><u>2,220</u></u>	<u><u>1,980</u></u>

Equity:

Ordinary share capital	1,800	1,760
Retained earnings	<u>420</u>	<u>220</u>
	<u>2,220</u>	<u>1,980</u>

Required:

As the Financial Consultant appointed to carry out the financial analysis,

- a. Draft a report addressed to the chairman, board of directors of Ibadan Limited to assess the financial performance and position of the two companies.

Your report should make use of the following specific ratios:

- (i) Profitability ratios: gross profit percentage and net profit margin.
- (ii) Liquidity ratios: acid test ratio, current ratio, trade receivable period.
- (iii) Long term financial stability ratios: gearing ratio and proprietary ratio.
- (iv) Efficiency ratios: total asset turnover and non-current asset turnover. (12 Marks)

- b. Explain the limitations of ratio analysis and further information that may be useful to the board of directors of Ibadan Limited when making the acquisition decision (8 Marks)

(Total 20 Marks)

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

QUESTION 5

In Nigeria, financial statements are reported in more detail in both words and figures following the introduction of International Financial Reporting Standards (IFRS).

You are required to:

- a. Explain the following qualitative characteristics of financial statements reported under IFRS and assess how they make the information very useful.
 - i. Relevance
 - ii. Comparability
 - iii. Understandability
 - iv. Faithful Representation (6 Marks)

- b. Explain the differences between the accruals, cash and break up basis of accounting. (6 Marks)
 - c. Explain with relevant examples the meaning of 'true and fair' view of financial statements. (3 Marks)
- (Total 15 Marks)**

QUESTION 6

- a. IAS 12 - Income Tax details the requirements relating to the accounting treatment of deferred tax and current income tax.

Required:

Explain the need to provide for deferred tax and briefly outline the principles of accounting for deferred tax contained in IAS 12 . (7 Marks)

- b. Lawmarg Nigeria Limited purchased an item of plant for ₦2,000,000 on October 1, 2014. It had an estimated life of eight years and an estimated residual value of ₦400,000. The plant is depreciated on a straight-line basis. The tax authorities do not allow depreciation as a deductible expense. Instead an initial capital allowance of 40% of the cost of this type of asset can be claimed against income tax, and 20% per annum (on a reducing balance basis) of its tax base thereafter. The rate of income tax can be taken as 30%.

Required:

In respect of the above item of plant, calculate the deferred tax charge/credit in Lawmarg Nigeria Limited's statement of profit or loss for the year ended December 31, 2017 and the deferred tax balance in the statement of financial position at that date. (8 Marks)

(Total 15 Marks)

QUESTION 7

- a. Explain the disclosure requirements in published financial statements with respect to property, plant and equipment in accordance with IAS 16. (5 Marks)
- b. As the accounting officer in charge of your company's property plant & equipment (PPE), draft a memo to the chief accountant explaining how impairment of PPE should be identified and accounted for by your company in accordance with IAS 36. (7 Marks)

- c. Odeda Limited operates its business with plant and equipment that qualified under IAS 16 as property, plant and equipment. On January 1, 2016 the cost of the company's plant was ₦4,000,000 and the accumulated depreciation was ₦1,600,000. On January 2, 2016 the company bought a new equipment at the cost of ₦1,000,000 and the equipment supplier accepted an old equipment owned by Odeda Limited in part exchange for a value of ₦80,000. The equipment originally cost ₦600,000 and its accumulated depreciation is ₦500,000.

You are required to calculate the gain or loss on the disposal of the old equipment.

(3 Marks)

(Total 15 Marks)

SOLUTION 1

(a)

Adanna Plc

Consolidated Statement of Profit or Loss and Other Comprehensive Income for the year ended December 31, 2017

	₦'000
Revenue (Wk 1)	1,300,752
Cost of sales (Wk 2)	<u>(674,107)</u>
Gross profit	626,645
Other income (wk 3)	60,270
Distribution cost (wk 4)	(125,558)
Administrative expenses (wk 5)	(255,660)
Other expenses	(47,922)
Finance costs	<u>(30,820)</u>
Profit before tax	226,955
Income tax expenses	<u>(77,837)</u>
Profit for the year	149,118
Other comprehensive income:	
Gain on revaluation of property	<u>97,368</u>
Total comprehensive income	<u>246,486</u>
Profit for the year attributable to:	
Equity owners of parent (149,118 – 12,966)	136,152
Non-controlling interest (NCI) Wk 7	<u>12,966</u>
	<u>149,118</u>
Total comprehensive income attributable to:	
Equity owners of parent (246,486 - 20,267)	226,220
Non-controlling interest (NCI) Wk 4	<u>20,267</u>
	<u>246,486</u>

Working Notes**Wk 1: Revenue** **₦'000**

Adanna Plc	986,546
Ebuka Limited	614,206
Intra-group Sales	<u>(300,000)</u>
Consolidated Revenue	<u>1,300,752</u>

Wk 2: Cost of Sales **₦'000**

Adanna Plc	593,204
Ebuka Limited	365,903
Intra-group Sales	(300,000)
Unrealised profit on inventory (working 6)	<u>15,000</u>
Consolidated Cost of Sales	<u>674,107</u>

Wk 3: Other Income **₦'000**

Adanna	57,850
Ebuka	12,420
Inter group mgt charges	<u>(10,000)</u>
	<u>60,270</u>

Wk 4: Distribution Costs **₦'000**

Adanna	69,496
Ebuka	40,562
Under – Depreciation	<u>15,500</u>
	<u>125,558</u>

Wk 5: Administrative Expenses **₦'000**

Adanna	158,624
Ebuka	95,636
Inter group mgt charges	<u>(10,000)</u>
	<u>255,660</u>

Wk 6: Unrealised Profit on Inventory **₦'000**

25/125 of ($\frac{1}{4} \times \text{₦}300,000$)	<u>15,000</u>
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Wk 7: Profit Attributable to NCI **₦'000**

Profit for the year	72,364
Intra-group Management charges	10,000
Unrealised profit on inventory (Wk 6)	(15,000)
Under-depreciation (155,000/10)	<u>(15,500)</u>
	<u>51,864</u>

NCI Share at (25% x 51864)	12,966
NCI Share of OCI (25% x 29,202)	<u>7,301</u>
Total Comprehensive Income to NCI	<u>20,267</u>

(b) Determination of Goodwill on Acquisition at fair value

	₦'000	₦'000
Consideration transferred by Parent		1,200
NCI at fair value (400 x ₦1.80)		<u>720</u>
		1,920
Less: Net Assets of Subsidiary at acquisition		
Equity Share Capital	250	
Share Premium	550	
Retained Earnings	<u>680</u>	<u>(1,480)</u>
Goodwill on Acquisition		<u>440</u>

- c. IFRS 10 states that, with certain exceptions, a parent must present consolidated financial statements in which it consolidates its investments in subsidiaries. However, there are exceptions to this rule. This allows a parent that is itself a subsidiary not to prepare consolidated financial statements.

A parent needs not present consolidated financial statements if and only if all the following conditions apply:

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

EXAMINER'S REPORT

The question tests candidates' knowledge and understanding of group accounts. Part (a) requires candidates to prepare consolidated statement of profit or loss and other comprehensive income. Part (b) expects candidates to calculate goodwill on acquisition where non-controlling interest was valued at fair value. Part (c) requires candidates to outline the exception to the rule requiring parent to prepare consolidated financial statements.

All the candidates attempted the question as it was compulsory and the performance was fair. About half of the candidates obtained 50% of the marks allocated to the question.

Candidates' commonest pitfall were their inability to correctly calculate the goodwill on acquisition and lack of knowledge of IFRS 10 that stipulates exceptions to the preparation of consolidated financial statements by parent.

Candidates are advised to study all aspects of the syllabus that deals with group accounts while preparing for future examination of the Institute in Financial Reporting.

Marking Guide		Marks	Total
(a)	Preparation of consolidated statement of Profit or Loss		
	- Title of financial statement	$\frac{1}{3}$	
	- Determination of consolidated gross profit	5	
	- Determination of consolidated profit before tax	$7\frac{1}{3}$	
	- Determination of consolidated profit for the year	1	
	- Determination of consolidated total comprehensive income	1	
	- Determination of profit for the year attributable to parent	$\frac{2}{3}$	
	- Determination of profit for the year attributable to NCI	$2\frac{1}{3}$	
	- Determination of total comprehensive income attributable to parent	1	
	- Determination of total comprehensive income attributable to NCI	$1\frac{1}{3}$	
			<u>20</u>
(b)	Determination of goodwill on acquisition		
	- Stating consideration transferred	$\frac{1}{2}$	
	- Determination of NCI at fair value	1	
	- Determination of net asset of subsidiary at acquisition	2	
	- Goodwill on acquisition	$\frac{1}{2}$	
			4
(c)	Exceptions to preparation of consolidated financial statements		
	Any 4 points at $1\frac{1}{2}$ marks each		<u>6</u>
	Total Marks		<u>30</u>

SOLUTION 2

- a. It is important that financial statements should reflect the economic substance of a transaction, where this differs from legal form, because this provides users with a 'faithful representation' of the transaction. For instance, if an asset held under a finance lease were treated according to its legal form it would not appear under non-current assets and the related lease liability would not be shown. This would make the entity's gearing look lower than it actually was and probably inflate its returns on capital employed (ROCE). This treatment is not allowed under IFRS. Sale and leaseback or sale and repurchase arrangements can be used to disguise the substance of loan transactions by taking them 'off balance sheet'. In this case, the legal position is that the asset has been sold, but the substance of the transaction is that the seller still retains the benefits of ownership. Features which suggest that the substance of a transaction may differ from its legal form are:
- i. The seller of an asset retains the ability to use the asset;
 - ii. The seller remains exposed to the risks of ownership e.g. maintenance;
 - iii. An asset which has been sold can reasonably only be used by the seller;
 - iv. A 'sold' asset remains on the sellers premises;
 - v. An asset has been transferred at a price substantially above or below its fair value;
 - vi. An asset has been 'sold' under terms which make it very unlikely that it will not be repurchased; and
 - vii. A number of linked transactions have taken place.
- All of these features suggest that 'control' has been separated from legal ownership and that the substance of the transaction may not have been correctly represented.
- b.(i) Yo-Yo Product Limited has entered into a repurchase agreement involving a call option at a price greater than the original selling price. This means that Abeokuta Nigeria Ltd does not obtain control of the asset and IFRS 15 requires this transaction to be treated as a financing arrangement.

	<u>Legal form April 1</u>			
	2018	2019	2020	Total
	₦'000	₦'000	₦'000	₦'000
Revenue	36,000	-	60,000	96,000
Cost of Sales	<u>(30,000)</u>	-	<u>(47,916)</u>	<u>(77,916)</u>
Gross Profit	6,000	-	12,084	18,084
Finance costs	<u>-</u>	-	<u>-</u>	<u>-</u>
Net profit	<u>6,000</u>	-	<u>12,084</u>	<u>18,084</u>

	<u>Substance over form April 1</u>			
	2018	2019	2020	Total
	₦'000	₦'000	₦'000	₦'000
Revenue	-	-	60,000	60,000
Cost of Sales	-	-	(30,000)	(30,000)
Gross Profit	-	-	30,000	30,000
Finance costs	(3,600)	(3,960)	(4,356)	(11,916)
Net profit	(3,600)	(3,960)	25,644	18,084

(b)(ii)

Comments:

- The profits will be reported at different periods with different classification of costs.
- Both methods arrive at the same profit figure.
The legal form creates elements of smoothening and completely excludes finance cost while substance over form reflects finance cost for the three years.
- The effect on statements of financial position is that recording the legal form of the transaction does not show the inventory.
- The legal form is an example of off-balance sheet/statement of financial position financing.
- The overall performance of the company is that interest cover and inventory turnover would be higher while the gearing will be lower using the legal form rather than substance over form.
- Reporting under the legal form of the transaction removes the finance cost, which will have a favourable effect on interest cover, and will also have removed the loan from the statement of financial position, thus making gearing appear lower.
- Similarly, under the legal form, the assets will not appear in the statement of financial position, which will make ROCE appear higher than it would otherwise have been.

EXAMINER'S REPORT

The question tests candidates' knowledge of the issue of substance over legal form. Part (a) requires candidates to discuss the importance of recording transactions based on their substance over legal form. Part (b) requires candidates to prepare projected statement of Profit or Loss with separate calculations each for legal form and substance form of the transactions and to comment on the effects of the two forms on the performance of the company.

Very few candidates attempted the question and the performance was very poor as less than 10% of the candidates obtained 50% of the mark allocated to the question.

Candidates' commonest pitfalls were their inability to explain the different features between substance and legal forms and also to correctly prepare the projected statement of profit or loss separately for legal and substance over forms. Most of the candidates made wrong comments on the effects of the two forms.

Candidates are advised to pay more attention to the applicable accounting standards for the Financial Reporting paper when preparing for future examinations.

Marking Guide		Marks	Total
(a)	Discussion on the importance of recording transactions in financial statements based on their substance over form:		
	- Explanation of substance over form	2	
	- Relevant examples	2	
	- Features that show that substance may differ from legal form of transactions	<u>2</u>	6
(b)(i)	Preparation of projected statement of profit or loss		
	Legal Form:		
	- Determination of projected net profit for 2018	1 ¹ / ₄	
	- Determination of projected net profit for 2019	1 ¹ / ₄	
	- Determination of projected net profit for 2020	1 ¹ / ₄	
	- Determination of Total projected net profit	1 ¹ / ₄	
	Substance over form:		
	- Determination of projected net profit for 2018	1 ¹ / ₄	
	- Determination of projected net profit for 2019	1 ¹ / ₄	
	- Determination of projected net profit for 2020	1 ¹ / ₄	
	- Determination of total Project net profit	<u>1¹/₄</u>	10
(b)(ii)	<u>Comments on the effects of calculations on company performance</u>		
	Any 4 points at 1 mark each		<u>4</u>
	Total Marks		<u>20</u>

SOLUTION 3

(a)

ABAGANA PLC

Statement of Cash flows for the year ended July 31, 2017

	₦	₦
Net cash flows from operating activities		(187,000)
Investing activities		
Dividend received	7,500	
Proceeds from disposal of non-current assets	31,500	
Proceeds from disposal of equipment	15,000	
Purchase of PPE by cash (WK 1)	<u>(105,000)</u>	(51,000)
Financing activities		
Proceeds from issue of shares (₦75,000 x ₦1.60)	120,000	
Proceeds from issue of 12% loan notes	45,000	
Dividend paid by cash	<u>(150,000)</u>	
Net cash flow from financing activities		<u>15,000</u>
Net decrease in cash & cash equivalent		(223,000)
Cash & cash equivalent 1/8/16		<u>163,000</u>
Cash & cash equivalent 31/7/17		<u>(60,000)</u>

WORKINGS (WK 1)

	₦
Balance b/f	675,000
Disposal	<u>(45,000)</u>
Expended balance c/f	630,000
Actual balance c/f	<u>735,000</u>
Addition by cash purchase	<u>105,000</u>

(b)

Reconciliation of cash and cash equivalent

	1/8/16	Change	31/7/17
	₦	₦	₦
Cash at bank and in hand	88	(88)	-
Cash/equivalent (7 days Deposit)	75	(75)	-
Bank overdraft	-	<u>(60)</u>	<u>(60)</u>
	<u>163</u>	<u>(223)</u>	<u>(60)</u>

(c) Comments on significance of information provided by the statement of cashflows

- The company's cash position has deteriorated during the year; despite raising ₦165,000 of new finance and selling investments. The real problem seems to be that operating activities generated cash out flow rather than a cash inflow, and then made it difficult for the company to find the cash required to pay dividends and to replace non-current assets.
- The cash outflow from operating activities was caused principally by large increases in inventories and trade receivables. It may be that the company has been trying to make itself more attractive to customers by holding greater inventories and offering longer credit, but this policy has had negative effect on the company's cash position
- Without access to recent statement of profit or loss, it is difficult to be sure whether the company has become more profitable in the year to July 31, 2017, but the massive reduction in the taxation liability may indicate that profits have fallen.
- In summary, the company seems to have had a bad year, from both the cash and profit points of view; however, further information would be required before a full analysis of the situation could be carried out.

EXAMINER'S REPORT

The question tests candidates' knowledge of the preparation of statement of cash flows. Part (a) requires candidates to prepare a statement of cash flows using the indirect method. Part (b) requires the reconciliation of the total cash and cash equivalent revealed in the statement of cash flows with their opening and closing balances in the statement of financial position. Part (c) asks for comments on the significance of the information provided by the prepared statement of cash flows.

About 96% of the candidates attempted the question and the performance was very poor as only about 10% of the candidates obtained up to fifty percent of the marks allocated to the question.

The candidates commonest pitfalls were their inability to recognise that the result of the operating activities portion of the statement is given and that only investing and financing activities should be ascertained. Many candidates could not prepare the required reconciliation of cash and cash equivalents. They were also making general comments on the benefits of statement of cash flows without relating the comments to the statement prepared.

Candidates are advised to prepare adequately by paying attention to the relevant sections of the syllabus when preparing for future examinations.

Marking Guide	Marks	Total
(a) Preparation of statement of cash flows		
- Title of financial statement	$\frac{1}{2}$	
- Stating net cash flow from operating activities	$\frac{1}{2}$	
- Determination of cash flow from investing activities	5	
- Determination cash flow from financing activities	$3\frac{1}{2}$	
- Stating cash and cash equivalent	<u>$2\frac{1}{2}$</u>	
		12
(b) Reconciliation of cash and cash equivalent		
- Stating the opening balances	$1\frac{1}{2}$	
- Stating the changes in cash and cash equivalent	2	
- Stating the closing balances	<u>$1\frac{1}{2}$</u>	
		5
(c) Comments on the significance of the information provided by the statement of cash flows		
Any 3 points at 1 mark each		<u>3</u>
Total Marks		<u>20</u>

SOLUTION 4

(a)

**XYZ Consultants and
Chartered Accountants**

May 15, 2018

The Chairman
Board of Directors
Ibadan Limited,
Nigeria.

Dear Sir,

ANALYSIS OF FINANCIAL PERFORMANCE AND POSITION OF ABUJA LIMITED AND RIVERS LIMITED

From the computed ratios stated in the appendix. The financial performance of Abuja Ltd, is better than that of Rivers Ltd as explained below:

- The profitability performance of the two companies shows that Abuja Ltd is better in terms of gross profit percentage and net profit margin;
- The outstanding performance of Abuja Ltd in terms of profitability may however be due to good assets turnover recorded by the company;
- However, the liquidity ratios of Rivers Ltd appeared better than that of Abuja Ltd which means that Rivers Ltd may be able to meet its current financial obligation better than Abuja Ltd; and
- The two companies (Abuja Ltd and Rivers Ltd) are lowly geared which are good indicators of strong long term financial stability by both companies.

CONCLUSION

However, in view of the fact that Abuja Ltd will be capable of utilising its resources more efficiently and considering the fact that it is a highly profitable company with a fairly suitable liquidity position. We would advise that the directors of Ibadan Ltd should acquire Abuja Ltd

XYZ

FINANCIAL CONSULTANTS AND CHARTERED ACCOUNTANTS

Appendix - Table of Ratios

(I)	PROFITABILITY RATIOS:		Abuja Ltd		Rivers Ltd
	Gross profit margin				
•	$\frac{\text{Gross profit}}{\text{Revenue}} \times \frac{100}{1}$		$\frac{1,340}{3,980} \times \frac{100}{1}$		$\frac{652}{2,240} \times \frac{100}{1}$
		=	33.7%		29.1%
•	Net profit margin				
	$\frac{\text{Profit before Interest \& tax}}{\text{Revenue}} \times \frac{100}{1}$		$\frac{704+140}{3980}$		$\frac{312+40}{2240}$
		=	21.2%		15.7%
(II)	LIQUIDITY RATIOS:				
•	Current ratio -				
	$\frac{\text{Current assets}}{\text{Current liabilities}}$		$\frac{1500}{1,460}$		$\frac{2,320}{1,700}$
		=	1.03:1		1.36:1
•	Acid Test Ratio				
	$\frac{\text{Current assets less inventory}}{\text{Current Liabilities}}$		$\frac{1500-620}{1460}$		$\frac{2,320-560}{1,700}$
		=	0.60:1		1.04:1

Trade receivables period		
$\frac{\text{Trade receivable} \times 365 \text{ Days}}{\text{Revenue}}$	$\frac{680 \times 365 \text{ days}}{3980}$	$\frac{1580 \times 365}{2240}$
=	62 days	257 days

(III) LONGTERM FINANCIAL STABILITY RATIOS:

- Gearing ratio

$\frac{\text{Long term borrowings}}{\text{Shareholders fund}} \times \frac{100}{1}$	$\frac{880 \times 100}{2220 \quad 1}$	$\frac{280 \times 100}{1980 \quad 1}$
---	---------------------------------------	---------------------------------------

=	39.6%	14.1%
---	-------	-------

OR

$\frac{\text{Longterm debts}}{\text{Longterm debts} + \text{Shareholder fund}} \times \frac{100}{1}$	$\frac{880}{880+2,220} \times \frac{100}{1}$	$\frac{280}{280+1980} \times \frac{100}{1}$
=	28.4%	12.4%

- Proprietary ratio:

$\frac{\text{Shareholders' funds}}{\text{Tangible assets}}$	$\frac{2,220}{3060+1500}$	$\frac{1980}{1640 + 2320}$
=	0.49:1 OR 49%	0.50:1 or 50%

IV. EFFICIENCY RATIOS:

- Total asset turnover

$\frac{\text{Revenue}}{\text{Total assets}}$	$\frac{3980}{3060+1500}$	$\frac{2240}{1640+2320}$
=	0.87 times	0.57 times

- Non-current assets turnover

$\frac{\text{Revenue}}{\text{Non-current assets}}$	$\frac{3980}{3060}$	$\frac{2240}{1640}$
=	1.3 times	1.37 times

4b.(i) LIMITATIONS OF RATIO ANALYSIS

- Heterogeneity or Homogeneity: A company may have various divisions operating in many different industries. This can make it difficult to find comparative industry ratios to use for comparison purposes.
- Need to determine whether the results of the ratio analyses are consistent: One set of ratios may indicate a problem, whereas another set may indicate that the potential problem is only short-term in nature.
- Need to use judgment: Although financial ratios are used to help assess the growth, and risk profile of a company, they cannot be used alone. The entire operations of the company must be examined, and the external economic and industry setting in which it is operating must be considered when interpreting financial ratios.

- The use of alternative accounting methods: Companies frequently have latitude when choosing certain accounting methods. Ratios obtained from financial statements that employ different accounting choices may not be comparable unless adjustments are made.
- Management assumptions, basis of estimation and judgment: IFRS is principles-based; it requires significant judgement from management of entities, this could result in material differences in the financial statements of the entities. It can also further limit the financial analyses of financial statements with accounting ratios unless further adjustments are made to the accounts.
- Differences in accounting policies: IFRS as a principles-based financial reporting system, allows alternative treatments of transactions via accounting policy choice, which invariably makes comparison of company's performance via accounting ratios more difficult and less meaningful unless alignment of the accounting policies of the entities are considered.
- Use of historical cost data: Decisions about future expectations are based on historical data which in some cases make it difficult to reach economic decisions that are likely to take into consideration changes in underlying variables that determine company's performance.
- Inflation can distort the financial statements: Inflation can distort the financial statements (particularly the statement of financial position). Any problem in the financials caused by inflation can be passed on to ratios.
- Difference in ratio definitions may make it difficult to compare ratios from different sources. There can be many different ways to compute the same ratio. This can cause confusion or different answers.
- Use of industrial average: Comparison against industry average may be subjected to factors that are not common in the industry.
- Lack of comparative figures for a new entity: In the company's first year of trading, there will be no comparative figures, hence no indicator to compare with.

(b)ii. Further information that may be useful to the Board of Directors of Abuja Ltd when making acquisition decisions are:

- In this case, the analysis has been made on the draft financial statements. These may be unreliable or change when finalised. Audited financial statements would add credibility;

- Other relevant information should be considered eg. profit forecasts, cash budgets, capital expenditure budget and future prospects;
- There would be need to ascertain current (fair) value of assets to be acquired;
- The level of risk and uncertainty within the business industry should be considered;
- The purchase consideration and mode of payment for the acquisition should also be considered;.
- Tax implication;
- Competitive advantage; and
- Management quality of the target entity.

EXAMINER'S REPORT

The question tests candidates' knowledge and understanding of financial analysis using ratios. Part (a) requires candidates to draft a report communicating their assessment of the financial performance and position of two companies based on computed ratios. Part (b) requires candidates to explain the limitations of ratio analysis and to state further information that may be useful to the board in decision making.

About 96% of the candidates attempted the question and the performance was fair as up to 45% of the candidates obtained over 50% of the marks allocated to the question.

Candidates' commonest pitfalls include, the inability to present their solution in a report form, wrong calculations of ratios required for the assessment and not being able to articulate further information that may help the board in decision making.

Candidates are advised to prepare adequately for better performance in the Institute's future examination.

Marking Guide		Marks	Total
(a)	Draft a report assessing the financial performance and position of the two companies		
	- Preparation as letter/report format	1	
	- Any 3 points on assessment of performance/position at one mark each	3	
	- Correct conclusion	1	
	- Closing/signing of report	1	
	- Computation of relevant ratios	<u>6</u>	

12

(b)	Limitations of ratio analysis:		
	- Any 4 explanations of the limitations of ratio analysis (1 mark each)	4	
	- Further information that may be useful to the board of directors when making the acquisition decision Any 4 points at 1 mark each	<u>4</u>	<u>8</u>
Total Marks			<u>20</u>

SOLUTION 5

(a)i **Relevance**

A set of financial statements is relevant when it can influence economic decisions of users and it allows them to assess and reassess decisions made in the past.

The financial statements are more useful because they are predictive in nature, that is, users of the statements can use past information to predict the direction the entity is moving to in the future.

ii. **Comparability**

Comparability refers to comparison of figures reported in the financial statements of an entity with the entities past performance and with the performance of other entities. For comparison to be meaningful, financial statements must be prepared on the same basis from one year to the other. The essence of comparison is to take major economic decisions.

iii. **Understandability**

Conceptual framework of the International Accounting Standard Boards (IASB) refers to understandability as presenting and classifying financial information clearly and concisely. If the financial statements are understandable, users will be able to use it to take decisions.

iv. **Faithful representation**

Financial information is faithfully represented when it is complete, neutral and free from bias. A set of financial statements that had not made provision for known liabilities or assets values had not been correctly stated could not be said to be reliable and faithfully represented. Transactions must be reported in accordance to their economic substance and not their legal form.

(b) **Differences between accrual, cash and break-up basis of accounting**

- i) Accrual basis of accounting (accrual accounting and the accrual concept) recognises transactions and other events and circumstances in the period in which those events occur, even if the resulting cash receipt and payments occur in a different period. This means that
- revenue from sales and other income would be reported in the period when the income arises (which might not be the same as the period when cash is received).
 - cost of sales in the statement of comprehensive income must be matched with sales. Income and matching expenses must be reported in the same financial period.
 - other expenses should be charged in the period to which they relate, not the period in which they are paid for.
- ii. Cash basis accounting
Cash basis accounting recognises transactions in the period in which cash receipts and payments occur. This means:
- revenue from sales and other income would be reported in the period when cash is received (which might be in a later period than when the Income arose);
 - expenses are charged in the period to which they are paid not the period in which they are incurred. Over time the accrual based accounting and cash based accounting result in recognising the same amount. However, transactions might be recognised in different periods under each system.
- iii. Break-up basis accounting
The break-up basis of accounting is used when the business is no longer a going concern. This basis results in assets and liabilities being measured at the amount of cash that they can be sold for (assets) or settled (liabilities).

Both the accrual and cash basis assume that a business is a going concern. That means that the business is expected to continue into the future.

This may however not be the case, a business might be brought to an end (wound up) either due to financial difficulties or if the owners decide that the business has run its course.

(c) **True And Fair View**

It means that income, expenses, assets and liabilities reported in the financial statements are complete, neutral and free from material misstatements and faithfully represented the financial performance and position of an entity.

True

This means that financial statements are factual, correct and have been prepared under applicable reporting framework e.g. International Financial Reporting Standards (IFRS). It also means the financial statements do not contain any material errors that can mislead users of the statements.

Fair

This means that financial statements report faithfully without bias. It shows the economic substance of the transactions.

Examples

- An asset that was classified as an expense shows that the financial statements are not true and fair.
- Omission or under reporting of items of incomes, expenses, assets and liabilities shows that financial statements are not true and fair.
- Under provision of known losses. Shows that the financial statements are not true and fair

EXAMINER'S REPORT

The question tests candidates' knowledge of the following:

- Explanation of some qualitative characteristics of financial statements;
- Differences between the three bases of accounting; and
- Meaning of "true and fair view" in relation to presentation of financial statements.

80% of the candidates attempted the question and performance was good.

Some of the candidates' pitfalls include their inability to clearly differentiate between the three (3) bases of accounting while others could not provide meaningful examples for "true and fair view" presentation of financial statements.

Candidates are advised to pay more attention to accounting framework and relevant accounting standards at this level of the Institute's examinations.

Marking Guide

	Marks	Total
(a) Correct explanation of qualitative characteristics :		
- Relevance	1½	
- Comparability	1½	
- Understandability	1½	
- Faithful Representation	<u>1½</u>	
		6
(b) Differences between the accrual, cash and break-up bases of accounting		
- Explanation with examples of accrual basis	2	
- Explanation with examples of cash basis	2	
- Explanation with examples of Break up basis	<u>2</u>	
		6
(c) Explanation of "True and Fair view" of financial statements		
- Explanation of "True"	1	
- Explanation of "Fair"	1	
- Relevant examples of "True and Fair view"	<u>1</u>	
		<u>3</u>
Total Marks		<u>15</u>

SOLUTION 6

- (a) An explanation of why deferred tax is provided for lies in understanding that accounting profit (as reported in a company's financial statements) differs from the profit figure used by the tax authorities to calculate a company's income tax liability for a given period. If deferred tax were ignored (flow through system), then a company's tax charge for a particular period, may bear very little resemblance to the reported profit. For example if a company makes a large profit in a particular period, but, perhaps because of high levels of capital expenditure, it is entitled to claim large tax allowances for that period, this would reduce the amount of tax it had to pay. The result of this would be that the company reported a large profit, but very little, if any, tax charge. This situation is usually 'reversed' in subsequent periods such that tax charges appear to be much higher than the reported profit could suggest that they should be.

Many commentators feel that such a reporting system is misleading in that the profit after tax, which is used for calculating the company's earnings per share, may bear very little resemblance to the pre - tax profit. This can mean that a government's fiscal policy may distort a company's profit trends. Providing for deferred tax goes some way towards relieving this anomaly, but it can never be entirely corrected due to items that may be included in the income statement but will never be allowed for tax purposes (referred to as permanent differences in some jurisdictions). Where tax depreciation is different from the related accounting depreciation charges this leads to the tax base of an asset being different from its carrying amount on the statement of financial position (these differences are called temporary differences) and provision for deferred tax is made. This 'balance sheet liability' approach is the general principle on which IAS 12 bases the calculation of deferred tax. The effect of this is that it usually brings the total tax charge (i.e. the provision for the current year's income tax plus the deferred tax) in proportion to the profit reported to shareholders.

The main area of debate when providing for deferred tax is whether the provision meets the definition of a liability. If the provision is likely to crystallize, then it is a liability, however if it will not crystallise in the foreseeable future, then arguably, it is not a liability and should not be provided for. The IASB takes a prudent approach and IAS 12 does not accept the latter argument.

b. **Carrying amount at December 31, 2017**

	₦'000	₦'000
Cost of plant		2,000
Accumulated depreciation at December 31, 2017 (2000-400)/8 years for 3 years (200x3)		<u>(600)</u>
Carrying amount		<u>1,400</u>
<u>Tax base at December 31</u>		
Initial tax base (original cost)		2,000
Year to December 31, 2015 (2000x40%)	800	
Year to December 31, 2016 (1200x20%)	240	
Year to December 31, 2017 (960x20%)	<u>192</u>	<u>(1,232)</u>
Tax base December 31, 2017		<u>768</u>
Temporary differences at December 31, 2017 (1400 -768)		632
Deferred tax liability at December 31, 2017 (632 x 30% tax rate)		190
Income Statement credit for the year ended December 31, 2017 (192(w1) -190)		<u>2</u>

(w1) **WORKINGS:**

<u>Deferred Tax Liability December 2016</u>	₦'000
Carrying amount 2016	
Cost of plant	2,000
Accumulated depreciation to year 2016	<u>(400)</u>
Carrying amount 2016	<u>1,600</u>
<u>Tax Base – 2016</u>	
Original cost of Plant	2,000
Capital Allow: Year 2015 (2,000x40%)	(800)
Year 2016 (1700x20%)	<u>(240)</u>
	<u>960</u>
Temporary Difference Year 2016 (1600 – 960) =	<u>640</u>
Deferred Tax Liability December 2016(640 x 30%)	<u>192</u>

b. Alternative Solution

YEAR	COST OF ASSETS (a)	ACCUM DEPRE. (b)	CARRYING AMOUNT (a-b)	CAPITAL ALLOW (c)	TAX BASE (a-c)	TEMPORARY DIFF. (a-b)-(a-c)	DIFF. TAX @ 30%	OPENING DIFF. TAX (S.F.P)	DIFF TAX CHARGED TO P OR L DR/(CR)	CLOSING DIFF. TAX (SFP)
	₦'000	₦'000	₦'000	₦'000	₦'000	₦'000	₦'000		₦'000	₦'000
2015	2,000	200(w1)	1800	800(w2)	1200	600	180	-	180	180
2016	2,000	400(w1)	1,600	1040 (w2)	960	640	192	180	12	192
2017	2,000	600(w1)	1,400	1,232(w2)	768	632	190	192	(2)	190

WORKINGS:

(w1) Year	<u>Acc Dep.</u> ₦'000	(w2) Year	<u>Capital Allowance</u> ₦'000
2015	<u>200</u>	2015	(2,000x40%) <u>800</u>
2016	<u>200</u>		
	<u>400</u>	2016	(1,200x20%) <u>240</u>
2017	<u>200</u>		<u>1040</u>
	<u>600</u>	2017	(960 x 20%) <u>192</u>
			<u>1232</u>
Amount credited to P & L	=		<u>₦2,000</u>
Balance per SFP 31/12/17	=		<u>190,000</u>

EXAMINER'S REPORT

The question tests candidates' knowledge of the principles and needs for providing for deferred tax in accordance with IAS 12 - Income Tax. They are also required to compute deferred tax to be charged to statement of profit or loss and the amount to be disclosed in the statement of financial position as at year end.

About 10% of the candidates attempted the question and performance was poor.

The commonest pitfalls of the candidates were as follows:

- Inability of the candidates to explain the need to provide for deferred taxation in the financial statements; and
- Wrong calculations of deferred tax charged/credited for the year and balance of deferred tax to be disclosed in the statement of financial position as at year end.

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

Marking Guide	Marks	Total
(a) Need to provide for deferred tax and the principles of accounting for deferred tax – IAS 12		
- Explanation of the need to provide for deferred tax	4	
- Principles/steps of accounting for deferred tax	<u>3</u>	
		7
(b) Calculation of Deferred tax		
- Calculation of deferred tax credit/charge	4½	
- Calculation of deferred tax balance in the statement of financial position	<u>3½</u>	
		<u>8</u>
Total Marks		<u>15</u>

SOLUTION 7

(a) Disclosure requirements of IAS 16

IAS 16 requires the following disclosures in the notes to the financial statements, for each major class of property, plant and equipments(PPE);

- i. The measurement bases used (cost or revaluation model);
- ii. The depreciation methods used;
- iii. The useful lives or depreciation rates used; (cost or revaluation model);
- iv. Gross carrying amounts and the accumulated depreciation at the beginning and at the end of the period;

- v. A reconciliation between the opening and closing values for gross carrying amounts and accumulated depreciation, showing:
- Additions during the year;
 - Disposals during the year;
 - Depreciation charge for the year;
 - Assets classified as held for sale in accordance with IFRS 5;
 - Acquisitions of assets through business combinations;
 - Impairment losses; and
 - The effect of revaluations.

(b) **ABC LTD.**

MEMO

From: Account Officer

To: Chief Accountant

Date: May 2018

Subject: Procedures for Identification and Accounting for Impairment of property, plants and equipment.

Impairment of PPE should be identified and accounted for as follows:

- At the end of each reporting period our company should assess whether there is any indication that an assets (PPE) may be impaired;
- If there are indications, our company should estimate the asset's (PPE) recoverable amount;
- If the recoverable amount is less than the carrying amount, the amount by which the value of the assets is written down is impairment;
- The Impairment loss is recognised as loss for the period;
- Depreciation charge for the impaired assets (PPE) should be adjusted to allocate the assets' revised carrying amount minus residual value over its remaining useful life (to be revised if necessary); and
- Please note that there is no specific guidance on the double entry needed to record impairment. One way of accounting for it is to set up accumulation of Impairment loss account and then account for it just like depreciation.

Thank you

Mr. XYZ
Accounting Officer

(c) Calculation of gain/loss on the Disposal of the Old Equipment

	₦	₦
Sales proceed on disposal		80,000
Less:		
Old equipment cost	600,000	
Accumulated depreciation	<u>(500,000)</u>	
Carrying amount as at disposal date Jan 2, 2016		<u>(100,000)</u>
Loss on disposal of equipment		<u>(20,000)</u>

EXAMINER'S REPORT

The question tests candidates' knowledge of the disclosure requirements of Property, plant and equipment-IAS 16 and the procedure for identifying and accounting for impairment in accordance with the provisions of IAS 36.

90% of the candidates attempted the question and performance was fair. About 40% of the candidates that attempted the question scored more than 50% of marks allocated.

The candidates' commonest pitfalls were as follows:

- Inability to explain the disclosure requirements of property plant and equipment (PPE);
- Failure to use Memo format presentation as requested for by the examiner and inability to explain how to identify and account for impairment of PPE; and
- Inability to correctly calculate gain/loss on disposal of PPE.

Questions of this nature are regularly examined at this level of the Institute's examinations hence candidates are advised to pay more attention to the provisions of various relevant accounting standards at the Skills level of Institute's examinations for better performance in future.

Marking Guide		Marks	Total
(a)	Disclosure requirements of IAS 16 on PPE: Any 10 relevant disclosure requirements at ½ mark each		5
(b)	Draft a memo explaining how impairment of PPE should be Identified and accounted for		
	- Presentation in Memo format	1	
	- Any 5 relevant points at 1 mark each	5	
	- Closing/signing of memo	<u>1</u>	
			7
(c)	Calculation of gain or loss on disposal of PPE		<u>3</u>
	Total Marks		<u>15</u>

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION - MAY 2018

TAXATION

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

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

SECTION A: COMPULSORY QUESTION (30 MARKS)

QUESTION 1

Alhaji Tijani Bello is married and has six children aged between 4 and 21 years. All except Phillip aged 21 are still in school.

The following details were obtained from his employment records:

- (i) He retired from his previous employment with Standard Chartered Company Limited on September 30, 2015. He was on an annual salary of ~~₦~~6,630,000.
- (ii) On October 1, 2015, he took up a new employment with Rehoco International Consulting on a salary of ~~₦~~9,600,000 per annum, transport allowance of ~~₦~~480,000 per annum and rent allowance of ~~₦~~660,000 per annum.
- (iii) From October 1, 2015, he will be on a pension income of ~~₦~~960,000 per annum from his pension fund administrators.
- (iv) Contributions to National Housing Fund and National Pension Scheme are: ~~₦~~195,000 and ~~₦~~615,000, respectively.
- (v) Alhaji Tijani Bello has a Life Assurance Policy on his life with the sum assured of ~~₦~~7,500,000 and annual premium of ~~₦~~660,000.
- (vi) He lived with his wife and two aged parents on whom he spent a total sum of ~~₦~~1,500,000 per annum.
- (vii) Alhaji Tijani Bello received dividend from his publicly quoted investment on Nigeria Stock Exchange, as follows:

	₦
1/1/2014	600,000
1/7/2014	720,000

Required:

- a. Compute the Personal Income Tax payable by Alhaji Tijani Bello for the relevant year of assessment. (20 Marks)
 - b. With respect to Stamp Duties Act Cap S8 LFN 2004, briefly explain the following:
 - i. Adjudication (3 Marks)
 - ii. Benefits of adjudication (4 Marks)
 - iii. Fixed duties (3 Marks)
- (Total 30 Marks)**

QUESTION 2

Tosin Oguntona was an employee of a Federal Government parastatal in Nigeria. While in service, he invested his earnings in a wide range of investments. He, therefore, derives incomes from those investments in addition to the monthly pension from the parastatal. He made the following information available to your firm with the hope that he will be better educated on how investment incomes are taxed:

	Assessment Years	
	2013	2014
Dividends:		
Dividend from Nigerian companies	₦1,200,000	₦1,500,000
Dividend from abroad paid into a domiciliary account	\$4,000	\$4,500
Rental Income:	₦	₦
Rent from buildings in Ibadan	630,000	720,000
Rent from buildings in Abuja	1,500,000	1,740,000
Rent from buildings in Oyo	420,000	520,000
Rent from buildings in Lagos	750,000	780,000
Expenses:		
Repairs and maintenance	90,000	96,000
Personal income tax paid	240,000	280,000
Water rate	40,000	50,000
Depreciation on building	620,000	700,000
Agent's commission	96,000	108,000
Insurance	120,000	150,000
Depreciation on plant	150,000	162,000
Interest Incomes:		
Interest received from bank	360,000	420,000
Interest on domiciliary account	\$1,200	\$1,500

Other Information:

- (i) Capital allowances as agreed with the revenue authority for 2013 and 2014 assessment years were ₦150,000 and ₦180,000, respectively.
- (ii) Insurance on properties included ₦24,000 and ₦30,000 for 2013 and 2014 assessment years respectively, for his private residence.
- (iii) He received pension of ₦80,000 per month.
- (iv) Assume an exchange rate of ₦160 to \$1.

Required:

Compute the Assessable Incomes of Tosin Oguntona for 2013 and 2014 Assessment Years. (20 Marks)

QUESTION 3

Multiplicity of taxes and tax incidence are two challenges in taxation facing the top management of Ogoluwa Plc. They are aware that a number of tax provisions have been put in place to address multiplicity of taxes in Nigeria.

You are in charge of tax matters in the Finance Department of Ogoluwa Plc.

You are required to explain to top management of Ogoluwa Plc:

- a. Multiplicity of taxes (2 Marks)
 - b. Five types of multiple taxes (5 Marks)
 - c. The following concepts:
 - i. Tax Incidence (2 Marks)
 - ii. Tax Burden (2 Marks)
 - iii. Tax Impact (2 Marks)
 - iv. Tax Shift (2 Marks)
 - v. Tax Effect (2 Marks)
 - d. In the context of multiplicity of taxes, **explain TWO** tax provisions put in place to ensure that there is no multiplicity of taxes in Nigeria. (3 Marks)
- (Total 20 Marks)**

QUESTION 4

John Obi has been running his business in the name of JOBI NIG Enterprises. He is in the business of manufacturing spare parts for vehicles in Aba. He decided to change his accounting date which had hitherto been September 30. Some years later, the business was discontinued for lack of raw materials which he could not import from war-torn Syria. The adjusted profits of the enterprise are as follows:

	₦
Year ended September 30, 2007	840,000
Period ended December 31, 2008 (15 Months)	840,000
Year ended December 31, 2009	630,000
Year ended December 31, 2010	540,000
Year ended December 31, 2011	480,000
Year ended December 31, 2012	360,000
Year ended December 31, 2013 (Year of Cessation)	90,000

You are provided with the following additional information:

- (i) Bad debt in the sum of ~~₦~~120,000 which was written off in 2010 Assessment Year was recovered in October 2013.
- (ii) A sum of ~~₦~~20,000 was spent to recover the debt.
- (iii) An expenditure incurred in Assessment Year 2009, though taken into account in the statement of comprehensive income was not paid until August 2013.

On cessation, the revenue authority intends to conduct a back duty investigation and the taxpayer has been duly informed. As a tax consultant, you have been invited to ascertain the assessable profits for the periods covered by the change in accounting date and cessation of business.

Required:

Compute the Assessable Profits for all the relevant assessment years. **(20 Marks)**

QUESTION 5

- a. Mr. Kalejaiye Edet has been working for some years with Concrete Builders Limited, a construction company located in Sango-Ota, Ogun State. He was living with his family at Agege in Lagos State. One of his children, Thompson, gained admission to a University in Lagos State and Mr. Kalejaiye Edet submitted his Tax Clearance Certificate (TCC) issued by Ogun State Board of Internal Revenue Service to the Admission Officer. This was rejected on the ground that Mr. Edet

resides in Lagos State and should therefore submit TCC issued by Lagos State Government.

In order to resolve this dispute, you are required to:

Identify and explain **FIVE** rules that guide the determination of residence for different categories of individuals. **(10 Marks)**

- b. Mr. Kalejaiye Edet is also contemplating setting up his own business in the future but learnt that depreciation of his property, plant and equipment will not be allowed as an expense against his income. He is worried and has sought your explanation on the issue.

Required:

Explain briefly **THREE** conditions for granting such allowances. **(5 Marks)**
(Total 15 Marks)

QUESTION 6

- a. Withholding Tax is the deduction of tax at source from payments made to a taxable person. However, some dividends are exempted from Withholding Tax.

Required:

Briefly explain **THREE** dividends exempted from Withholding Tax. **(5 Marks)**

- b. Mr. Salami died in 2014 leaving all his property in trust for his three children. The following information was made available to you in 2016 for the purpose of preparing income tax computation and tax payable by the trustees and the children - Shola, Bimbo and Tiwa.

	₦
Profit (Year ended 31/12/15)	14,000,000
Capital allowances	3,000,000
Rent	8,000,000

Remuneration of the trustees has been fixed at ₦18,000 monthly. The sum of ₦60,000, ₦72,000 and ₦80,000 were paid towards the university education of the children. Expenses incurred by the trustees in administering the estate amounting to ₦116,500 were paid.

The trust created an annuity of ₦178,000 in favour of motherless babies home. The children are to share 30% of annual net income in ratio 3:2:1, respectively. The trustee has power to make discretionary payments.

Required:

Compute the amount due to the beneficiaries for 2016 Year of Assessment.

(10 Marks)

(Total 15 Marks)

QUESTION 7

As part of efforts in increasing the revenue of Federal Government, there is a proposal to increase VAT collectible by the government. This has generated reactions from the public on the negative impact of this measure on goods and services. Government in its public enlightenment programme, explained that the increase would not affect some goods and services as contained in the VAT Act. In fact, there are goods that are also exempted from VAT.

As a tax consultant, you are invited to a workshop to speak on the following issues relating to the above.

Required:

- a. i. State **THREE** goods and **THREE** services exempted from VAT. (6 Marks)
 - ii. Briefly explain zero-rated goods and services. (3 Marks)
 - b. Explain **THREE** differences between Value Added Tax and Withholding Tax. (6 Marks)
- (Total 15 Marks)**

NIGERIAN TAX RATES

1. CAPITAL ALLOWANCES

	Initial %	Annual %
Office Equipment	50	25
Motor Vehicles	50	25
Office Buildings	15	10
Furniture and Fittings	25	20
Industrial Buildings	15	10
Non-Industrial Buildings	15	10
Agricultural Production	95	Nil
Plant and Machinery - Others	50	25

2. INVESTMENT ALLOWANCE 10%

3. RATES OF PERSONAL INCOME TAX

Consolidated relief allowance is computed at ₦200,000 or 1% of Gross Income whichever is higher + 20% of Gross Income.

After the Consolidated relief allowance and tax exempt items have been granted, the balance of income shall be taxed as specified in the tax table below:

	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 | 30% of Total Profit |
| 5. TERTIARY EDUCATION TAX | 2% of Assessable Profit |
| 6. CAPITAL GAINS TAX | 10% |
| 7. VALUE ADDED TAX | 5% |

SOLUTION 1

ALHAJI TIJANI BELLO

COMPUTATION OF PERSONAL INCOME TAX PAYABLE FOR 2015 YEAR OF ASSESSMENT

	₦	₦
Earned Income		
Salary - Standard Chartered Company Limited		
1/1/2015 – 30/9/15		
9/12 x ₦6,630,000		4,972,500
- Rehoco International Consulting		
1/10/15 – 31/12/15		
Salary – 3/12 x ₦9,600,000	2,400,000	
Transport Allowance – 3/12 x ₦480,000	120,000	
Rent Allowance – 3/12 x ₦660,000	<u>165,000</u>	
		<u>2,685,000</u>
Gross Emoluments		7,657,500
Add: Dividend Income (Gross)		
1/1/2014	666,667	
1/7/2014	<u>800,000</u>	<u>1,466,667</u>
Gross Income		9,124,167
Dividend (Gross)		<u>(1,466,667)</u>
		7,657,500
Less:		
Consolidated Relief Allowance -		
Higher of 1% x ₦7,657,500 or		
₦200,000 +		
20% x ₦7,657,500	1,731,500	
Tax Exempted Items:		
Contribution to National Pension Scheme	615,000	
Contribution to National Housing Fund	195,000	
Life Assurance Premium	<u>660,000</u>	
Chargeable Income		<u>3,201,500</u>
		<u>4,456,000</u>

Personal Income Tax payable

₦

1 st	- ₦300,000	@ 7%	21,000
Next	- ₦300,000	@ 11%	33,000
Next	- ₦500,000	@ 15%	75,000
Next	- ₦500,000	@ 19%	95,000
Next	- ₦1,600,000	@ 21%	336,000
Next	- <u>₦1,256,000</u>	@ 24%	301,440
	<u>₦4,456,000</u>		
Final Tax Payable			<u>861,440</u>

- b. (i) Adjudication is the process of determining the correct amount of Stamp Duties payable on an instrument by the Commissioner of Stamp Duties.

A document will be duly stamped after adjudication only when the applicable duty has been paid.

(ii) Benefits of Adjudication

These include:

- It is the first step in disputing the Stamp Duties officer's view of the correct amount of duty;
- It shows the genuineness of a document;
- It satisfies the statutory requirement; and
- It makes instrument once adjudicated, admissible for all purposes notwithstanding any objection as to the duty to be paid.

(iii) Fixed Duties

These are duties that do not vary with the consideration for the document being stamped; e.g payment receipts, cheque leaves, proxy forms, guarantor forms, admission as solicitor or notary public.

EXAMINER'S REPORT

The question tests candidates' knowledge of the computation of Personal Income Tax and the provisions of Stamp Duties Act.

Candidates had a good understanding of the question and performance was good, although some of them performed better in the computation of tax liability than in stamp duties. The commonest pitfall was the inability of the candidates to explain the provisions of Stamp Duties Act.

Candidates are advised to cover all areas of the syllabus in future examinations.

S/No.	Marking Guide	Marks	Marks
1a.	Salary – Standard Chartered Company Limited. 1/1/2015 – 30/9/15 $9/12 \times \text{N}6,630,000$ - Rehoco International Consulting 1/10/15 – 31/12/15 Salary – $3/12 \times \text{N}9,600,000$ Transport Allowance – $3/12 \times \text{N}480,000$ Rent Allowance – $3/12 \times \text{N}660,000$ Gross Emoluments Add: Dividend Income 1/1/2014 1/7/2014 Gross Income Consolidated Relief Allowance - Higher of $1\% \times \text{N}7,657,500$ or $\text{N}200,000 +$ $20\% \times \text{N}7,657,500$ Pension NHF Life Assurance Premium Chargeable Income Applying Tax Table Rate	 2 2 2 1 1 1 1 1 1	 2 6 2 1 4 1

1 st – ₦ 300,000 @ 7%	1/2	
Next – ₦ 300,000 @ 11%	1/2	
Next – ₦ 500,000 @ 15%	1/2	
Next – ₦ 500,000 @ 19%	1/2	
Next – ₦ 1,000,000	1/2	
Next – ₦ 1,256,000	1/2	
Tax payable	<u>1</u>	4
bi. Definition of adjudication	1 1/2	
Stamping	<u>1 1/2</u>	3
ii. Benefits (4 points at 1 mark each)		4
iii. Explanation of fixed duties	2 1/2	
Examples	<u>1/2</u>	<u>3</u>
Total		<u>30</u>

SOLUTION 2

Tosin Oguntona

Computation of Assessable Incomes for 2013 and 2014 Assessment Years

Dividend Income	2013	2014	Incomes that are tax exempt.
	₦	₦	
Dividend income (Nigeria)	0	0	
Dividend income (Foreign)	<u>0</u>	<u>0</u>	
Rental Income:			
Rent from building in Ibadan	630,000	720,000	
Rent from building in Abuja	1,500,000	1,740,000	
Rent from building in Oyo	420,000	520,000	
Rent from building in Lagos	<u>750,000</u>	<u>780,000</u>	
	3,300,000	3,760,000	
Less expenses:			
Repairs and maintenance	90,000	96,000	
Water rate	40,000	50,000	
Agent's commission	96,000	108,000	
Insurance less that of private residence	<u>96,000</u>	<u>120,000</u>	
Assessable rent	2,978,000	3,386,000	
Capital allowances	<u>(150,000)</u>	<u>(180,000)</u>	
Chargeable rent	<u>2,828,000</u>	<u>3,206,000</u>	
Interest Income:			
Bank interest	<u>360,000</u>	<u>420,000</u>	

SUMMARY

Dividend income	0	0
Rental income	2,828,000	3,206,000
Interest income	<u>360,000</u>	<u>420,000</u>
	<u>3,188,000</u>	<u>3,626,000</u>

EXAMINER'S REPORT

The question tests candidates' knowledge of the assessment of Investment Incomes.

Candidates displayed a good understanding of the question.

Candidates should pay attention to the treatment of Franked Investment Income.

Marking Guide		Marks
Dividend Income:		
Nigeria	(½ mark x 2)	1
Foreign	(½ mark x 2)	1
Total	(½ mark x 2)	1
Rental Income:		
Ibadan building	(½ mark x 2)	1
Abuja building	(½ mark x 2)	1
Oyo building	(½ mark x 2)	1
Lagos building	(½ mark x 2)	1
Total of rental income	(½ mark x 2)	1
Expenses:		
Repairs	(½ mark x 2)	1
Water Rate	(½ mark x 2)	1
Agent's Commission	(½ mark x 2)	1
Insurance (½ mark x 2)	(½ mark x 2)	1
Assessable rent	(½ mark x 2)	1
Capital allowances	(½ mark x 2)	1
Chargeable rent	(½ mark x 2)	1
Bank interest		1
Summary:		
Dividend income	(½ mark x 2)	1
Rental income	(½ mark x 2)	1
Interest income	(½ mark x 2)	1
Total income	(½ mark x 2)	<u>1</u>
Total		<u>20</u>

SOLUTION 3

(a) Multiplicity of Taxes

This is a tax regime under which various and similar types of taxes are imposed on taxpayers by different tiers of government.

For instance, while the Federal Government imposed the Value Added Tax on consumption and made it applicable throughout the federation, some states, notably, Lagos State, introduced the sales tax based on the same principle as the former and made it applicable in Lagos State.

The type of taxes introduced and collected by local governments vary from one local government to the other.

(b) Some of these taxes are:

- (i) Entertainment Tax;
- (ii) Road Tax;
- (iii) Permit for closure of streets;
- (iv) Refuse collection Tax;
- (v) Market taxes and levies; and
- (vi) Loading and offloading levies.

(c)(i) Tax Incidence

It is an economic term for the division of a tax burden between buyers and sellers. It does reveal the person that will pay the tax liability. For instance, if the government decides to impose an increased tax rate on cigarettes, the producers may increase the selling price by the full amount of the tax. If the consumers purchase cigarettes at the same amount after the price increase, it will be said that the tax incidence will fall entirely on the buyers.

(ii) Tax Burden

This is the amount of income, property or consumption tax levied on an individual or business. Tax burdens vary depending on a number of factors including income level, jurisdiction, and current tax rates. Income tax burdens are typically satisfied by deductions from an individual's pay slip each time he or she is paid.

(iii) Tax Impact

This is the effect of a tax on the production or consumption of the product being taxed. For example, the tax impact of raising the levy on tobacco might be a reduction in tobacco sales.

(iv) Tax Shift

This is also referred to as tax swap. It is a change in taxation that eliminates or reduces one or several taxes and establishes or increases others while keeping the overall revenue the same.

(v) **Tax Effect**

This is a general term that describes the consequences of a specific tax scenario with respect to a particular tax-paying entity.

(d) Some of the tax provisions put in place by government to address multiplicity of taxes in Nigeria include but not limited to:

- (i) Those laws that are not in the exclusive list can be legislated upon by state governments but it must be ensured that the liability of persons must be regulated to ensure tax or duty is not levied on the same by more than one State;
- (ii) A House of Assembly when making laws for the local governments shall also regulate the liability of persons to ensure that same liability is not levied by more than one Local Government Council; and
- (iii) Act 21, Taxes and Levies (Approved list for collection) 1998, which stipulates the collectible taxes by each tier of government is also an attempt to ensure that there is no multiplicity of taxes.

EXAMINER'S REPORT

The question tests candidates' knowledge of the general principles of taxation.

Candidates' performance was poor. The commonest pitfall was the poor knowledge of the multiplicity of taxes.

Candidates are advised to pay attention to general principles of taxation in future examinations.

S/No.	Marking Guide	Marks	Marks
3a.	Definition of multiplicity of taxes	1	
	Explanation	<u>1</u>	2
b.	Types of multiple taxes (1 mark each subject to a maximum of 5 points)		5
c.(i)	Tax incidence (1 mark each for definition and explanation)		2
c.(ii)	Tax burden (1 mark each for definition and explanation)		2
c .(iii)	Tax impact (1 mark each for definition and explanation)		2
c.(iv)	Tax shift (1 mark each for definition and explanation)		2
c.(v)	Tax effect (1 mark each for definition and explanation)		2

- d. Multiplicity of taxes
(1½ marks for each tax provision subject to a maximum of 2 provisions)

3
20

SOLUTION 4

JOBI NIG. ENTERPRISES COMPUTATION OF ASSESSEABLE PROFITS FOR THE RELEVANT ASSESSMENT YEARS

OLD BASIS

Assessment Year	Basis Period	Assessable Profit N
2008	1/10/06 – 30/9/07	840,000
2009	1/10/07 – 30/9/08 (¹² / ₁₅ x N840,000)	672,000
2010	1/10/08 – 30/9/09 (³ / ₁₅ x N840,000) + (⁹ / ₁₂ x N630,000)	<u>640,500</u> <u>2,152,500</u>

NEW BASIS

Assessment Year	Basis Period	Assessable Profit N
2008	1/1/07 – 31/12/07 (⁹ / ₁₂ x N840,000 + ³ / ₁₅ x N840,000)	798,000
2009	1/1/08 – 31/12/08 ¹² / ₁₅ x N840,000	672,000
2010	1/1/09 – 31/12/09	<u>630,000</u> <u>2,100,000</u>

CESSATION

Assessment Year	Basis Period	N	Assessable Profit N
2013	1/1/13 – 31/12/13		190,000
2012	Higher of: 1/1/12 – 31/12/12 OR 1/1/11 – 31/12/11	<u>360,000</u> <u>480,000</u>	<u>480,000</u> <u>670,000</u>

CESSATION

2013 Assessment Year	₹
Assessable Profit	
1/1/13 – 31/12/13	90,000
Add: Bad debt recovered	<u>120,000</u>
	210,000
Less: Cost of recovery	<u>20,000</u>
	<u>190,000</u>

EXAMINER'S REPORT

The question tests candidates' knowledge of change of accounting date and back duty investigation.

Candidates displayed good understanding of the question. The commonest pitfall was the inability of the candidates to put basis periods in the relevant years of assessment.

Candidates are advised to study the placement of basis periods in the relevant years of assessment as this is a frequent examination area.

Marking Guide	Marks
Heading	½
<u>Old basis:</u>	
Basis Period [1 mark each for 2008, 2009 and 2010]	3
Assessable Profit (1 mark each for 2008, 2009, 2010)	3
<u>New basis</u>	
Basis Period (1 mark each for 2008, 2009 and 2010)	3
Assessable Profit (1 mark each for 2008, 2009 and 2010)	3
<u>Cessation</u>	
Basis Period – 2013	1
- 2012 (1 mark each for 2 options)	2
Assessable Profit - 2013	1
- 2012 (1 mark each for 2 options)	2
Computation of 2013 Assessable Profit:	
Basis Period/Assessable profit	½
Bad debts recovered	½
Cost of recovery	½
Total	<u>20</u>

SOLUTION 5

A. RULES THAT GUIDE THE RESIDENCE OF DIFFERENT CATEGORIES OF INDIVIDUALS

Liability to income tax is often determined according to whether a person receiving income is resident in a state for a particular year of assessment.

A taxpayer is therefore liable to the tax authority of the territory in which he is deemed to be resident for a year of assessment.

- (i) An **Individual** whether in employment or whose only sources of income are unearned income is deemed to be resident for a year of assessment in the territory in which he has a place available for his domestic use in Nigeria on the first day of January of the assessment year, and does not include any hotel, rest house or other place at which he is temporarily lodging.
- (ii) An **Executor** is deemed to be resident in the territory in which the deceased individual was last deemed to be resident or would have been deemed to be resident if the law had been in force prior to the death of his date.
- (iii) A **Trustee** of any trust or settlement is deemed to be resident where all the income of the settlement or trust for a year of assessment arises. Where the income arises in more than one territory or where the tax authority cannot be determined, the Federal Inland Revenue Service Board is the tax authority.
- (iv) **Partners** in partnership are deemed to be resident where the principal office or the place of the partnership is situated on the first day of that year or is first established during the year.
- (v) A **Village** or an indigenous community is deemed to be resident in the territory in which the community is found.
- (vi) An **Itinerant** worker is deemed to be resident where he is found in a year of assessment.
- (vii) An individual not being a person assessable by FIRS (S, 2, 1(b) who holds a foreign employment on the 1st day of January in a year of assessment or who first becomes liable to income tax in Nigeria for that year by reason of his entering that employment during that year, shall be deemed to be resident for that year in the territory in which the principal office of his employer is situated on that day or on the day his foreign employment commences as the case may be.
- (viii) An individual whose only source of earned income arising in Nigeria on the 1st day of January in a year of assessment is a pension, or who had a place or principal place on that day shall be deemed to be resident for that year in the territory in which that place or principal place of residence was situated on that day.

B. CONDITIONS FOR GRANTING CAPITAL ALLOWANCE

Capital allowance is claimable only on the following conditions:

- (i) Capital expenditure must have been incurred in the basis period;
- (ii) The qualifying capital expenditure must have been put into use for the purpose of trade or business by the taxpayer;
- (iii) Ownership over the assets must not be in dispute;
- (iv) Assets must be in use as at the end of the basis period; and
- (v) Application for Acceptance Certificate must be made with the Federal Ministry of Industry where total value of additions to property, plant and equipment exceed ₦500,000; in any given year.

EXAMINER'S REPORT

The question tests candidates' knowledge of Tax Clearance Certificate and treatment of capital allowances.

Candidates displayed a fair understanding of the question and performance was average. Some candidates could not fully match residency rules with individuals or group of individuals.

Candidates are advised to pay attention to general principles regarding the taxation of individuals.

Marking Guide	Marks	Marks
5a. Rules that guide the determination of residence		
- Identification of the categories of individuals (1 mark each subject to a maximum of 5 categories)	5	
- Explanation of the categories of individuals (1 mark each subject to a maximum of 5 categories)	<u>5</u>	10
b. Conditions for granting Capital Allowances		
(1 st 2 conditions at 1½ marks each)	3	
(3 rd condition at 2 marks)	<u>2</u>	<u>5</u>
Total		<u>15</u>

SOLUTION 6

(a) DIVIDENDS EXEMPTED FROM WITHHOLDING TAX

These include:

- (i) Dividends paid out of pioneer profit;
- (ii) Dividends paid by issue of bonus shares;
- (iii) Dividends from small companies in the manufacturing sector in the first five years of operation;

- (iv) Dividends paid out of taxed petroleum profits;
- (v) Dividends from companies engaged in petrochemical and liquefied natural gas;
- (vi) Dividends received from investments in wholly export oriented businesses;
- (vii) Dividends received by a company from a country outside Nigeria and brought into Nigeria through government approved channels; and
- (viii) Dividends distributed by Unit Trust.

(b)

COMPUTATION OF TRUSTEES SETTLEMENT

ESTABLISHMENT OF MR. SALAM (DECEASED) 2016 YEAR OF ASSESSMENT

	₦	₦
Income	14,000,000	
Capital Allowance	<u>(3,000,000)</u>	11,000,000
Profit from other source: Rent (Gross)		<u>8,000,000</u>
		19,000,000
Less		
Remuneration of Trustees	216,000	
Discretionary payments	212,000	
Trust expenses	116,500	
Annuity	<u>178,000</u>	<u>(722,500)</u>
Computed Income		<u>18,277,500</u>
Distribution to beneficiaries		5,483,250
Retained by the Estate		<u>12,794,250</u>
Total		<u>18,277,500</u>

	Shola ₦	Bimbo ₦	Tiwa ₦	Total ₦
Share of Computed Income	2,741,625	1,827,750	913,875	5,483,250
Discretionary payments	<u>60,000</u>	<u>72,000</u>	<u>80,000</u>	<u>212,000</u>
	<u>2,801,625</u>	<u>1,899,750</u>	<u>993,875</u>	<u>5,695,250</u>

WORKINGS

- Trustees' Remuneration = $\text{₦}18,000 \times 12 = \text{₦}216,000$
- Share of Income
 - Shola = $\frac{3}{6} \times \text{₦}5,483,250 = \text{₦}2,741,625$
 - Bimbo = $\frac{2}{6} \times \text{₦}5,483,250 = \text{₦}1,827,750$
 - Tiwa = $\frac{1}{6} \times \text{₦}5,483,250 = \text{₦} 913,875$

EXAMINER'S REPORT

The question tests candidates' knowledge of the provisions relating to the taxation of trust incomes.

Candidates displayed a good understanding of the question. The commonest pitfall was the inability of the candidates to present the solution appropriately.

Candidates are advised to pay attention to appropriate format in the taxation of trust incomes as given in the Institute's study texts and pathfinders.

Marking Guide	Marks
6a. Dividends exempted from Withholding Tax (First two points at 1½ mark each) (Third point at 2 marks)	5
b. Computation of amounts due to the beneficiaries	
Income	½
Capital Allowance	½
Total	½
Rent	½
Sub total of Income	½
Remuneration of Trustees	½
Discretionary payments	½
Trust expenses	½
Annuity	½
Total of expenses	½
Distribution to beneficiaries	½
Retained by the estate	½
Computation of amounts due to beneficiaries:	
Share of Computed Income	2
Discretionary payments	<u>2</u>
	<u>15</u>

SOLUTION 7

a(i) Examples of Exempted Goods from VAT

These include:

- All medical and pharmaceutical products;
- Basic food items;
- Books and educational materials;
- Baby products;

- Plant, machinery and goods imported for use in the Export Processing Zone or Free Trade Zone, provided that 100% production of such company is for export otherwise tax shall accrue proportionally on the profits of the company;
- Plant, machinery and equipment purchased for utilization of gas in downstream petroleum operations;
- Tractors, ploughs and agricultural equipment and implements purchased for agricultural purposes;
- Exports relating to:
 - i. Fertilizers locally produced, agricultural and veterinary medicine; and
 - ii. Services exempted from VAT.
- Oil exports;
- Vegetable oil; and
- Motorcycle (CKD)/Bicycle (SKDs); and their spare parts.

Services Excepted From VAT

These include:

- Medical services;
- Services rendered by Micro finance banks and mortgage institutions;
- Plays and performances conducted by educational institutions as part of learning;
- Oil exported services
- Rent/lease of residential property;
- Life insurance; and
- Shared passenger-transport service available for use by the general public is now VAT exempt. This exemption is not applicable to hired or rented vehicles or transportation apparatus for private use like Uber, etc.

- a(ii) Zero-rated goods and services are products that are not subject to value added tax mainly due to their societal importance. For VAT purposes, these goods are zero-rated and do not have additional taxes levied on them.

These include:

- Non-oil exports;
- Goods and services purchased by diplomats;
- Humanitarian donor funded project undertaken by NGOs, religious and social clubs or societies recognized by law and activities for not-for-profit organizations and in the public interest.

Note:

On June 6, 2018, the Federal Executive Council (FEC) approved two Executive Orders and five Amendment Bills, which amended certain controversial tax provisions and those relating to VAT have been accommodated in the examples given above.

b. MAJOR DIFFERENCES BETWEEN VALUE ADDED TAX (VAT) AND WITHHOLDING TAX (WHT)

VAT	WHT
i. An indirect tax	A direct tax
ii. Imposed on goods and services	Imposed on incomes at source
iii. Imposed at 5%	Rate applicable is dependent on type of transaction
iv. Backed by VAT Act 2004 (as amended)	Backed by certain Sections of CITA 2004 and PIT (Amendment) Act 2011
v. Is governed only by Federal Inland Revenue Service	Is governed partly by State Internal Revenue Service
vi. VAT is shared by the 3 tiers of government	Withholding tax collected by state government is not shared by the 3 tiers of government

EXAMINER'S REPORT

The question tests candidates' knowledge of the principles of value added tax and withholding tax.

Candidates displayed poor understanding of the question. The commonest pitfall was the candidates' inability to succinctly articulate their points but resorted to long explanations.

Candidates are advised to highlight their points when they are answering questions of this nature.

Marking Guide	Marks	Marks
ai. Goods and services exempted from VAT		
- Goods exempted (1 mark each for any 3 points)	3	
- Services exempted (1 mark each for any 3 points)	<u>3</u>	6
ii. Zero-rated goods and services		
Definition	2	
Examples – ½ mark each subject to a maximum of 2 points	<u>1</u>	3
b. Major differences between Value Added Tax and Withholding Tax		
<u>VAT</u> 1 mark each subject to a maximum of 3 points	3	
<u>Withholding Tax</u> 1 mark each subject to a maximum of 3 points	<u>3</u>	<u>6</u>
Total		<u>15</u>

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA
SKILLS LEVEL EXAMINATION – MAY 2018
PERFORMANCE MANAGEMENT

Time Allowed: 3¹/₄ hours (including 15 minutes reading time)

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

SECTION A: COMPULSORY QUESTION (30 MARKS)

QUESTION 1

DASET DRINKS NIGERIA PLC.

Daset Drinks Nigeria Plc. has been operating in the Nigerian food and beverages industry as an entity with three distinct factories across the country. One of the factories bottles soft drink while the other two produce bottles and crown corks for the soft drink factory.

The company has recently been experiencing problems with its performance evaluation system across the three factories. Each factory manager is of the opinion that his factory is the one contributing the most to the overall performance of the company.

In a recent management retreat, the guest speaker, a performance management expert, emphasised the need to develop Key Performance Indicators (KPI) for each of the factories and departments in the company. According to him, this will enhance performance evaluation of all the managers in the company and will also make performance management easier. He suggested that the company should adopt a divisional structure whereby each of the factories will become an autonomous division with responsibilities for investment, revenues, profits and costs.

At the last Executive Management meeting, after the retreat, the company's top management decided to adopt the recommendations of the guest speaker. The top management agreed transfer prices acceptable to each of the divisional managers and also the needs to decide whether the two factories manufacturing bottles and corks could sell to external markets.

The top management has mandated you, as the company's management accountant, to supply necessary data that will assist them in taking appropriate decisions.

Financial data collected about the company's operations are as follows:

The costs and selling prices of the divisions are:

	Soft drink	Bottle	Crown cork
	₦	₦	₦
Selling price (price on the external market)	100	5	0.50
Variable cost of production	*80	3	0.30
Contribution	20	2	0.20

*This includes costs of bottle and crown cork. To produce one bottle of soft drink requires one bottle and one crown cork.

The bottling division has the choice to buy its bottle and crown cork requirements from the external market.

The variable costs of production for external sales and internal transfers are the same and bottles and crown corks are being transferred to the bottling division at these costs.

For brand protection, the soft drink factory is not willing to buy bottles and crown corks from any external supplier.

Required:

- Differentiate among an investment centre, a profit centre, a revenue centre and a cost centre, in a divisional organisation giving one example of each.
(8 Marks)
 - Explain a divisional structure, stating the problems associated with this type of structure in an organisation.
(8 Marks)
 - Advise the top management on the transfer prices that will maximise the company's profit and be acceptable to the factory managers.
(10 Marks)
 - Discuss **TWO** qualitative factors that the top management needs to consider in taking these decisions.
(4 Marks)
- (Total 30 Marks)**

SECTION B: YOU ARE REQUIRED TO ANSWER ANY TWO OUT OF THREE QUESTIONS (40 MARKS)

QUESTION 2

Nwokocha and Sons Bakery Limited uses absorption costing technique in its accounting system. The company produces and sells three bakery products, namely four corner loaf (F), round corner loaf (R) and executive loaf (E) which are substitutes for each other. The following standard selling prices and cost data relate to these three products:

Product	Selling Price Per unit (₦)	Direct materials per unit	Direct labour per unit	Variable expenses per unit
F	200.00	25kg at ₦3 per kg	1.2hrs at ₦10.00 per hr	1.2hrs at ₦5 /hr
R	250.00	30kg at ₦3 per kg	1.5hrs at ₦10.00 per hr	1.5hrs at ₦5/ hr
E	300.00	38kg at ₦3 per kg	1.8hrs at ₦10.00 per hr	1.8hrs at ₦5/hr

Annual budgeted fixed production overhead was ₦3,840,000. The company policy is that overhead will be absorbed on a machine hour basis. The standard machine hour for each product and the monthly budgeted level of production and sales for each product are as follows:

Product	F	R	E
Standard machine hour per unit	0.3 hr	0.6hr	0.8 hr
Monthly budgeted production and sales (units)	10,000	13,000	9,000

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

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

You are required to:

- Calculate the following variances for overall sales for the particular month:
 - Sales price variance; (2 Marks)
 - Sales volume profit variance; (2 Marks)
 - Sales mix profit variance; and (3 Marks)
 - Sales quantity profit variance. (3 Marks)
- Determine the monthly budgeted profit for the company. (6 Marks)
- Discuss the significance of mix variances in a standard costing system? (4 Marks)

(Total 20 Marks)

QUESTION 3

- a. Adetoy Nigeria Limited has been in business for more than a decade. The company distributes and sells children toys. The company has an Accounts Department that normally prepares monthly and yearly financial statements. The management of Adetoy has found this report adequate for its need over the years until recently when the company decided to be producing its own brand of toys with special orders from some of its customers.

The management of Adetoy has been struggling on how to decide on the price to charge for special orders and whether to accept some large orders with a reduction in prices. The company's production facility has enough capacity to meet all the orders. However, because of its full cost-plus pricing system, it has been rejecting some orders where the customers could not pay the price the company charges. As a result of this, the company has been losing some of its customers.

To help the company look at its cost structure and provide management information for decision making, the company recently employed a management accountant. During the last management meeting, the management accountant informed management that the company has been losing its customers and potential profits because it has not been using relevant costs for its decisions. The management therefore asked the management accountant to explain the concept of relevant costs to inform the management more about this.

Required:

In the context of relevant costs, explain the following:

- i. Incremental costs;
- ii. Differential costs;
- iii. Avoidable and unavoidable costs;
- iv. Committed costs;
- v. Sunk costs; and
- vi. Opportunity costs. (12 Marks)

- b. Deban Construction Limited is deciding whether or not to proceed with a one-off special contract for which it would receive a one-off payment of ₦2,000,000.

Details of relevant costs are:

- (i) The special contract requires 2,000 hours of labour at ₦600 per hour. Employees possessing the necessary skills are already employed by Deban Construction Limited but are currently idle due to a recent downturn in business;
- (ii) Materials X and Y will be used, 100 tonnes of material X will be needed and sufficient quantity of material X is in inventory as the

material is in common use by the company. Original cost of material X in inventory was ₦1,500 per tonne but it would cost ₦1,800 per tonne to replace if used on this contract. Material Y is in inventory as a result of previous over-purchasing. The original cost of material Y was ₦500,000 but it has no other use. Material Y is toxic and if not used in this contract, Deban Construction Limited must pay ₦240,000 to have it disposed;

- (iii) The contract will require the use of a storage unit for three months. The company has recently leased the unit for one year at a rental of ₦80,000 per month. The unit is not in use at present. However, a neighbouring business has recently approached Deban construction Limited offering to rent the unit from them for ₦110,000 per month; and
- (iv) Overheads are absorbed at ₦750 per labour hour which consist of ₦500 for fixed overhead and ₦250 for variable overhead. Total fixed overheads are not expected to increase as a result of the contract.

A trainee accountant has performed the following calculation which shows that the contract will cost ₦3,590,000 to deliver and concluded that the contract should therefore not be accepted for ₦2,000,000:

Description	Relevant cost ₦
Labour: 2,000 hours x ₦600	1,200,000
Material X: 100 tonnes x ₦1,500	150,000
Material Y: Original cost	500,000
Storage: 3 months x ₦80,000	240,000
Overheads: ₦750 x 2000	<u>1,500,000</u>
Total	<u>3,590,000</u>

Required:

Calculate the relevant cost of the contract and advise whether the contract should be accepted or not on financial grounds. (8 Marks)

(Total 20 Marks)

QUESTION 4

ABC Limited is a medium-sized family-owned company, located in Lagos. It manufactures a range of high-quality electrical household goods as well as buying completed products for resale from a number of suppliers. It sells its products through a variety of outlets such as mail order catalogue companies, large stores, small retail outlets and directly to household customers.

The company has many computer systems which were installed 10 years ago. However, the systems are not networked in terms of the information they hold about inventory, customers, sales and purchases information, as each department

is responsible for only its part of the system. For example, the accounting department keeps a regularly updated file on customers and orders placed, but this data is held separately from the data maintained by the sales department on customers.

Although, the systems have proved adequate in the past for areas such as payroll, financial accounting and sales order invoicing, but do not meet the changing information requirements for management decision-making in a competitive market. For example, information relating to inventory levels is available to sales staff online, but is often out of date as the master-files are only updated on a weekly basis. Technical faults and breakdowns mean that the systems are often unavailable and customers are requested to try again later. Managers at all levels of the company are now clamouring for a change in the company's information system and have therefore recommended to the directors to consider changing the systems.

The directors, who also wish to expand the company within the whole country, have accepted this recommendation. They now want to appoint a temporary Project Manager to lead a small team responsible for the new systems development project. The directors of ABC Limited consider that the appointed Project Manager will be required only for a secondment period of approximately 12 months, while the systems development and installation are taking place. After the successful completion of the project, the appointee will return to his or her original position; however, the directors consider this to be an opportunity for a member of staff to gain excellent organisational, management and systems experience.

Required:

- a) Identify and describe the responsibilities of the Project Manager within ABC Limited. (10 Marks)
 - b) Discuss the skills that a Project Manager would require to successfully implement a major project involving the design and installation of the new computer system within ABC Limited. (10 Marks)
- (Total 20 Marks)**

SECTION C: YOU ARE REQUIRED TO ANSWER ANY TWO OUT OF THREE QUESTIONS (30 MARKS)

QUESTION 5

Classic Wears Plc. manufactures three unique jeans wears for which the maximum revenue for the coming year is estimated as follows:

	₦
Trousers	2,875,000
Jackets	4,800,000
Skirts	6,200,000

Summarised unit cost data are as follows:

Products	Trousers	Jackets	Skirts
	₦	₦	₦
Direct material	1,000	900	700
Variable costs	800	1,600	1,000
Fixed costs	<u>250</u>	<u>500</u>	<u>400</u>
Total costs	<u>2,050</u>	<u>3,000</u>	<u>2,100</u>

The allocation of fixed costs was derived from last year's production level and this may be reviewed, if current output plans are different.

Estimated selling prices are:

Products	Price
	₦
Trouser	2,300
Jackets	3,200
Skirts	2,480

The products are processed on sewing machines housed in a building of three blocks.

Block A contains type I machine which has an estimated maximum of 19,600 machine hours available in the forthcoming year with fixed overhead cost of ₦980,000 per annum.

Block B contains type II machine of which 10,000 machine hours are estimated in the forthcoming year with a fixed overhead cost of ₦750,000 per annum.

Block C also contains type II machine which also has an estimate of 8,000 machine hours available in the forthcoming year. The fixed overhead cost of ₦370,000 is estimated per annum for Block C.

The required machine hours for one unit of output for each Jeans on each type of machine are as follows:

	PRODUCTS		
	Trouser	Jacket	Skirt
Type I Machine	2hours	4hours	6hours
Type II Machine	3hours	6hours	2hours

You are required to:

- Determine the optimal production plan which Classic Wears Limited should adopt. (12 Marks)
 - Calculate the total profit that would be made, if the production plan in (a) above is adopted. (3 Marks)
- (Total 15 Marks)**

QUESTION 6

Ben John (BJ) Limited produces light fittings, and has reputation for constant design innovation. As a result, its products are seen as highly fashionable, but have a short product market life cycle. The new product has been launched using market skimming pricing policy. The industry is highly competitive and only a small number of companies have survived in the industry and those that remain are constantly aiming to develop new products.

Required:

Explain, with reasons, the likely changes that will occur in the unit selling price and in the unit production costs of the product as it moves through each of the four stages of its product life cycle of:

- a. Introduction;
- b. Growth;
- c. Maturity; and
- d. Decline.

(Total 15 Marks)

QUESTION 7

Adrak Nigeria Limited produces five different products, and sells each product in a different market.

The management accountant has obtained the following information about market size and market share for each product which consists of actual data for each of the last three years and forecasts for the next two years:

	2016 Actual	2017 Actual	2018 Actual	2019 Forecast	2020 Forecast
Product 1 (₦'million)					
Total market size	50	58	65	75	84
Product 1 sales	2	2	2.5	3	3.5
Product 2 (₦'million)					
Total market size	150	152	149	153	154
Product 2 sales	78	77	80	82	82
Product 3 (₦'million)					
Total market size	40	50	60	70	80
Product 3 sales	3	5	8	10	12
Product 4 (₦'million)					
Total market size	60	61	61	61	60
Product 4 sales	2	2	2	2	2

Product 5 (N'million)

Total market size	100	112	125	140	150
Product 5 sales	4	5	5.5	6	6.5

In the current year, the market share of the market leader or the nearest competitor to the company has been estimated as follows:

Market share of market leader or the company's nearest competitor

Market for:	%
Product 1	37
Product 2	26
Product 3	12
Product 4	29
Product 5	20

Required:

- Using the Boston Consulting Group model, how should each of these products be classified? (7½ Marks)
 - How will this analysis help the management of the company to make strategic decisions about its future products and markets ('product-market strategy')? (7½ Marks)
- (Total 15 Marks)**

Formulae

Learning curve

$$Y = ax^b$$

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

a = the time taken for the first unit of output

x = the cumulative number of units produced

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

LR = the learning rate as a decimal

Demand curve

$$P = a - bQ$$

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

a = price when Q = 0

$$MR = a - 2bQ$$

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

$$Y = a + bX \text{ or } Y - \bar{Y} = b(x - \bar{X})$$

where

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

$$a = \bar{Y} - b\bar{X}$$

$$\sum Y = na + b \sum X$$

$$\sum XY = a \sum X + b \sum X^2$$

Annuity Table

Present value of an annuity of 1 i.e. $1 - (1 + r)^{-n}$

r

Where r = discount rate

n = number of periods

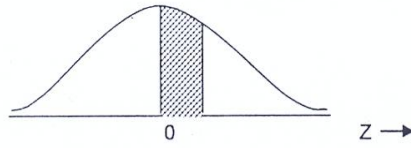
Discount rate (r)

Periods

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

NORMAL DISTRIBUTION

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



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

SOLUTION 1

(a) DASET DRINKS NIGERIA LIMITED

Investment centre

An investment centre is a division within an organisation where the manager is responsible not only for the costs of the division and the revenues, but also for decisions relating to investment in assets for the division. An investment centre manager usually has authority to purchase new assets, such as items of plant or equipment, and so should be responsible for the profit or return that the division makes on the amount that it has invested.

The performance of an investment centre might be measured by calculating the profit as a percentage of the amount invested (The Return on Investments (ROI)). It could also be measured by considering the residual profit after making provision for cost of capital.

An investment centre might include a number of different profit centres. For example, a company manufacturing cars and buses may have two investment centres: (1) car-making and (2) bus-making. Within the bus-making division, there could be several profit centres, each of these being a separate location or factory at which buses are manufactured and assembled.

Profit centre

A profit centre is a department or division within the organisation for which revenues as well as costs are established.

The profit or loss that the centre makes is determined by measuring the costs of the products or services produced by the centre to the revenues earned from selling them.

The following is an example of a summarised profit centre report:

	N'000
Revenues of the profit centre	***
Costs of the units sold by the profit centre	(***)
Profit/(loss) of the profit centre	<u>**</u>

A profit centre may consist of several cost centres. For example, a factory might be treated as a profit centre, and within the factory, the machining department, assembly department and finishing department could be three cost centres.

Revenue centre

A revenue centre is a department or division within the organisation for which revenues are generated. In a revenue centre, there is no measurement of cost or profit. Revenue centre managers will only need to have information relating to revenues and will be accountable for revenues

only. For example, the income accountant in a hospital is only responsible for recording and controlling the different incomes that are received from funding bodies or other sources (for example, private patients, donors, fundraising and so on).

Cost centre

A cost centre is a department or work group for which costs are established, in order to measure the cost of output produced by the centre. For example, in a factory, a group of machines might be a cost centre. The costs of operating the machines would be established, and a cost could then be calculated for each unit of product manufactured by the machines.

In a cost centre, there is no measurement of revenue or profit.

- (b) A divisionalised structure refers to the organization of an entity in which each operating unit has its own management team which reports to a head office. Divisions are commonly set up to be responsible for specific geographical areas or product lines within a large organization.

When an organization has a divisionalised structure, some of the divisions may supply goods or services to the other divisions in the same organization. The division that sells goods or services to other divisions is referred to as selling division. While the division(s) that buy(s) the goods or services is (are) referred to as buying division(s).

The problems likely to be associated with a divisionalised structure include:

- i. The problem of acceptable transfer price between the selling and the buying division. A decision has to be made about what the transfer price should be for goods and services transferred from one division to another;
- ii. Goal congruence – Each divisional manager may be pursuing goals that are good for his/her division but not in the best interest of the organization as a whole. For example, a divisional manager for a division that is an investment centre, may put off buying a needed non – current asset so as to improve his/her return on investment (ROI);
- iii. Top management may lose control over the organization if they allow decentralization without accountability. It will be necessary to monitor divisional performance closely. The cost of such monitoring system may be high;
- iv. Performance Measurement – How to evaluate the performance of the Divisional Managers may pose some problems; and
- v. There may be duplication of functions and functional managers. Each division may have to set up its functional units with managers overseeing the functions.

(c) Ideal transfer Price:

First, what is in the best interest of the company as a whole is determined. For each bottle of soft drink that the company produced and sold, the company makes additional contribution as follow:

	Soft drink	Bottle	Crown cork	Company
	₦	₦	₦	₦
Selling price/Transfer price	100.0	3.0	0.30	
Less: Variable cost of bottle	3.0	3.0	-	
Variable cost of crown cork	0.3	-	0.30	
Variable additional processing costs (80 – (3 + 0.3))	<u>76.7</u>	-	-	
	<u>80.0</u>	<u>3.0</u>	<u>0.30</u>	
Contribution per unit	<u>20.0</u>	<u>NIL</u>	<u>NIL</u>	<u>20.0</u>

If bottling division buys bottles and crown corks internally, the company, as a whole, will make ~~₦~~20.0/unit contribution even though it looks like bottle and crown corks divisions did not contribute anything to the overall contribution.

However, if the bottling division buys bottles and crown cork at external market prices, the company, as a whole, also makes ~~₦~~20 contribution with soft drinks bottle and crown cork divisions making contribution as follows:

	Soft drink	Bottle	Crown cork	Company
	₦	₦	₦	₦
Selling price/Transfer price	100.0	5.0	0.50	
Variable cost (76.7 + 5 + 0.5)	<u>82.2</u>	<u>3.0</u>	<u>0.30</u>	
Contribution	<u>17.8</u>	<u>2.0</u>	<u>0.20</u>	<u>20.00</u>

Ideal Transfer Prices:

Since the external market price of bottles and crown corks are ₦5 and ₦0.5 respectively, and variable costs of production are ₦3 and ₦0.3 respectively, the ideal transfer prices are as follows:

- Bottles; from ₦3 to ₦5.
In view of the current arguments of the divisional managers, ₦5, which is the external market price, will be the most ideal for evaluation of the divisional manager's performance.
- Crown corks; from ₦0.3 to ₦0.5.
In view of the current arguments of the divisional managers, ₦0.5, which is the external market price, will be the most ideal for evaluation of the divisional manager's performance.

- (d) Other qualitative factors the top management needs to consider in taking these decisions include:
- Will the external supplier be able to meet up with the quality that meets with the bottling division's specifications?
 - To protect the company's brand, it is also very important to buy from the internal supplier rather than the external supplier;
 - The company may not be able to control the external supplier as it can do with the internal suppliers;
 - The external suppliers may not be able to meet up with the demand of the bottling division for bottles and crown corks, as the case may be, because they will have to satisfy their other customers as well;
 - **Market conditions:** Would the bottle and crown cork divisions be able to produce and sell all their products in the external market?
 - The need to encourage initiatives of the divisional managers;
 - Loss of market shares if transfers are to be made internally using variable costs; and
 - The level of exposure and experience of the divisional managers.

EXAMINER'S REPORT

The question tests candidates' understanding of the concept of performance evaluation in a divisionalised organisation and differentiate the various responsibility centres and the management problems that may be faced by the organisation.

It also tests the candidates' ability to apply the concept of transfer pricing in advising a company as well as relevant qualitative factors for decision making.

- (a) Candidates are expected to explain and give at least, one example each of Investment Centre, Profit Centre, Revenue Centre and Cost Centres.
- (b) A vivid explanation of the concept of divisionalisation as an organisational structure in identifying its basic features and problems associated with it.
- (c) Candidates are expected to present data on the contributions made by the three divisions respectively, when cost-based (variable costs) and market-based transfer prices are used. This is to arrive at a conclusion and recommended prices for the divisions that will maximise the company's profit and at the same time acceptable to divisional managers. They are also expected to identify and explain two qualitative factors that support the decision made in part c of the question.

About 20% of the candidates showed a good understanding of the various concepts tested in the question.

The commonest pitfall of the candidates in answering the question was their inability to identify and explain the decision-making problems, authority and responsibilities of the respective centres.

Candidates are advised to put in more extensive attention to details while reading and preparing for future examination.

MARKING GUIDE

Description	Marks	Marks
(a) Definition and description of investment centre, profit centre, revenue centre and cost centre 1 mark each	4	
Appropriate example for each 1 mark each	<u>4</u>	8
(b) Description of divisional structure	4	
List of associated problems, at least 4	<u>4</u>	8
(c) Calculation of optimal result for the company as a whole: Contribution of each soft drink bottle, if bottle and crown cork are sourced internally	3	
Contribution of each soft drink bottle, if bottle and crown cork are sourced from the external market	3	
Determination of optimal decision (1 mark each)	2	
Determination of ideal transfer price for bottles	1	
Determination of ideal transfer price for crown corks	<u>1</u>	10
(d) Qualitative factors, at least 2 points at 2 marks each		<u>4</u>
		<u>30</u>

SOLUTION 2

NWOKOCHA AND SONS BAKERY LIMITED

a. CALCULATION OF SALES VARIANCES

(i) Sales Price Variance						
	Standard		Actual		Variance	
	(Std. price x Act. qty)		(Act. price x Act. qty)			
Product F	₦200 x 9,500 = 1,900,000		₦220 x 9,500 = 2,090,000		190,000 F	
Product R	₦250 x 13,500 = 3,375,000		₦260 x 13,500 = 3,510,000		135,000 F	
Product E	₦300 x 8,500 = <u>2,550,000</u>		₦320 x 8,500 = <u>2,720,000</u>		<u>170,000 F</u>	
	<u>7,825,000</u>		<u>8,320,000</u>		<u>495,000 F</u>	
(ii) Sales Volume Profit Variance						
	Budgeted qty	Actual	Difference	Profit Margin	Variance	
		(Actual qty)				
Product F	10,000	9,500	500	101.67	50,835 A	
Product R	13,000	13,500	-500	126.83	63,415 F	
Product E	<u>9,000</u>	<u>8,500</u>	<u>500</u>	144.78	<u>72,390 A</u>	
	<u>32,000</u>	<u>31,500</u>	<u>500</u>		<u>59,810 A</u>	
(iii) Sales Mix Profit Variance						
	Standard Mix		Actual Mix	Difference	Profit Margin	Variance
	(Std. proportion x Actual qty)					
Product F	10,000/32,000 x 31,500 = 9,844		9,500	344	101.67	34,974 A
Product R	13,000/32,000 x 31,500 = 12,797		13,500	-703	126.83	89,161.49 F
Product E	9,000/32,000 x 31,500 = <u>8,859</u>		<u>8,500</u>	<u>359</u>	144.78	<u>51,976 A</u>
	<u>31,500</u>		<u>31,500</u>	<u>0</u>		<u>2211.49 F</u>
(iv) Sales quantity Profit Variance						
	Standard Yield	Actual Yield		Difference	Profit Margin	Variance
	(Budgeted qty)	(Std. proportion x Actual qty)				
Product F	10,000	9,844		156	101.67	15,861 A
Product R	13,000	12,797		203	126.83	25,746.49 A
Product E	<u>9,000</u>	<u>8,859</u>		<u>141</u>	144.78	<u>20,414 A</u>
	<u>32,000</u>	<u>31,500</u>		<u>500</u>		<u>62,021.49 A</u>

Calculation of Standard Profit Margin						
Product	Selling price (₦)	Direct Material (₦)	Direct Labour (₦)	Variable expenses (₦)	Fixed overhead (₦)	Profit Margin (₦)
F	200	(75)	(12)	(6)	(5.33)	<u>101.67</u>
R	250	(90)	(15)	(7.50)	(10.67)	<u>126.83</u>
E	300	(114)	(18)	(9)	(14.22)	<u>144.78</u>

- $$\text{OAR} = \frac{\text{Fixed Production Overhead (FPOH)}}{\text{Budgeted Machine hours}} = \frac{\text{₦3,840,000}}{216,000} = \text{₦17.78/machine hr}$$

Where OAR = Overhead Absorption Rate

Budgeted Machine hours per annum = (0.3hr x 10,000 x 12mths) + (0.6hr x 13,000 x 12mths) + (0.8hr x 9,000 x 12mths) = 216,000hrs

Therefore, fixed overhead per unit for;

Product F = 0.3hr x ₦17.78 = ₦5.33

Product R = 0.6hr x ₦17.78 = ₦10.67

Product E = 0.8hr x ₦17.78 = ₦14.22

(b) Budgeted Profit

Monthly budgeted Sales	₦	₦
F = 200 x ₦10,000 =	2,000,000	
R = 250 x ₦13,000 =	3,250,000	
E = 300 x ₦9,000 =	<u>2,700,000</u>	7,950,000
Less Standard cost		
Material: F = 25 x 3 x ₦10,000	750,000	
R = 30 x 3 x ₦13,000 =	1,170,000	
E = 38 x 3 x ₦9,000 =	<u>1,026,000</u>	(2,946,000)
Labour: F = 1.2 x 10 x ₦10,000	120,000	
R = 1.5 x 10 x ₦13,000	195,000	
E = 1.8 x 10 x ₦9,000	<u>162,000</u>	(477,000)
Variable Expenses:	₦	₦
F = 1.2 x 5 x ₦10,000	60,000	
R = 1.5 x 5 x ₦13,000	97,500	
E = 1.8 x 5 x ₦9,000	<u>81,000</u>	(238,500)
Monthly Budgeted Fixed overhead		
₦3,840,000 /12		<u>(320,000)</u>
Budgeted Profit =		<u>3,968,500</u>

(c) Significance of mix variances in standard costing system.

Variance analysis generally, is important for performance evaluation, cost control and management by exception. A firm operating a standard costing system calculates variances for each element of cost for which standards have been set.

Increase in efficiency

Mix variance analysis helps in increasing the efficiency as well as effectiveness of production;

Proper decisions

Mixed variances are also helpful for taking proper decisions for deciding cost which will help management in reducing cost burden.

EXAMINER'S REPORT

The question tests candidates' understanding and knowledge of calculating sales price variances, sales volume variance, sales mix profit and the significance of mix variances in standard costing system.

The points expected to be raised include evaluating individual performances between attained performance and desired performance, assigning responsibilities to individuals top management drawing their attention only to exceptional variances and increase in the efficiency of production, effective utilisation of resources, using the principle of management by exception.

Candidates' understanding of the question was not encouraging as most of them were using selling price instead of contribution margin. The candidates did not have good understanding of variance analysis. About 80% of them did not take into consideration the fixed cost element in determining the profit of each product.

The commonest pitfalls could be traced to lack of knowledge and understanding of the topic. Candidates' inability to calculate mix variance and the fact that they could not identify correctly whether the variances are favourable or adverse.

Candidates should pay more attention to the nitty gritty of standard costing with emphasis on variance analysis and make better use of relevant text books on the topic, while preparing for future examinations.

MARKING GUIDE

	Marks	Marks
2. ai. Computation of sales price variance 4 ticks at $\frac{1}{2}$ mark each	2	
ii. Computation of sales volume profit variance 4 ticks at $\frac{1}{2}$ mark each	2	
iii. Computation of sales mix profit variance 6 ticks at $\frac{1}{2}$ mark each	3	
iv. Computation of sales quality profit variance 6 ticks at $\frac{1}{2}$ mark each	<u>3</u>	10
b. Determination of monthly budgets profit 18 ticks at $\frac{1}{3}$ mark each		6
c. Discussion of significance of a mix variances Any 4 points out of 7 points at 1 mark each		<u>4</u>
		<u>20</u>

SOLUTION 3

ADETOY NIGERIA LIMITED

(a)

i. **INCREMENTAL COST**

An incremental cost is an additional cost that will be incurred if a particular decision is taken. An incremental cost is a relevant cost provided that this additional cost is a cash flow,

ii. **DIFFERENTIAL COST**

A differential cost is the amount by which future costs will be different, depending on which course of action is taken. A differential cost is therefore an amount by which future costs will be higher or lower, if a particular course of action is chosen. Provided that this additional cost is a cash flow, a differential cost is a relevant cost.

Example:

A company needs to hire a bus for the next six months. It has to decide whether to continue using a particular type of bus, which it currently rents for ₦25,000 each month, or whether to switch to using a bigger bus that will cost ₦36,000 each month. If it hires the bigger bus, it will be able to terminate the rental agreement for the current bus immediately.

The decision is whether to continue with using the current bus, or to switch to the bigger bus.

One way of analysing the comparative costs is to say that the bigger bus will be more expensive to rent, by ₦11,000 each month for six months.

The differential cost of hiring the bigger bus for six months would therefore be ₦66,000.

iii. **AVOIDABLE AND UNAVOIDABLE COSTS**

An avoidable cost is a cost that could be saved (avoided), depending whether or not a particular decision is taken. An unavoidable cost is a cost that will be incurred anyway.

- ☐ Avoidable costs are relevant costs.
- ☐ Unavoidable costs are not relevant to a decision.

Example:

A company has one year remaining on a short-term lease agreement on a warehouse. The rental cost is ₦500,000 per year. The warehouse facilities are no longer required, because operations have been moved to another warehouse that has spare capacity.

If a decision is taken to close down the warehouse, the company would be committed to paying the rental cost up to the end of the term of the lease. However, it would save local taxes of ₦56,000 for the year, and it would no longer need to hire the services of a security company to look after the empty building, which currently costs ₦240,000 each year.

The decision about whether to close down the unwanted warehouse should be based on relevant costs only.

Local taxes and the costs of the security services (₦296,000 in total for the next year) could be avoided and so these are relevant costs.

The rental cost of the warehouse cannot be avoided, and so should be ignored in the economic assessment of the decision whether to close the warehouse or keep it open for another year.

iv. **COMMITTED COST**

Committed costs are a category of unavoidable costs. A committed cost is a cost that a company has already been committed to or an obligation already made, that it cannot void by any means.

Committed costs are not relevant costs for decision making.

Example:

A company bought a machine one year ago and entered into a maintenance contract for ₦240,000 per annum for three years.

The machine is being used to make an item for sale. Sales of this item are disappointing and are only generating ₦150,000 per annum and will remain at this level for the next two years.

The company believes that it could sell the machine for ₦250,000.

The relevant costs in this decision are the selling price of the machine and the revenue from sales of the item.

If the company sells the machine it would receive ₦250,000 but lose ₦300,000 revenue over the next two years – an overall loss of ₦50,000

The maintenance contract is irrelevant as the company has to pay ₦240,000 per annum whether it keeps the machine or sells it.

Leases normally represent a committed cost for the full term of the lease, since it is extremely difficult to terminate a lease agreement.

v. **SUNK COSTS**

Sunk costs are costs that have already been incurred (historical costs) or costs that have already been committed by an earlier decision. Sunk costs must be ignored for the purpose of evaluating a decision, and cannot be relevant costs.

Example:

A company must decide whether to launch a new product into the market.

It has spent ₦1.9m on developing the new product, and a further ₦750,000 on market research.

A financial evaluation for a decision whether or not to launch the new product should ignore the development costs and the market research costs, because the ₦2.65m has already been spent. The costs are sunk costs.

vi. **OPPORTUNITY COSTS**

Relevant costs can also be measured as opportunity costs. An opportunity cost is a benefit that will be lost by taking one course of action instead of the next-most profitable course of action.

Example:

A company has been asked by a customer to carry out a special job. The work would require 50 hours of skilled labour time. There is a limited availability of skilled labour, and if the special job is carried out for the customer, skilled employees would have to be moved from doing another work that earns a contribution of ₦6,000 per labour hour.

A relevant cost of doing the job for the customer is the contribution that would be lost by switching employees from other work. This contribution forgone (i.e $50 \text{ hours} \times ₦6,000 = ₦300,000$) would be an opportunity cost.

This cost should be taken into consideration as a cost that would be incurred as a direct consequence of a decision to do the special job for the customer. In other words, the opportunity cost is a relevant cost in deciding how to respond to the customer's request.

- (b) i. The relevant cost of labour is zero as no extra cost will be incurred as a result of this contract.
- ii. The relevant cost of a material that is used regularly is its replacement cost. Additional inventory of the material must be purchased for use in this contract. The relevant cost of material X is therefore ₦1,800 per tonne i.e. $₦1,800 \times 100 = ₦180,000$
- There is a relevant saving from using material Y from not having to pay the disposal cost of ₦240,000.
- iii. As the company has already leased the storage unit for one year, the monthly rental cost is not relevant to the contract. However, the opportunity cost is the foregone rental income that the company would have made from the neighbouring business for the three months needed for this contract. i.e. $3 \times ₦110,000 = ₦330,000$.
- iv. The fixed overhead is not relevant because there is no increment to fixed overheads expected as a result of this contract. Therefore the relevant overhead cost is just the variable part of ₦250 per hour \times 2,000 hours = ₦500,000.

So, the total relevant cost is ₦770,000 as follows:

Description	Relevant cost ₦
Labour	-
Material X	180,000
Material Y	(240,000)
Storage	240,000
Storage	90,000
Overheads	<u>500,000</u>
Total	<u>770,000</u>

Conclusion: The contract should be accepted as it would make an incremental profit to the company, i. e, ₦1,230,000 (revenue of ₦2,000,000 less relevant costs of ₦770,000).

EXAMINERS REPORT

The question tests candidates' understanding of Relevant Costing as a tool for management decision making.

Candidates are expected to demonstrate their knowledge on:

- (i) Incremental cost, Additional cost, Relevant cost and extra unit produced;

- (ii) Differential cost – comparison between two alternative costs; and
- (iii) Sunk cost – past cost and irrelevant cost.
- (iv) Committed cost – irrelevant, obligatory and committed expenses that must be paid.

About 80% of the candidates who attempted the question scored 50% or above of the allocated marks.

Commonest pitfall of the candidates who did not do well was their inability to identify the relevant cost especially on labour and opportunity cost.

Candidates are advised to make better use of standard texts, such as the Institute's Pathfinder past editions and Study Text.

MARKING GUIDE

	Marks	Marks
(a) Discussion of each of the 6 concepts (2 marks each)		12
(b) i. Calculation of Total Relevant Cost	6	
ii. Heading	$\frac{1}{2}$	
iii. Advice/Accept	$\frac{1}{2}$	
iv. Basis of Acceptance	<u>1</u>	<u>8</u>
		<u>20</u>

SOLUTION 4

- (a) Project management has nine key elements. The responsibilities of the project manager will be to manage each of these nine elements.

- **Scope**

At the outset of the project, the project manager will define the scope of the project and set objectives. These will then need to be agreed with the Board of Directors before the project begins and form the basis for the overall project direction;

- **Risk management**

The project manager will be responsible for identifying any major risk associated with the project (e.g. a supplier delivering late), and managing these risks through transferring risks to other parties, avoiding risks or accepting them and managing the consequences as they happen;

- **Integration**
The project manager will need to develop plans for the development and implementation of the new systems. This will ensure that the process happens quickly and easily and uses the resources in the best way.

To integrate the new system into the organisation, these plans will need to consider change in management issues. People have been using the old system for a while and will need to adapt to the change in approach. It may also mean changing job roles and working practices which could cause conflict and staff dissatisfaction if not effectively managed;
- **Time**
Each of the activities will need to be defined and their duration estimated. They can then be sequenced and time schedules made, using techniques such as Gantt Charts or Network Analysis. This will help to ensure that the project is well organised and co-ordinated;
- **Cost**
A budget for the project must be defined. This might be done through cost estimates from suppliers or by costing each specific element of the project individually. Throughout the course of the project, the project manager will need to monitor costs and take control action if costs are not in line with budget;
- **Quality**
It is project manager's responsibility to develop the Project Quality Plan which outlines expected quality of the new information and systems. They will need to monitor progress against this plan and ensure that the quality objectives are met. This will mean ensuring that the systems are developed by experienced suppliers and adequate testing is undertaken prior to the system going live;
- **Resources**
This will involve the acquisition and effective management of staff, materials, buildings and equipment, and ensuring that each of these resources is adequately co-ordinated and managed;
- **Communication**
Communication to all stakeholders will need to be undertaken on a regular basis. This will include reporting to the Board of Directors on progress, and agreeing with any major changes in the scope.

It will also involve good team communication and management to ensure team members remain motivated and committed to the project;

- **Procurement**

The project manager will be responsible for procuring goods and services from external suppliers. This is likely to include the design and development of the new information system since ABC Limited has little in-house expertise; and

- **Motivation**

Motivation is a key role in managing people for productivity, hence every team member should be given the opportunity to own the tasks assigned to him/her. The project manager is expected to provide the required enabling environment for team members to excel.

(b) The skills required by the project manager are as follows:

- **Change management skills**

He/She will have to be skilled in understanding the people aspects of the change and helping to overcome resistance to change. This may involve knowledge of change management tools;

- **IT skills**

Since the project is IT-based, some IT knowledge and ability will help the project manager to understand the key issues and negotiate effectively with suppliers;

- **Leadership**

Leadership involves obtaining results through personal direction and influence. The project manager will need to be able to create a vision for the team, be assertive, inspire and motivate staff;

- **People skills**

The project manager will need to understand the concerns and motivations of team members and to effectively manage them. This may involve the use of a suitable management style and understanding of approaches to motivation of staff. The aim will be to create a motivated and happy team that works well to achieve the project's goals;

- **Communication skills**

A key role of the project manager is communication with staff, suppliers or the Board of Directors. He/She will therefore have to be

able to use a variety of communication methods (i.e. presentations, meetings, reports, e-mails) and know when to use these appropriately and be skilled at using each;

- **Problem-solving and decision-making skills**

There will inevitably be many decisions to be taken during the course of the project and problems to be overcome. The project manager needs to be an analytical thinker who will be able to solve problems as they arise and who is firm and decisive so that the project is not delayed;

- **Negotiation skills**

Negotiation with suppliers and internal departments is an inevitable part of the process. The project manager will need to understand the basis of negotiation in order to ensure the best outcomes are achieved for the organisation. This may involve being able to understand leverage points over potential suppliers, to see the other parties' perspective being firm and willing to walk away when the deal is not right; and

- **Planning skills**

The project manager will need project planning skills, and need to be able to use project management software to make and monitor plans. Knowledge of techniques such as Gantt Chart and Network Analysis will facilitate this process.

Some basic financial knowledge or expertise would be an asset to help with the budgeting and cost monitoring process.

EXAMINER'S REPORT

The question tests candidates' understanding of Project Management with emphasis on the roles/responsibilities and the skills required of a project manager.

Candidates were expected to list the responsibilities of a project manager, discuss each of the responsibilities and also list the skills of a project manager describing each of the skills.

The candidates showed lack of understanding of the requirements of the question. Performance was poor as about 50% of the candidates who attempted the question scored below 50% of the allocated mark.

The inability of the candidates to differentiate between the role/responsibility of a project manager and that of ICT manager and not having clear understanding of

responsibilities and skills required by a project manager for successful implementation of programme/project is their major pitfall.

Candidates are advised to understand the requirement of the question before attempting it. They need to cover the syllabus and practise questions and answer provided in the ICAN Pathfinder and Study Text.

MARKING GUIDE

Marks

(a)	2 marks per responsibility identified and explained, maximum of 5	10
(b)	2 marks per relevant skill identified and explained, maximum of 5	<u>10</u>
		<u>20</u>

SOLUTION 5

(a) i.

CLASSIC WEARS LIMITED

Computation of Machine Limited Hours

	Machine I HRS	Machine II HRS
Sales Requirements:		
Trouser:		
1,250 x 2	2,500	
1,250 x 3		3,750
Jackets:		
1,500 x 4	6,000	
1,500 x 6		9,000
Skirts:		
2,500 x 6	15,000	
2,500 x 2		<u>5,000</u>
Total hours needed	23,500	17,750
Less: Total hours available	<u>19,600</u>	<u>18,000</u>
Deficit/Surplus	<u>(3,900)</u>	<u>250</u>

Based on the above, machine 1 hours represent the limiting factor because the hours available are lower than required.

ii. **Determination of Ranking**

Products	Trouser	Jacket	Skirt
Selling Price	₦2,300	₦3,200	₦2,480
Less: variable costs	<u>₦1,800</u>	<u>₦2,500</u>	<u>₦1,700</u>
Contribution	<u>₦500</u>	<u>₦700</u>	<u>₦780</u>
Machine hour required: Type I	2	4	6
Contribution per hour	₦250	₦175	₦130
Ranking	1 st	2 nd	3 rd

iii. **Determination of Production Plan**

	Hrs per unit	Hrs available ¾ Production	Hrs Utilised	Hrs Rem. After plan	Production achieved
T: 1,250 x 2	2	19,600	2,500	17,100	1,250
J: 1,500 x 4	4	17,100	6,000	11,100	1,500
S: (11,100 ÷ 6) = 1.850	6	11,100	11,100	NIL	1,850

Production Plan

Trouser = 1,250 ; Jacket = 1,500 ; Skirt = 1,850

Workings

Estimated production

Estimated sales ÷ Estimated Selling Price

Trouser = $\frac{₦2,875,000}{₦2,300} = 1,250$ units

Jacket = $\frac{₦4,800,000}{₦3,200} = 1,500$ units

Skirts = $\frac{₦6,200,000}{₦2,480} = 2,500$ units

b. **Computation of Optimum profit**

	Trouser ₦	Jacket ₦	Skirt ₦	Total ₦
Unit (A)	1,250	1,500	1,850	
Unit contribution (B)	500	700	780	
Total Contribution (A x B)	625,000	1,050,000	1,443,000	3,118,000
Less Fixed Cost				
Block A Machine	980,000			
Block B Machine	750,000			
Block C Machine	<u>370,000</u>			<u>2,100,000</u>
Total optimum profit				<u>1,018,000</u>

EXAMINER'S REPORT

The question tests candidates' knowledge of Marginal Costing involving the application of limiting factors in the determination of optimum company's profit.

Candidates were expected to address the following points:

- (a) Determination of machine I, as the limiting factor out of machines I and II for each product;
- (b) Contribution per machine I hours for each product;
- (c) Product ranking;
- (d) Production hour's utilised in producing each of the three products; and
- (e) Units turned out for each product and optimum company's profit.

About 90% of the candidates attempted the question. About 50% of the candidates who attempted the question scored 50% or above of the allocated marks.

Candidates' commonest pitfall was that some of them took the requirements of units and Naira of sales as same and not able to calculate beyond the determination of contribution per hour.

Candidates are advised to put in more effort while preparing for future examinations and pay more attention on this aspect of the syllabus.

MARKING GUIDE

	Marks	Marks
(a) Determination of Optimal Production		
i. Computation of sales in units for each product		1
ii. Computation of machine limiting hours (Deficit/Surplus)		
- Machine I	1½	
- Machine II	1½	
- Machine Limitation	<u>1</u>	4
iii. Determination of contribution		
Trouser	1¼	
Jacket	1¼	
Skirt	1¼	
Ranking	<u>¼</u>	4
iv. Computation of machine time required:		
Machine time	1½	
Production plan	<u>1½</u>	3
(b) Computation of total profit from plan		
i. Contribution	1¼	
ii. Fixed cost	1¼	
iii. Profit	<u>½</u>	<u>3</u>
Total		<u>15</u>

SOLUTION 6

The company has just launched an innovative new product using a market skimming pricing policy. This means that the selling price of the product is high and thus, the product is only available to a small segment of the market that can afford to pay the high price for something that is unique and innovative.

The four stages to the product life cycle of each of unit selling price and unit production cost are Introduction, Growth, Maturity and Decline.

Unit Selling Price

Introduction: The initial selling price will be high as this will quickly recover the development costs of the product. The High Net Worth customers will not be deterred from buying the product as it will be sold on the basis of its uniqueness rather than its price.

Growth Stage: Unit selling price is likely to be reducing for a number of reasons.

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

Maturity Stage: As the product enters the maturity stage, the price will need to be lowered further, possibly by short-term one-off offers or discounts for multiple purchases so that the product continues to be financially viable for as long as possible.

Decline Stage: When the product enters the decline stage, the price will be lowered to marginal cost or even lower in order to sell off inventories of what is now an obsolete product as it has been replaced by a more technologically advanced product.

Unit Production Costs:

Introduction: Production costs are also likely to change throughout the product's life cycle. Initially, production costs may be high due to low volume of activity and the level of fixed costs being incurred to provide the production facility. In addition, the labour and related costs are likely to be high as the employees have not yet become experienced in making the product.

Growth Stage: Unit production costs are likely to reduce for the following reasons:

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

The extent of the decrease in unit labour cost in particular, and its speed will depend on the complexity of the manufacturing process, its similarity to previous products, the experience and level of retention of the workforce.

Maturity Stage: In the maturity stage, production costs per unit are likely to remain fairly constant because the learning period will have ended, the workforce will be experienced in producing and in handling the raw materials and operating the machinery.

Costs are incurred to maintain manufacturing capacity, marketing and product enhancement cost to extend maturity

Decline Stage: In the decline stage, production costs per unit may increase due to both lower volume and high workforce being less interested in a declining product and trying to learn new skills in relation to other products.

Close attention to cost is needed as withdrawal decision might be expensive.

EXAMINER'S REPORT

The question tests candidates' understanding of product market life cycle, behavioural pattern with regards to unit selling price and unit production cost when market skimming pricing policy is used.

Candidates are expected to explain, with reasons, the effect on unit selling price and unit production cost as the product goes through the four stages of its life cycle.

About 70% of the candidates did not fully understand the requirements of the question and they left parts of the question unanswered thus losing vital marks allocated. About 30% who attempted the question scored 40% or above of the marks allocated.

Candidates' commonest pitfall is their inability to fully provide solution to the question thereby leading to loss of marks.

Candidates are advised to work harder while preparing for future examinations by covering all aspects of the syllabus and make better use of the Institute's Study Text, past edition of Pathfinder and relevant text books for future examinations.

Marking Guide	Marks	Marks
Introduction	1	
Price – relevant comments at the various stages	7	
Cost – same as price	<u>7</u>	<u>15</u>

SOLUTION 7

ADRAK NIGERIA LIMITED

Boston Consulting Group Model (Matrix)

		Relative Market Share	
		High	Low
Market Growth	High	Stars	Question Marks
	Low	Cash Cows	Dogs

- (a) A star is a product in a market that is growing quickly, where the company's product has a large market share or where the market share is increasing. Product 3 appears to be a star. The total market is expected to double in size between Year 2016 and Year 2020. The expected market share in two years' time is 15% compared with 7.5% in Year 2. Its market share in the current year is over 13%, which makes it the current market leader.

A cash cow is a product in a market that has little or no growth. The market share, however, is normally quite high, and the product is therefore able to contribute substantially to operational cash flows. Product 2 appears to be a cash cow. In the current year, its market share was over 53% and it is the market leader.

A dog is a product in a market with no growth where the product has a low share of the market. Dogs are likely to be loss-making and its cash flows are probably negative. Product 4 appears to be a dog. The total market size is not changing, and the market share for product 4 is only about 3%. This is much less than the 29% market shares of the market leader.

A question mark is a product with a low market share in a market that is growing fairly quickly. Product 1 appears to be a question mark. The total market is growing quite quickly, but the market share of Product 1 is about 4% and this is not expected to change. Product 5 also appears to be a question mark for the same reason.

- (b) This model will help the company to decide on its strategy for the products it will sell. The company may therefore, decide as follows:
- i. It should benefit from the cash flows generated by its only cash cow, i.e. Product 2;
 - ii. It should invest in its star, i.e. Product 3, with the objective that this will eventually become a cash cow;
 - iii. It should give serious consideration to abandoning its dog, i.e. Product 4, and withdrawing it from the market;
 - iv. It has to make a decision about its two question marks, i.e. Product 1 and Product 5. The main question is whether either of these products can become a star and cash cow. Additional investment and a change of strategy for these products might be necessary in order to increase market share; and
 - v. For all the products (with the exception of Product 4, if this is abandoned) the company should also consider ways of making the products more profitable. Techniques, such as value chain analysis, might help to identify cost savings.

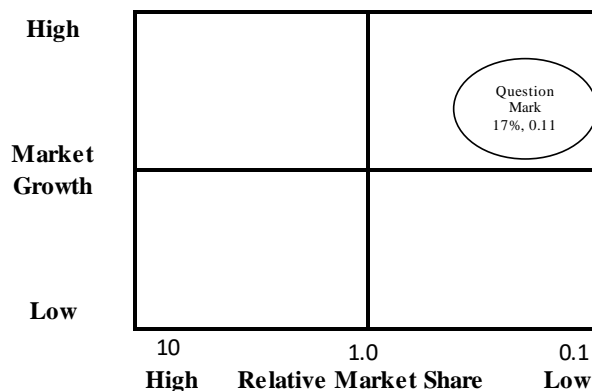
ALTERNATIVE SOLUTION TO QUESTION 7

ADRAK NIGERIA LIMITED

a. PRODUCTS CLASSIFICATION USING BOSTON CONSULTING GROUP (BCG) MODEL

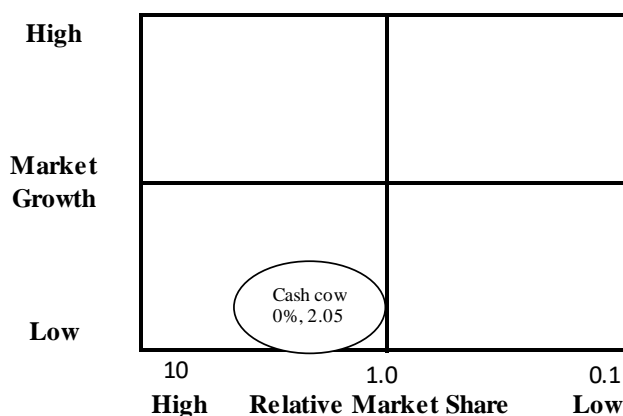
Product 1 appears to be a question mark. A question mark is a product with a fairly low market share in a market that is growing fairly quickly. The total market is growing quite quickly, but the market share of Product 1 is about 4% (i.e. $3.5/84 \times 100\%$) and this is not expected to change.

Product 1



Product 2 appears to be a cash cow. A cash cow is a product in a market that has little or no growth. The market share, however, is normally quite high, and the product is therefore able to contribute substantially to operational cash flows. In the current year, its market share was over 53% (i.e. $82/154 \times 100\%$), and it is the market leader.

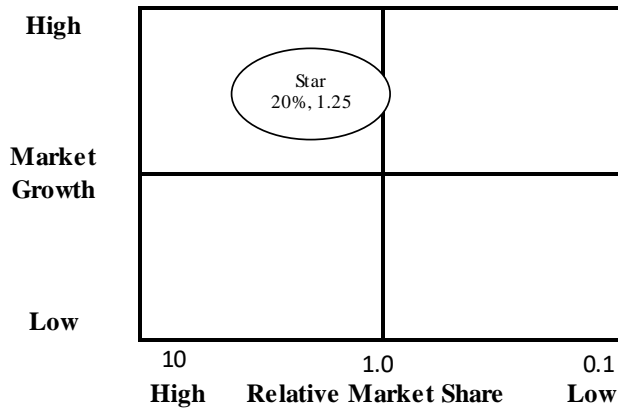
Product 2



Product 3 appears to be a star. A star is a product in a market that is growing quickly, where the company's product has a large market share or where the market share is increasing. The total market is expected to double in size between 2016 and 2020. The expected market share in two years' time is 15% (i.e. $12/80 \times 100\%$), compared with 7.5% (i.e. $3/40 \times 100\%$) in

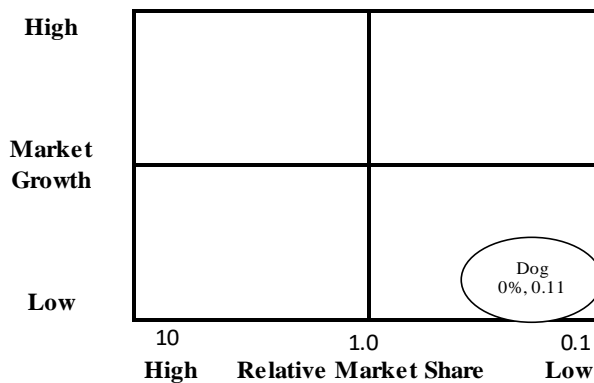
2016. Its market share in the current year is over 13% ($8/60 \times 100\%$), which makes it the current market leader.

Product 3



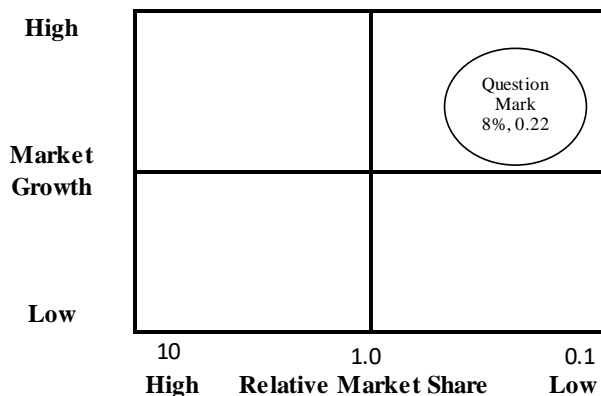
Product 4 appears to be a dog. A dog is a product in a market with no growth, and where the product has a low share of the market. Dogs are likely to be loss-making and its cash flows are probably negative. The total market size is not changing, and the market share for Product 4 is only about 3% (i.e. $2/60 \times 100\%$). This is much less than the 29% market share of the market leader.

Product 4



Product 5 also appears to be a question mark. A question mark is a product with a fairly low market share in a market that is growing fairly quickly. The total market is growing quite quickly, but the market share of Product 5 is about 4% (i.e. $6.5/150 \times 100\%$) and this is not expected to change.

Product 5



% Trend Analysis

	2016 Actual	2017 Actual	2018 Actual	2019 Forecast	2020 Forecast	Market share of market leader
$\frac{\text{Product sales}}{\text{Total market share}} \times 100$	%	%	%	%	%	%
Product 1	4.00	3.45	3.85	4.00	4.167	37
Product 2	52.00	50.66	54.00	53.69	53.59	26
Product 3	7.5	10.00	13.33	14.29	15.00	12
Product 4	3.33	3.28	3.28	3.28	3.33	29
Product 5	4.00	4.46	4.46	4.29	4.33	20

EXAMINER'S REPORT

The question tests candidates' knowledge of Boston Consulting Group (BCG) model as it affects market performance of multi-products organisation and their ability to use the BCG model to make strategic decisions about future products and markets.

The question expects the candidates to classify the products using all the quadrants in the BCG model viz STARS, CASH COWS, QUESTION MARKS and DOGS and ability to explain each. Candidates are also expected to use the classification of products to make strategic decision on future of the products and the market performance.

About 60% of the candidates attempted the question out of which about 20% scored 50% or above of the marks allocated.

The candidates' commonest pitfall was their inability to correctly draw and interpret the BCG matrix. They were not able to calculate the trend analysis, in percentage form, which is necessary to determine the relative growth rate and market share.

Candidates are advised to create time to study and read widely in preparing for future examinations and also make better use of the ICAN Study Text with other relevant study materials.

Marking Guide

	Marks	Marks
(a) Model (Matrix)	1½	
% Trend Analysis	1	
Star – Product 3	1	
Cash cow – (Product 2)	1	
Dog – Product 4	1	
Question mark – Product 1	1	
Question mark – Product 5	<u>1</u>	7½
Alternative Solution		
Model (Matrix)	1½	
% Trend Analysis	1	
Product 1	1	
Product 2	1	
Product 3	1	
Product 4	1	
Product 5	<u>1</u>	<u>7½</u>
(b) Any five points out of six at 1½ marks per point		<u>7½</u>
Total		<u>15</u>

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION - MAY 2018

AUDIT AND ASSURANCE

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

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

SECTION A: COMPULSORY (30 MARKS)

QUESTION 1

The following figures were supplied by a small business client to your firm regarding its non-current assets for the year ended 31 December 2016:

	GENERATING PLANT ₦	EQUIPMENT ₦	FURNITURE & FITTINGS ₦	MOTOR VEHICLES ₦
Non-current assets:				
Opening balance	400,000	3,637,000	247,000	1,450,000
Additions	-	530,000	-	-
Disposal	-	-	-	(400,000)
Closing Balance	400,000	4,167,000	247,000	1,050,000
Depreciation:				
Opening balance	160,000	873,000	59,800	859,000
Charge for the year	80,000	416,700	24,700	260,000
Charge on disposal	-	-	-	(236,966)
Closing Balance	240,000	1,289,700	84,500	882,034

Required:

- Identify **FIVE** substantive procedures you will carry out to verify additions to the assets in 2016. (10 Marks)
 - Explain **FIVE** substantive procedures for verifying disposal of assets during the year. (10 Marks)
 - Explain briefly **FOUR** of the statutory books that the auditor is required to audit in the course of his audit engagement in an entity. (10 Marks)
- (Total 30 Marks)

SECTION A
SOLUTION 1

- (a) **Substantive procedures that will be carried out to verify additions to non-current assets in 2016 include:**
- i. Obtain/prepare a schedule of additions for the period;
 - ii. Check the authorisation of the expenditure to purchase these additions;
 - iii. Confirm that the total additions reconcile with the movement between the opening and closing balances in the notes to the financial statements;
 - iv. Inspect the purchase invoice or other documents as evidence of the cost of any addition, and confirm that these documents are in the company's name;
 - v. Verify the existence of the acquired non-current assets, by means of physical inspection where appropriate;
 - vi. Check that the entries in the accounting records are correct, confirming the allocation of total expenditure between capital and revenue expenditure; and
 - vii. Check for post-acquisition related or corroborative evidence such as cost of installation, insurance, servicing and maintenance of the asset.
- (b) **Substantive procedures that will be carried out to verify disposal of non-current assets in 2016 include:**
- i. Obtain/prepare a schedule of disposals for the period;
 - ii. Check the authorisation of the disposals;
 - iii. Verify that the cost and related accumulated depreciation have been removed from the accounting records;
 - iv. Verify the calculation of the figure for the profit or loss on disposal, and verify that this figure has been correctly recorded in the accounting records i.e. asset account, accumulated depreciation account and disposal account;
 - v. Discuss with management the possibility of unrecorded disposals of assets; and
 - vi. Check for post-disposal related or corroborative evidence such as stoppage of costs for insurance, servicing and maintenance of the asset.
- (c) **The statutory books that the auditor is required to audit during the course of his audit engagements are:**
- i. Copies of directors' service contracts and details of directors' remuneration packages: the audit work to be performed on this area

- should confirm that relevant legal disclosure requirements are complied with;
- ii. Minutes of board meetings and minutes of general meetings of the Company: The auditor should also audit the minutes of board meetings and minutes of general meetings of the company in the course of carrying out his audit engagements, especially to ensure that appropriate decisions are duly approved;
 - iii. Register of directors and their interests in the shares and loan capital of the company: The register of directors and their percentage interest in the company should also be worked on during the course of carrying out the audit engagements; and
 - iv. Register of members/shareholders: the register of all members and shareholders of the company should also be taken into consideration while carrying out the audit engagements to confirm members' shareholdings.

EXAMINER'S REPORT

The question is compulsory and tests in parts (a) and (b) substantive procedures to verify additions to and; disposals of non-current assets respectively. Part (c) tests candidates on statutory books.

Almost all the candidates attempted the question.

Candidates generally showed fair understanding of parts (a) and (b) hence performance was fair. The performance of candidates was poor in part (c).

The short comings of candidates were mixing up of solutions to (a) and (b) and non utilization of study materials especially the Institute's Study Text.

Candidates are advised to study well, especially the Institute's Study Texts when preparing for the Institute's future examinations.

MARKING GUIDE

	Marks
a. Substantive procedures to verify additions to assets 2 marks x 5 points (maximum)	10
b. Substantive procedures to verify assets disposals 2 marks x 5 points (maximum)	10
c. Statutory books to be audited 2½ marks x 4 points	<u>10</u> <u>30</u>

SOLUTION 2

(a) Sufficiency of Audit Evidence

Deciding on whether existing audit evidence is sufficient is a matter of judgement by the auditor. The sufficiency (i.e. quantity) of audit evidence required will depend largely on the following:

- i. The quality of that evidence. The quality will depend on the source of the evidence and its reliability;
- ii. The seriousness of the risk that the financial statements might not give a true and fair view. When this risk is high, more audit evidence will be required;
- iii. The materiality of the item;
- iv. The strength of the internal controls in the client's accounting systems; and
- v. The sampling method that the auditor will use to obtain the audit evidence, the chosen method will affect the size of the audit sample that the auditor requires.

(b) Reliability of Audit Evidence

There are a number of general principles set out in ISA 500 to assist the auditor in assessing the reliability of audit evidence. These can be summarised as follows:

- i. Audit evidence is more reliable when it is obtained from independent sources outside the entity under audit. Bank balances confirmed by the bank itself is considered a more reliable source of audit evidence than the ones obtained from the entity's accounting records;
- ii. Internally generated audit evidence is more reliable when the related controls are effective;
- iii. Audit evidence obtained directly by the auditor is more reliable than audit evidence obtained indirectly or by inference. For example, observation of the operation of a control by the auditor is more reliable than inquiry about the operation of that control;
- iv. Audit evidence is more reliable when it exists in documentary form. This could be paper, electronic or other medium. For example, a written record of a meeting made at the time is more reliable than a subsequent oral representation of the matters discussed;
- v. Audit evidence provided by original documents or documents certified by the courts is more reliable than audit evidence provided by photocopies, documents that have been filmed or otherwise transformed into electronic form. This is because the reliability of those other forms may depend on the controls over their preparation and maintenance.

(c) Relevance of Audit Evidence

There are a number of general principles set out in ISA 500 to assist an auditor in assessing the relevance of audit evidence. These can be summarised as follows:

- i. Relevance deals with the logical connection with, or bearing upon, the purpose of the audit procedure, and, where appropriate, the assertion under consideration. For example, relevance may be affected by the direction of testing, such as, when testing for overstatement in the existence or valuation of accounts payable, testing the recorded accounts payable may be a relevant audit procedure. On the other hand, when testing for understatement, testing the recorded accounts payable would not be relevant, but rather testing subsequent disbursements, unpaid invoices, suppliers' statements and unmatched receiving reports may be relevant;
- ii. A given set of audit procedures may provide audit evidence that is relevant to certain assertions, but not others. For example, inspection of documents related to the collection of receivables after the period end may provide audit evidence regarding existence and valuation, but not necessarily cut-off;
- iii. Tests of controls are designed to evaluate the operating effectiveness of controls in preventing, detecting and correcting material misstatements at the assertion level. Relevant audit evidence would include identifying conditions that indicate performance of a control and deviation conditions. The presence or absence of those conditions can then be tested by the auditor; and
- iv. Substantive procedures are designed to detect material misstatements at the assertion level. Designing substantive procedures includes identifying conditions relevant to the purpose of the test that constitute a misstatement in the relevant assertion.

EXAMINER'S REPORT

The question tests the requirement of ISA 500 about audit evidence.

About 90% of the candidates attempted the question.

Candidates exhibited good understanding in parts (a) and (b) but poor understanding in part (c). Performance was relatively poor in part (c)

The commonest pitfall was wrong interpretation of the requirements of the question and mix-up of solutions especially in parts (b) and (c).

Candidates are advised to prepare very well for future examinations which would obviously translate to confidence in answering questions correctly.

MARKING GUIDE

	Marks
a. Factors in determining sufficient audit evidence 2 marks x 3 points (maximum)	6
b. Principles to assess reliability of audit evidence 2 marks x 2 points (maximum)	4
c. Principles to assess the relevance of audit evidence 2½ marks x 4 points (maximum)	<u>10</u>
	<u>20</u>

SOLUTION 3

(a) Limitations of Internal Control Systems

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

(b) The problems that may arise when control systems rely excessively on the involvement of senior management in small entities include the following:

- i. There may be lack of evidence as to how systems are supposed to operate. The auditor will need to rely more on enquiry than on review of documentation;
- ii. There may be lack of evidence of controls - how does the auditor know that the controls exist and are being applied?;
- iii. Management may override controls that are in place;
- iv. Management may lack the expertise necessary to control the entity effectively;
- v. There may not be an independent person within the management team as there would be within “those charged with governance” in a large entity; and
- vi. It is likely the auditor places a lower level of reliance on controls in a small entity, subsequently requiring the auditor to carry out a larger amount of substantive testing.

EXAMINER'S REPORT

The question tests candidates on internal control systems. About 85% of the candidates attempted the question.

Candidates have a fair understanding of the question and performance was therefore average.

The commonest pitfall was poor interpretation of the requirements of the question occasioning repetition of solutions proffered in parts (a) and (b).

Candidates should ensure they understand the requirements of a question properly before answering it in future examinations.

MARKING GUIDE

	Marks
a. Limitations of internal control systems 2 marks x 4 points	8
b. Problems that may arise when control systems rely excessively on senior management in small entities 2 marks x 6 points	<u>12</u>
	<u>20</u>

SOLUTION 4

a. Ethical matters worthy of consideration

The ethical issues worthy of consideration as Joe Adams joins Maikai Airlines Limited which may especially affect actual and perceived independence include:

- i. The seniority of the individual when he was on the assurance team (being an ex-partner) accentuates the risk;
- ii. The position he has taken up at the client's office - the risk is higher because he has taken up a top management position;
- iii. The amount of future involvement he will have with the assurance team, as a member of the client's staff. As finance director, he is responsible for the financial statements, thus, the risk is higher; and
- iv. The length of time that has passed since he was on the assurance team. The longer the time period, the less significant the risk.

(b) The threats that could arise include:

- i. Self-interest threat: the audit team coming for subsequent audits might be unwilling to give an unfavourable audit opinion because such could indirectly indict their ex-partner;

- ii. Familiarity threat: the ex-partner had worked intimately with most of the staff in the firm especially the partners. With this relationship, the audit team may become sympathetic to the interests of the ex-partner; and
 - iii. Intimidation threat: the audit team could be influenced to accept the ex-partner's opinion without suspicion because of his/her past exposure, position, experience and knowledge.
- (c) **Matters specified by the Code include:**
- i. The individual concerned must not be entitled to any benefits or payments from the firm, unless these are fixed or pre-determined arrangements;
 - ii. Amounts owed to the individual (for example, in the case of an ex-partner) must not be so significant that they could threaten independence;
 - iii. The individual must no longer take part or appear to take part in the firm's business; and
 - iv. In respect of audit clients, a key audit partner should not accept a key management position with their audit client until at least two years after the conclusion of the audit.

EXAMINER'S REPORT

Part (a) of the question is on ethical matters relating to Chartered Accountants in practice joining their audit clients, part (b) tests candidates on threats that may arise from (a) above and part (c) tests safeguards specified by the Code of Ethics on the threats that may arise from the above.

About 65% of the candidates attempted the question. The candidates showed fair understanding in part (b), but poor understanding in parts (a) and (c).

The observed shortcoming is their inability to interpret and relate scenarios to real life or practical situations.

Candidates are advised to utilise their acquired skills to address issues in given scenarios. They should also make use of the Institute's Study Text, when preparing for future examinations.

MARKING GUIDE

	MARKS
a. Ethical matters 2 marks x 4 points	8
b. Threats 2 marks x 3 points	6
c. Safeguards 2 marks x 3 points (maximum)	<u>6</u> <u>20</u>

SOLUTION 5

(a) Major Controls to be put in place to minimise the risks inherent in Electronic Data Interchange (EDI) system include:

- i. Controls over transmission of data: This is one of the controls to be put in place to minimise the risks inherent in EDI system. These include encryption, acknowledgement and authentication codes. Authentication codes are used so that senders and receivers of transmitted data have to authenticate their identity before data is transmitted and/or received. Encryption involves translating data into coded form of transmission and then re-translating it at the recipient's end;
- ii. Monitoring and checking of output: Another type of control to be put in place is monitoring and checking of output. There should be proper monitoring and checking of all outputs in an EDI system with only authorised persons having access to the output and ensuring reasonableness of the output at the receiving end;
- iii. Virus protection system: There should also be a virus protection system to be put in place to minimise the risk inherent in Electronic Data Interchange system; and
- iv. Contingency plans and back up arrangements.

(b) Features of EDI systems that may create additional problems for an Auditor include:

- i. There is lack of paper audit trail where a transaction can be followed through the stages of its processing, by going from one paper document to another. With EDI, the system needs an electronic audit trail for transactions and the computer system should be able to provide one;
- ii. Any computer failure may have an increased impact on the client's operations, because there is an increased level of dependency on the computer systems in the organisation. General controls for Information Technology (IT) will therefore be extremely important;
- iii. There are also security risks in the transmission of data. Unauthorised individuals may be able to read and/or corrupt transmitted data; and
- iv. The risk of loss or corruption of data in the process of transmission of the data.

EXAMINER'S REPORT

The question tests candidates on information Technology (IT) - Electronic Data Interchange (EDI). About 50% of the candidates attempted the question.

Performance of candidates was generally below average apparently due to lack of understanding of the requirements of the question.

The commonest pitfall was the wrong interpretation of the question.

Candidates are advised to adequately cover the syllabus, make use of the Institute's Study Text and specifically study the IT section for future examinations.

MARKING GUIDE

	Marks	
a. Controls to minimise risks in EDI system		
2 marks x 4 points		8
b. Features of EDI system that may create problems for an auditor		
2½ marks x first 2 points	5	
1 mark x last 1 point	<u>2</u>	<u>7</u>
		<u>15</u>

SOLUTION 6

Five elements contained in an assurance engagement performed by an auditor are:

i. A three Party Relationship:

- Practitioner,
- Responsible Party,
- Intended Users.

ii. subject matter;

iii. suitable criteria;

iv. evidence; and

v. assurance report.

i. A three Party relationship:

- **Practitioner** – the individual providing professional services that will review the subject matter and provide the assurance e.g. the audit firm in a statutory audit;
- **Responsible party** – the person(s) responsible for the subject matter e.g. the Directors are responsible for preparing the financial statements to be audited; and

- **Intended users** – the person(s) or class of persons for whom the practitioner prepares the assurance report, e.g. the shareholders in a statutory audit.
- ii. **Subject matter:** This is the data such as the financial statements that have been prepared by the responsible party for the practitioner to evaluate. Another example might be a cash flow forecast to be reviewed by the practitioner;
 - iii. **Suitable criteria:** This can be thought of as ‘the rules’ against which the subject matter is evaluated in order to reach an opinion. In a statutory audit this would be the applicable reporting framework e.g. IFRS and company law;
 - iv. **Evidence:** Information used by the practitioner in arriving at the conclusion on which their opinion is based. This must be sufficient (enough) and appropriate (relevant); and
 - v. **Assurance Report:** The report (normally written) containing the practitioner’s opinion. This is issued to the intended user following the collection of evidence.

EXAMINER’S REPORT

The question tests candidates’ knowledge of assurance engagement.

About 90% of the candidates attempted the question.

The understanding they showed was commendable and the performance was very good.

The commonest pitfall in some cases was poor presentation which cost some candidates some marks.

Candidates should imbibe and apply culture of good communication skills in future examinations.

MARKING GUIDE

	Marks
Identification of each element 1 x 5	5
Explanation of each element 2 x 5	<u>10</u>
	<u>15</u>

SOLUTION 7

(a) **Three Key factors the auditor has to take into consideration in designing a sample according to ISA 530 are:**

- i. Considering the purpose of the audit procedure and the population from which the sample will be drawn - the auditor has to consider the purpose of the audit procedure and the population from which the sample will be drawn to arrive at a very good conclusion;
- ii. Determining a sample size sufficient to reduce sampling risk to an acceptably low level and the sample must be representative of the entire population otherwise sampling risk would be high; and
- iii. Selecting items for the sample in such a way that each sampling unit in the population has an equal chance of selection.

(b) i. **Statistical sampling approach** is a method of using random selection from a large population in order to make guesses as to what the whole population looks like. It is the sampling approach that involves selection and application of probability theory to the evaluation of the sample result and the measurement of sampling risk.

Non statistical sampling approach is any sampling technique not based on probability theory, but on a judgement opinion by the auditor about the results of the sample. It is also known as judgment sampling.

(c) **Advantages of Statistical Sampling are:**

- ✓ Statistical sampling provides an objective, mathematically precise basis for the sampling process;
- ✓ There may be circumstances where statistical sampling is the only means of auditing efficiently, for example, in the case of very large populations of homogeneous Items, like transactions of large public enterprises; and
- ✓ The required sample can be calculated precisely.

Disadvantages of Statistical Sampling are:

- ✓ It is essential that auditors are required to be trained and should have appropriate technical expertise, if the sampling technique is to be used effectively;
- ✓ Required training of staff may require an investment, and so additional costs;
- ✓ Sample sizes may be larger than under a non-sampling approach with attendant increase in audit time and costs; and
- ✓ There may be lack of consistent application of statistical sampling techniques across audit teams. Some auditors

believe it is preferable to rely on the skill, experience and judgment of the auditor, rather than rely on mere statistical/mathematical models.

EXAMINER'S REPORT

The question tests candidates' understating of sampling approaches/techniques in auditing.

About 80% of the candidates attempted the question. Candidates exhibited fair understanding of the requirements of the question, hence the performance was just average.

The commonest pitfall observed was wrong interpretation of the requirements of the question thereby making them to answer the questions out of context.

Candidates are advised to read and understand the requirements of a question well before attempting it in future examinations.

MARKING GUIDE

	Marks	Marks
a. Key factors when designing a sample 2 marks x 3 points		6
b. Statistical sampling method explained	2	
Non-statistical sampling method explained	<u>2</u>	4
c. Advantages of statistical sampling 1 $\frac{1}{4}$ marks x 2 points		2 $\frac{1}{2}$
Disadvantages of statistical sampling 1 $\frac{1}{4}$ marks x 2 points		<u>2$\frac{1}{2}$</u>
		<u>15</u>

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION - MAY 2018

PUBLIC SECTOR ACCOUNTING & FINANCE

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

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

SECTION A: COMPULSORY QUESTION (30 MARKS)

QUESTION 1

It has become a very important task for Accounting Officers of Ministries, Departments and Agencies (MDAs) to pay more attention to and make regular checks on their corporation's cash books and bank accounts.

Internal control system is usually put in place to prevent the possibility of committing errors and fraud. This has been more challenging and requires all accounting officers to be more knowledgeable in the act of keeping records. Every organisation has to keep close watch on its bank account transactions to guide against fraud or the infiltration of extraneous entries. This is done through regular preparation of bank reconciliation statements.

As a result of widespread internet fraud, the Accounting Officer of the Ministry of Land and Housing, Alhaji Maito Garba, has been concerned with the Ministry's banking transactions. In recent times there have been challenges reconciling the Ministry's banking transactions. There was no time the Ministry's bank balance agreed with the cash book balance. However, there was no adequate information to suggest that there was fraud or misappropriation of funds. Nonetheless, Alhaji Maito Garba invited you to his office for professional advice.

He informed you that the Director of Finance of the Ministry had been avoiding him on matters relating to the Ministry's bank and cash positions.

He also informed you that he was able to retrieve some of the finance department's data which he handed over to you as detailed below:

Transactions recorded in the books for the year ended December 31, 2017

	₦000
Subvention received	55,000.00
Interest from investment	3,501.68
Rent on property	11,300.35
Ground rent	16,801.00
Saving deposits interest	6,281.00
Grants for construction of estates	51,301.50
Deposits for land	19,000.60
Personnel costs	36,801.00
Travel and transport	7,000.40
Telephone services	2,401.50

Repairs of property	4,868.25
Stationery	901.86
Provision of water for estate	14,300.60
Consultancy services	3001.26
Training and staff development	1,001.56
Auditing and staff development	1,500.00
Entertainment and hospitality	500.00
Construction of estate	35,607.58
Construction of access roads	8,400.60
Cash book balance as at 1/1/2017	21,500.00

Preliminary investigations revealed the following information:

- (i) 1,370 prospective land owners deposited ~~₦~~10,000 each, while 580 deposited ~~₦~~20,000 for high and low density areas of the estate respectively;
- (ii) Included in the payments for the construction of estate were various duplicated vouchers amounting to ~~₦~~9 million;
- (iii) The bank balance as per the statement on December 31, 2017 was ~~₦~~39,560,600;
- (iv) Uncredited cheques amounted to ~~₦~~6.9million while unpresented cheques stood at ~~₦~~4,337,800;
- (v) There were some falsifications in the bills for items bought for the provision of water. The total discrepancies amounted to ~~₦~~3,561,800; and
- (vi) Standing order for insurance premium was ~~₦~~201,500 while bank charges and commissions amounted to ~~₦~~144,250.

Required:

- a. Prepare an adjusted cash book. (8 Marks)
 - b. Prepare an appropriate reconciliation statement to show if any fraud was committed during the period (7 Marks)
 - c. Identify **FOUR** statutory institutions that the suspicious case(s) in (b) above could be reported to. (4 Marks)
 - d. State the procedures the Ministry could follow to bring suspicious individuals to book in accordance with the Financial Regulation 2502. (6 Marks)
 - e. Explain the related offences that **TWO** of the statutory Institutions can deal with in this case. (5 Marks)
- (Total 30 Marks)**

SECTION B: YOU ARE REQUIRED TO ANSWER ANY TWO OUT OF THREE QUESTIONS (40 MARKS)

QUESTION 2

The Local Development Authorities (LDAs) of Imafidion Council agreed to transfer their Social Centres for the purpose of adequate maintenance to the state government's Ministry of Happiness. The state government accepted to take over the centres and therefore requested for their 2019 budget. The following were supplied by the Social Centres to the government through the Director of Accounts, Ministry of Happiness.

Actual salaries, wages and overhead expenses (2018)

	₦'Million	₦'Million
Salaries	9.75	
Wages	<u>8.42</u>	18.17
Rates	8.73	
Power/Electricity	2.70	
Rent	2.60	
Artifacts for sale	2.80	
Security services	1.00	
Other supplies	2.51	
Service level agreement	2.85	
Promotion expenses	<u>2.01</u>	<u>25.20</u>
Total expenditure		43.37
Actual Income (2018)		
Admissions	9.01	
Sales in the centre	4.78	
Other incomes	1.48	
Grant	<u>1.00</u>	
Total Income		<u>16.27</u>
Net Expenditure		<u>27.10</u>

Other details provided include:

i. Salaries are made up as follows:	Director Ministry of Happiness	Social Officer	Total
	₦'Million	₦'Million	₦'Million
Salaries	4.80	3.00	7.80
National insurance	0.48	0.30	0.78
Pension	<u>0.72</u>	<u>0.45</u>	<u>1.17</u>
Total	<u>6.00</u>	<u>3.75</u>	<u>9.75</u>

- ii. The wages were for 5 employees (known as Happiness Assistants) paid on hourly basis with maximum of 20 hours per week at ₦1,260 per hour, plus over time bonus as follows:

	Salary ₦'Million	Insurance ₦'Million	Pension ₦'Million	Total ₦'Million
Happiness Assistant: 20 hours Per week at ₦1,260 per hour (52 weeks)	1.31	0.131	0.20	<u>1.641</u>
For 5 Happiness Assistants				8.205
Overtime				<u>0.230</u>
				<u>8.435</u>

The guideline for the budget has been given as follows:

- i. Rent to remain as for last year since the lease would still be running for two years, but security service providers would charge only ₦0.6m next year;
- ii. No festival would be planned for the following year and as a result there would be no promotion expenses and grant in the following year;
- iii. Though same number of visitors would come to the centre, the rate of admission fees would go up by 10 percent for the following year;
- iv. There would be an increase of 5% on other incomes. The budget for Artifact for sale would increase by the same proportion as the Sales in the Centre budget which would increase by 20%;
- v. Power/electricity and rates would increase by 8% and 2% respectively while other supplies would increase by 2.5%;
- vi. There would be 2.60% increase in wages, while the National Insurance contributions would increase to 12% of salaries instead of the current 10% and pension contribution would be 15% of salaries;
- vii. Director of Finance, Ministry of Happiness would not be due for salary increment but the Social Officer would earn increment of ₦0.088m;
- viii. There would be no overtime payment; and
- ix. Service level agreement was fixed at ₦2.948m.

You are required to prepare a proposed budget for Imafidon Local Government Authority Happiness and Social Centres for the year ended December 31, 2019 (use same format as in the Question). (Total 20 Marks)

QUESTION 3

IPSAS 27 deals with the accounting treatment and disclosures in relation to agricultural practice.

Required:

- a. Explain the term “agricultural activity.” (5 Marks)
 - b. Explain how the fair value of a biological asset or agricultural produce is determined. (8 Marks)
 - c. Identify **TWO** ways in which an entity should recognize a biological asset or agricultural produce. (3 Marks)
 - d. Explain the accounting treatment of gains or losses arising from a biological asset or agricultural produce. (4 Marks)
- (Total 20 Marks)**

QUESTION 4

In relation to public sector audit,

- a. Define ‘Value-for-Money’ audit (VFM). (2½ Marks)
 - b. Identify and explain **THREE** major components of ‘Value-for-Money’ audit. (6 Marks)
 - c. Explain **FIVE** steps towards a successful ‘Value-for-Money’ audit. (2½ Marks)
 - d. Identify **FIVE** factors which contribute to an effective ‘Value for Money’ audit. (5 Marks)
 - e. Explain the precise roles of internal audit unit in relation to ‘Value-for-Money’ audit of a Government Business Entity (GBE). (4 Marks)
- (Total 20 Marks)**

SECTION C: YOU ARE REQUIRED TO ANSWER ANY TWO OUT OF THREE QUESTIONS (30 MARKS)

QUESTION 5

In government’s quest to optimally develop and efficiently manage available resources, national budgets are usually prepared to put economic development firmly on course.

Required:

- a. Describe briefly a national budget. (3 Marks)
- b. Explain briefly the implication of each of the following for the performance of the economy:
 - i. A surplus budget
 - ii. A deficit budget (4 Marks)

- c. Explain **FOUR** problems to be encountered in the effective implementation of national budgets in Nigeria. (8 Marks)
(Total 15 Marks)

QUESTION 6

“The consequences arising from the continual accumulation of public debts in developing countries may discourage growth in such economies”.

- a. Explain the term “public debt”. (5 Marks)
b. Write brief notes on **FOUR** factors responsible for the accumulation of public debt in developing countries. (10 Marks)
(Total 15 Marks)

QUESTION 7

One major role of government (Federal, State or Local) is to ensure probity and accountability in all its functions.

- a. Explain **FOUR** conditions which could enhance the promotion of accountability in the public sector. (5 Marks)
b. Identify and explain **FOUR** principles guiding code of good practices on fiscal transparency. (10 Marks)
(Total 15 Marks)

SOLUTION 1

a.

Ministry of Land and Housing**Preparation of Adjusted Cash Book for the period ended December 31, 2017**

	₦'000	₦'000
Balance b/d		21,500.00
Receipts		
Subvention	55,000.00	
Interest from investment	3,501.68	
Rent on property	11,300.35	
Ground rent	16,801.00	
Saving deposits interest	6,281.00	
Grant from construction of estates	51,301.50	
Deposit for land	<u>19,000.60</u>	<u>163,186.13</u>
		184,686.13
Payments		
Personnel cost	36,801.00	
Travel and transport	7,000.40	
Telephone services	2,401.50	
Repairs of property	4,868.25	
Stationery	901.86	
Provision of water for sale	14,300.60	
Consultancy services	3,001.26	
Training and staff development	1,001.56	
Auditing and staff development	1,500.00	
Entertainment and hospitality	500.00	
Construction of estate	35,607.58	
Construction of access roads	<u>8,400.60</u>	<u>116,284.61</u>
Balance c/d		<u>68,401.52</u>
Standing Order for insurance premium	201.50	
Bank charges and commissions	<u>144.25</u>	<u>345.75</u>
Balance as per adjusted cash book		<u>68,055.77</u>

b. **Bank Reconciliation Statement for the year ended December 31, 2017**

	₦'000	₦'000
Balance as per adjusted cash book		68,055.77
Add: Unpresented cheques		<u>4,337.80</u>
		72,393.57
Less: Uncredited cheques		<u>6,900.00</u>
Expected balance in the bank		65,493.57
Less: Balance as per bank statement		<u>39,560.60</u>
Cash shortage		25,932.97
Other losses		
Deposit on land - 1,370 x ₦10,000	13,700.00	
- 580 x ₦20,000	<u>11,600.00</u>	
	25,300.00	
Less: Amount accounted for	<u>19,000.60</u>	6,299.40
Duplicated vouchers on construction		9,000.00
Falsification of bills for provision of water		<u>3,561.80</u>
Total Fraud committed		<u>44,794.17</u>

- c. The statutory institutions that the suspicious case(s) of fraud in (b) above could be reported are:
- i. The Chairman, Federal Civil Service Commission;
 - ii. The Auditor - General for the Federation;
 - iii. The Accountant - General of the Federation;
 - iv. The Federal Ministry of Finance;
 - v. Independent Corrupt Practices and Other Related Offences Commission (ICPC);
 - vi. Economic and Financial Crime Commission (EFCC); and
 - vii. The Nigerian Police
- d. According to the Financial Regulation 2502, a loss shall be charged as a personal advance against the officers responsible for the loss, pending a decision by the Federal Losses Committee.

The officer in charge of the office in which the loss occurs shall take the following actions:

- i. Report immediately to the Head of the Unit or Division by the fastest means if the loss occurs away from the Headquarters;
 - ii. Report to Police if fraud or theft is suspected;
 - iii. Initiate immediate action by completing Treasury Form 146 part 2 and forward it in quintuplicate to the Head of Unit or Division;
 - iv. Ensure that if a weakness in the system of control or in security is established, measures have been taken to prevent a re-occurrence of the loss; and
 - v. Ensure that accounting entries have been made for the loss.
- e. The related offences that two of the statutory institutions can deal in this case include:
- i. Falsification of bills for provision of water;
 - ii. Duplication of vouchers for payment for the construction of estate; and
 - iii. Fraudulent cash shortage.

The above offences may lead to the following:

- Any public officer who is involved in contract inflation shall be surcharged, removed from schedule of duty, dismissed and prosecuted;
- If contract inflation involves the Tenders Board, all the members that approved the inflated contract shall be severally and collectively sanctioned;

- If a public officer fraudulently pays money for a job not executed, he shall be required to refund in full, the amount wrongly paid and shall be removed from the schedule. The matter shall be referred to EFCC for prosecution; and
- Any public officer involved in fraudulent cash shortage, shall be made to refund the cash shortage, removed from the schedule of duty and reported to the EFCC or the police for prosecution.

EXAMINER'S REPORT

The question tests candidates' knowledge and skills on the preparation of adjusted cash book and bank reconciliation statement with a view to detecting any fraud. It also tests the procedures to be taken in reporting fraud cases to the appropriate statutory institutions with identified offences.

The question is compulsory and all the candidates attempted it. Candidates' performance was below average. The major pitfall was their poor understanding of the question's requirements.

Candidates are advised to make use of the Institute's Study Text and prepare very well for the future examination.

MARKING GUIDE

	MARKS	MARKS
a. Headings and Other items at ¼ except adjusted cash balance (28 ticks at ¼ mark per item) Correct calculation of adjusted cash book balance	7 <u>1</u>	8
b. Headings and Other items except total fraud committed (15 ticks at 1/3 mark per item) Correct calculation of total fraud committed	5 <u>2</u>	7
c. Any four statutory institutions at 1 mark each		4
d. Any four procedures at 1½ marks each		6
e. Any two offences at 2½ marks each		<u>5</u>
Total		<u>30</u>

SOLUTION 2

The Annual Budget for Imafidon Local Development Authority Happiness and Social Centres for the year ended December 31, 2019

Expenditure:	₦'million	₦'million
Salaries (W I)	10.018	
Wages (W II)	<u>8.534</u>	18.552
Rates (W III)		8.905
Power/Electricity (W III)		2.916
Rent		2.600
Artifacts for sale (W III)		3.360
Security Services		0.600

Other Supplies (W III)	2.573
Service Level Agreement	<u>2.948</u>
Total Expenditure	42.454
Income:	
Admissions (W IV)	9.911
Sales in the Centre (W IV)	5.736
Other Incomes (W IV)	<u>1.554</u>
Total Income	<u>17.201</u>
Net Expenditure	<u>25.253</u>

Working I:

Details of Salaries	Director Ministry of Happiness ₦'million	Social Officer ₦'million	Total ₦'million
2018 Salaries	4.800	3.000	7.800
2019 increment	<u>0</u>	<u>0.088</u>	<u>0.088</u>
2019 Salaries	4.800	3.088	7.888
National Insurance (12% of Salaries)	0.576	0.371	0.947
Pension Contribution (15% of Salaries)	<u>0.720</u>	<u>0.463</u>	<u>1.183</u>
Total	<u>6.096</u>	<u>3.922</u>	<u>10.018</u>

Working II:

Details of Wages	Happiness Assistants ₦'million
2018 Wages for the 5 Happiness Assistants multiply by 5	₦1.31million 6.550
2019 increment (2.60% of ₦6.550 million)	<u>0.170</u>
2019 Wages	6.720
Insurance (12% of ₦6.720 million)	0.806
Pension (15% of ₦6.720 million)	1.008
Overtime	<u>0</u>
Total	<u>8.534</u>

Working III: Expenditure	₦'million
Rates (102% of ₦8.73 million)	8.905
Power/Electricity (108% of ₦2.70 million)	2.916
Artifacts for sale (120% of ₦2.80 million)	3.360
Other Supplies (1.025% of N2.51 million)	2.573

Working IV: Income	₦'million
Admissions (110% of ₦9.01 m)	9.911
Sales in the Centre (120% of ₦4.78 m)	5.736
Other Incomes (105% of ₦1.48 m)	1.554

EXAMINER'S REPORT

The question tests candidates' ability to prepare a budget from a given historical data.

Majority of the candidates attempted the question and their performance was fair. However, candidates' major pitfall was their lack of understanding of the questions' requirements.

Candidates are strongly advised to be mindful of their workings and make use of the relevant information in the question.

They should also be more skillful in budget preparation.

MARKING GUIDE	MARKS	MARKS
Headings	1	
Expenditure budget (10 items at $\frac{1}{2}$ each)	5	
Total expenditure	1	
Income budget (3 items at $\frac{1}{2}$ each)	1 $\frac{1}{2}$	
Total income	1	
Net Expenditure	<u>2</u>	11 $\frac{1}{2}$
Workings:		
W I Salaries 18 ticks at $\frac{1}{4}$ mark each	4 $\frac{1}{2}$	
W II Wages 6 ticks at $\frac{1}{3}$ mark each	2	
W III Expenditure (4 ticks at $\frac{1}{4}$ mark each)	1	
W IV Income (3 ticks at $\frac{1}{3}$ mark each)	<u>1</u>	8 $\frac{1}{2}$
Total		<u>20</u>

SOLUTION 3

a. Agricultural Activity:

This is the management by an entity of the biological assets for sale, distribution or for conversion into agricultural produce. This comprises such activities like raising live stock, forestry, annual or perennial cropping, cultivation of plantations, floriculture and fish farming.

b. Determination of fair value for a Biological Asset or Agricultural Produce:

Section 14 of IPSAS 27 states that the fair value of an asset is based on its present location and condition. For instance the fair value of a barn of yams is the price of the yams in the market less the transport and other incidental cost of taking the yams to the market, which is an active market.

However, where there exists no active market, the Standard recommends any or a combination of the following as reference point for determining the fair value.

- i. The most recent market transaction price
- ii. Market price for similar assets with adjustment to reflect differences.

- iii. The agricultural sector benchmark i.e. per hectare of crops, per kilogram of meat, etc.
- c. **Recognition of Biological Assets and Agricultural Produce:**
According to the Standard, an entity shall recognize a biological asset or agricultural produce ONLY when:
 - i. The entity controls the assets as a result of past events;
 - ii. There is the probability that future economic benefits or service hitherto associated with the asset will flow into the entity; and
 - iii. The fair value or the cost of the asset can be measured reliably.
- d. **Accounting Treatment of Gains or Losses**
 - i. **Gains or Losses Arising on Initial Recognition**

In accordance with Section 30 of the Standard, gains or losses arising on initial recognition of a biological asset or agricultural produce at fair value less costs to sell is included in surplus or deficit for the period in which it relates e.g. a gain or loss arising when a kid is given birth to or when crops are harvested.
 - ii. **Gains or Losses from a Change in Fair Value Less Costs to sell**

Sections 32 of the Standard states that, gains or losses arising from a change in fair value less costs to sell of a biological asset is taken as surplus or deficit for the relevant period in which the gains or losses relate.

EXAMINER'S REPORT

The question tests candidates' knowledge on the contents and application of 'IPSAS 27' with the accounting treatment and disclosures in relation to agricultural produce. Few candidates attempted the question and their performance was poor.

Candidates' major pitfall was their non-familiarity with IPSAS 27 and lack of proper preparation for the examination.

Candidates are advised to make use of the Institute's Study Text in preparing for future examination and also be familiar with International Public Sector Accounting Standards.

MARKING GUIDE

	MARKS	MARKS
a. Explanation of the term "agricultural activity"	2	
Any three component of agricultural activity at 1 mark each	<u>3</u>	5
b. Explanation of the fair value of an asset	2	
Three reference points at 2 marks each.	<u>6</u>	8
c. Recognition of any two of Biological Assets and Agricultural produce by entity at 1½ marks each.		3

d.	Gains or losses arising on initial recognition	1	
	Explanation of accounting treatment	1	
	Gains or Losses from a Change in Fair Value Less Costs to sell	1	
	Explanation of accounting treatment	<u>1</u>	<u>4</u>
	Total		<u>20</u>

SOLUTION 4

- a. 'Value-for-money' (VFM) audit means using resources in the best way in order to achieve intended objectives. Value-for-money audit is the review of the financial transactions to confirm that an organisation has received adequate benefits for the money expended.
- b. The three major components of 'Value-for-Money' audit are:
- Economy.** This means spending money carefully, and not paying more than necessary for resources - materials, labour and other expenses.
 - Efficiency.** Efficiency means using resources in such a way that they produce the greatest possible amount of 'output'. It means getting more from the use of available resources. For example, efficiency in the use of an employee means getting a high rate of output for every hour or day worked.
 - Effectiveness.** Effectiveness means using resources in such a way as to achieve the desired objectives. Efficiency is of little value unless the output from the system is what the entity wishes to achieve.
- c. **The five steps towards a successful 'Value-for-Money' audit are:**
- Initial analysis of projects areas for 'value for money' audit through analysis of the annual budgets and other financial statements.
 - Adequate planning, co-ordination and control in order to;
 - Determine the annual programme of performance audit work, the staff and other resources needed to deliver on the programme;
 - Ensure that appropriate attention is devoted to important areas, potential problems are identified and that the work is completed expeditiously; and
 - Assist in the proper assignment of work to team members and the coordination of work performed by different audit teams.
 - Introduction of the main study area to the auditee should cover the following:
 - Purpose of the main study;
 - Time schedule for the main study;

- Members of the audit team;
 - The audit objective, audit question and assessment criteria;
 - Methods that will be used to collect data;
 - The information and support that will be requested from the auditee;
 - The purpose of the auditee appointing a contact person; and
 - The purpose of the exit meeting.
- iv. Carrying out compliance test to test the strength of internal control in operation
- v. Carry out substantive tests in order to:
- Ensure that resources (inputs) are obtained at the cheapest prices (Economy Test);
 - Ensure that wastages are reduced to the barest minimum (Efficiency Test); and
 - Ensure that resources were used in such a way as to achieve the desired objectives (Effectiveness Test).
- vi. Reporting involves:
- The clearance of the report through reviews;
 - Quality controls and exit meetings with the auditee; and
 - Submission of the report to the Legislature, Government and/or the audited entities.
- vii. Follow-up action involves:
- Processes that identify and document the audit impact;
 - The progress the auditee has made in implementing audit recommendations; and
 - Such processes that provide feedback to the auditor and to the Legislature.
- d. The factors contributing to effective 'Value-for-Money' audit are:
- i. **The independence of the auditor:** He should be given free hand to do a good job. The auditor should not be under the control of management of the Organisation.
 - ii. **The adequacy and scope of the auditor's power:** The authority of the auditor should be guaranteed. The auditor must be given adequate authority to discharge his responsibilities.
 - iii. **The expertise and professionalism of the auditor and his staff:** The auditor should be adequately trained, versatile and skillful at his job.
 - iv. **The resources at the auditor's disposal:** There should be enough funds at the disposal of the auditor to carry out his assignment.

- v. **Freedom of reporting and the qualitative nature of reports:** The reports, which the auditor transmits should be timely and promptly looked into so that effective decisions could be taken in order to comply with the Professional Audit Standards.
 - vi. **Unrestricted access:** Audits should be conducted with complete and unrestricted access to employees, property and records.
 - vii. **Stakeholder support:** The legitimacy of the audit activity and its mission should be understood and supported by a broad range of elected and appointed government officials, as well as the media and the citizens involved.
- e. The precise roles of Internal Audit Unit in relation to 'Value-for-Money' audit are to:
- i. Guide against unreasonable or extravagant expenditure;
 - ii. Ensure that sufficient funds are available to enable payment to be effected;
 - iii. Ensure compliance with budgetary, civil service rules, financial memorandum, legislation and other legal requirements on payment;
 - iv. Ensure that goods/services conform with the prescribed standards before payments; and
 - v. Confirm whether or not the public sector organisation has committed its resources economically, efficiently and effectively.

EXAMINER'S REPORT

The question tests candidates' knowledge and skills in public sector audit; specifically on "Value-for-Money" audit (VFM), its components, audit steps, factors that influence VMA and the roles of internal audit unit in relation to VFM.

Majority of the candidates attempted the question and their performance was below average. Candidates' major pitfall was their inability to answer parts c, d and e of the question.

Candidates are advised to make use of the ICAN Study Text as well as other relevant texts for future examinations of the Institute.

MARKING GUIDE		MARKS	MARKS
a.	Definition of 'Value-for- Money' (VFM) audit		2½
b.	Recognition of each of the three major components at 1 mark each	3	
	Explanation of each of the three major components at 1 mark each	<u>3</u>	6
c.	Explanation of any five steps at ½ mark each		2½
d.	Identification of any five factors at 1 mark each.		5
e.	Explanation of any four precise roles of Internal Audit unit at 1 mark each.		<u>4</u>
Total			<u><u>20</u></u>

SOLUTION 5

- i. **National Budget** is a document containing statements of intended expenditure and expected revenue of the national government during a particular period, usually a year. It usually consists of the review of the performance of the budget of the preceding year, statements of objectives of the present budget, revenue estimates, estimates of recurrent and capital expenditures, as well as macroeconomic policy measures to be adopted to promote the realization of the stated objectives of the budget. Thus, a national budget is an instrument of control of government activities and a major management tool of the economy.
- b.i **Surplus Budget:** A surplus budget occurs when the government revenue is planned to exceed the proposed government expenditure. This may be secured by a reduction in government expenditure or an increase in taxation to broaden the revenue base of the government. A government will budget for a surplus to reduce inflation. Price stability is needed to encourage investment in the economy and to prevent further fall in the living standard of the people.
- b.ii **Deficit Budget:** A deficit budget occurs when the government revenue estimate is less than the proposed government expenditure. A deficit budget is usually adopted to stimulate economic growth. Government usually contracts both domestic and external loans to bridge budgetary gap. The process may lead to generation of employment opportunities, increase in national output and living standards.
- c. Problems usually associated with the implementation of national budget include the following:
 - i. **Delay in formulation, presentation and approval process by the Executive and the National Assembly**
Government expenditure loses its objective as government becomes more concerned with recurrent expenditure and less concerned with capital expenditure. Everything becomes haphazard and the economy remains stagnated.
 - ii. **Lack of efficient database.** There are a lot of uncertainties in the data used for the budget preparation. The projection of revenues accruing from oil export may not be forthcoming in view of price instability in the world market.
 - iii. **The problem of inflation.** Inflation tends to reduce the purchasing power of money. When the value of money is falling, budget implementation may run into problems. The revenue available will not be able to cover the expenditure.
 - iv. **Human element.** Lack of probity and accountability of government officials affect successful budget implementation. Specifically, widespread corrupt practices usually cause budget leakages resulting

in haphazard or non-execution of critical projects. In this case, the objectives of the budget may not be fully realized.

- v. **Lack of qualified and experienced personnel:** This often limits the capacity to implement the budget to the letter.
- vi. **Political, social and cultural elements:** Each segment of the nation has its own cultural beliefs and taboos, which may take time to change. Introducing innovation may be met with stiff opposition. For example, a section of the country may not be willing to provide land for development purposes. Secondly, where there is political instability, budget implementation is at risk.
- vii. **Changing government policy:** Frequent changes of government policies affect budget implementation. For effective budget implementation, government policies have to be harmonized and consistent.
- viii. **Fiscal indiscipline:** Most spending officers are budget maximizers. Under the incremental budgeting system, they tend to expend the last Naira available in a year's budget in order to justify the demand for increased allocation in the subsequent year, with little or nothing to show under the current dispensation.
- ix. **The problem of debt management and optimal use of limited resources:** There is the challenge of striking a balance between what fraction of the nation's resources should be used for servicing debts and amount that should be utilized to directly promote economic growth and development.

EXAMINER'S REPORT

The question tests candidates' knowledge of national budget, its relevance as a tool for improved performance of the macroeconomy and the constraints militating against its effective implementation.

Majority of the candidates attempted this question and the performance was above average. The poor performance of some of the candidates was as a result of their ignorance of the policy relevance of national budget which was tested in part (b) of the question.

Candidates are advised to consult standard texts and ICAN Study Text to have more understanding, especially the policy relevance of national budget.

MARKING GUIDE		MARKS	MARKS
a.	Nation Budget	- Definition	1
		- Elements	1
		- Purpose	<u>1</u>
b.	Surplus Budget	- Definition	$\frac{1}{2}$
		- Implication	$1\frac{1}{2}$
	Deficit Budget	- Definition	$\frac{1}{2}$
		- Implication	<u>$1\frac{1}{2}$</u>
c.	Problems associated with implementation		
	For mentioning of any one (1) point	1	
	For explaining of any one (1) point	<u>1</u>	
	For any four (4) points at 2 marks each	2	<u>8</u>
	Total		<u>15</u>

SOLUTION 6

- a. **Public debt** refers to the total accumulated borrowing by the government or public authority from home and abroad. It is the total amount of a country's contractual obligations or liabilities to individuals, institutions, countries and other creditors. It is usually categorized into domestic (internal) and foreign (external) public debts and could be either on short or long term basis.

Sources of internal/domestic public debt include borrowing from the Central Banks, commercial banks (or deposit money banks) and non-bank public such as insurance companies, saving institutions, state and local governments and individuals. Domestic debt is procured through the sales of instruments such as Treasury Bills, Treasury Certificates, Development Stocks and Revenue Bonds.

Sources of external public debt include Paris Club of Creditors, London Club of Creditors, Multilateral Creditors, Promissory Note Creditors and Bilateral and Private Sector Creditors.

- b. **Factors responsible for accumulation of public debts in developing countries are:**
- Exchange rate movements:** As the dollar appreciates against the major currencies of the world, debt obligations or dollar-denominated debts appreciate significantly.
 - External shocks:** Due to oil price shock in the international market, economic growth process drastically slows down in the developing oil-exporting countries due to lack of capital/revenue to finance them. This leads to the accumulation of debt to finance trade debts or trade arrears.

- iii. **Interest capitalization due to default in payment:** Whenever a country defaults on her debt servicing, the interest payment dues are always added to the principal thereby increasing the debt stock.
- iv. **Varying market interest rate:** The application of varying market interest rate to loan contracts adds to the increase in debt profile especially when the market interest rates increase in response to market situation thereby leading to increase in the magnitude of total outstanding debt.
- v. **Low domestic savings:** The low domestic savings of the developing countries in the face of high demand for development often creates huge discrepancies between investment demand and the available resources. Thus, governments in developing countries have to supplement domestic resources with huge external borrowing.
- vi. **Huge and persistent budget deficits:** Government resorts to borrowing in order to finance deficits.
- vii. **Inappropriate domestic economic policy mix:** In many developing countries, a high proportion of short-term loans are contracted to finance long-term projects which makes the maturity of such loans not tallying with the payback period. As a result of this mismatch of loans with projects, amortization payments become due when the projects are hardly completed and this usually results in debt-service bunching which compounds the debt problem.
- viii. **Poor external debt management:** Many developing countries fail to carefully plan schedule of acquisition, utilization and repayment of loans. Inefficient debt management often leads to accumulation of debt.

EXAMINER'S REPORT

The question tests candidates' understanding of public debt: its meaning and factors responsible for its accumulation in developing economies.

Virtually all the candidates attempted the question, but the overall performance was poor. Majority of them lacked proper understanding of the requirements of the question. In most cases they discussed the need for borrowing rather than the factors actually responsible for debt accumulation in developing countries.

Candidates are advised to study thoroughly the question in terms of its requirements so as to raise relevant points. They should also consult the ICAN Study Text and other relevant materials on public debt for familiarity and better understanding.

MARKING GUIDE

	MARKS	MARKS
a. Definition of 'Public Debt	2	
Any three sources of domestic/internal debt at ½ mark each	1½	
Any three sources of foreign/external debt at ½ mark each	<u>1½</u>	5
b. Factors responsible for accumulation of public debts		
Identification of any four factors at 1 mark each	4	
Explanation of any four factors at 1 ½ marks each	<u>6</u>	<u>10</u>
Total		<u>15</u>

SOLUTION 7

- a. To further enhance the promotion of accountability in the public sector management in Nigeria the following conditions are canvassed:
- i. **Rendering of Account:** It is expected that accounts should be rendered in all public organizations. Public accountability can be achieved only if those who receive the accounts have the power and ability to take actions on the basis of those accounts.
 - ii. **Accountable Leadership:** The existence of leadership that genuinely believes and is committed to the notion of public accountability and will therefore ensure that the laws to safeguard public fund are enforced irrespective of the might of the public officer concerned.
 - iii. **Investigative Reporting/Media Attention:** Public accountability needs the presence of active investigative media that will help to keep the leadership on their toes.
 - iv. **Public Enlightenment:** Public accountability will be enhanced if the generality of the populace do not believe that embezzlement of public funds is part of the "political manifesto" which the political leaders must achieve while in office.
 - v. **Whistle Blowing Policy:** "Whistle blowing" should be encouraged in the public sector whereby any public official who encounters mismanagement or wrong doing in the conduct of government business may blow the whistle by taking the case to the public arena. The prospect that somebody may go public can deter some officials contemplating wrong doing.
 - vi. **Openness in Governance:** All unethical and corrupt practices should be exposed as much as possible while those who indulge in them should be promptly and severely punished in accordance with the law. To this end, there should be full implementation of the Freedom

of Information Act (FOIA), 2011 so as to promote openness and feedback in public governance and management.

- vii. **Encouragement of Due Process:** There should be strict compliance with due process and public procurement procedure as spelt out in the Public Procurement Act (Nigeria, 2007), as doing this will help curb corrupt practices and instill financial discipline in budget implementation by the public bureaucracy. Moreover, there should also be strict adherence to the provisions of the Fiscal Responsibility Act.
 - viii. **Review of current method of Asset Declaration:** The present method of secret declaration of assets by public officers leaves much to be desired. As such there is need to institute a more open method of declaring assets so as to afford the opportunity for patriotic citizens to scrutinize and report any incorrectly declared assets to the appropriate authorities.
 - ix. **Strengthening of Anti-graft Bodies:** All anti-graft bodies such as the Economic and Financial Crime Commission (EFCC), Independent Corrupt Practices and Other Related Offences Commission (ICPC), Code of Conduct Bureau (CCB) and Code of Conduct Tribunal (CCT) should be further strengthened by way of being adequately staffed, equipped and funded to make them more effective institutional mechanisms for fighting corruption. Furthermore, other law enforcement agencies notably the police should be strengthened so as to build their capacity to detect, investigate, prosecute and even deter or prevent corruption.
 - x. **Deletion of Immunity Clause:** The immunity clause should be expunged from the Nigerian Constitution. By doing so, political leaders who are fingered for corrupt practices can be prosecuted while in office.
- b. For Fiscal transparency to be achieved the following principles should be adopted:
- i. **Clarity of roles and responsibilities.** There should be a clear distinction between Government and Commercial activities, and there should be a clear legal and institutional framework governing fiscal administration and relations with the private sector. Policy and management roles within the public sector should be clear and publicly disclosed.
 - ii. **Open budget processes.** Budget information should be presented in a way that facilitates policy analysis and promotes accountability. Budget documentation should specify fiscal policy objectives, the macroeconomic assumptions used in formulating the budget and major fiscal risks. Procedures for collecting revenue and for monitoring approved expenditures should be clearly specified.

- iii. **Public availability of information.** The public should be provided with complete information on the past, current and projected fiscal activity of government and on major fiscal risks. This should be readily accessible. Countries should commit to the timely publication of fiscal information.
- iv. **Assurances of integrity.** Fiscal data and practices should meet accepted quality standards and should be subjected to independent scrutiny. Ethical standards of behaviour for public servants should be clear and made public. The national audit body or equivalent organisation should submit all reports, including its annual report to the legislature and publish them.

EXAMINER'S REPORT

The question tests candidates' knowledge of the conditions that enhance the promotion of accountability in the public sector and the principles guiding code of good practices in fiscal transparency.

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

Candidates' major pitfall was their lack of adequate understanding of the question's requirements.

Candidates are advised to make use of the ICAN Study Text and prepare very well for the Institute's future examination.

MARKING GUIDE		MARKS	MARKS
a.	Explanation of any four conditions at 1 ¼ marks each		5
b.	Identification of any four principles at 1 mark each	4	
	Explanation of the each of the four principles at 1½ marks each	<u>6</u>	10
	Total		<u>15</u>

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION - MAY 2018

MANAGEMENT, GOVERNANCE AND ETHICS

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

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

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

QUESTION 1

- a. Zidat Bottling Company has five different products: Zidat Cola, Zidat Orange, Zidat Apple, Zidat Bitters and Zidat Water. Faced with economic recession in the country, the company consulted you as an expert in business strategic management to advise it on the usefulness of the Boston Consulting Group (BCG) matrix, in its efforts to enhance the company's overall profitability.

You are required to:

- i. Discuss the different categories into which Zidat's products can be grouped and specify how the company should treat each of the product groups in accordance with the specifications of the BCG matrix. (8 Marks)
 - ii. Discuss the limitations of the BCG matrix. (11 Marks)
 - iii. Advise the company on whether or not it should adopt the matrix in analysing the competitive strength of its products to enhance overall profitability. (5 Marks)
- b. Ansoff argued that when a firm is planning its growth strategies, there should be a link between its current products and markets and its future products and markets. The management of Agaba Limited, an Aba based company has anchored its strategies for product-market development on Ansoff's growth vector matrix.

Required:

Distinguish between market development strategy and product development strategy adopted by Agaba Limited. (6 Marks)

(Total 30 Marks)

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

QUESTION 2

Since the onset of the global economic crises of 2008 that led to the collapse of many corporations across the world, there has been a heightened demand for companies to have good and effective corporate governance structures.

- a. Discuss the importance of effective corporate governance codes to corporations. (5 Marks)
 - b. Explain the **TWO** basic approaches of corporate governance and specify the one you consider to be more acceptable. (10 Marks)
 - c. Identify **FIVE** of the main governance aspects of Sarbanes-Oxley Act. (5 Marks)
- (Total 20 Marks)**

QUESTION 3

- a. There is an increasing demand for professional accountants to pay close attention to ethical standards as they carry out their professional duties. This requires, among other considerations, that accountants act professionally and in the public interest. They are also expected to abide by the code of ethics of their profession and the corporate code of ethics of the organisations in which they work.
 - i. As an Accountant, explain the quality of professionalism you need to exhibit in the discharge of your duties. (6 Marks)
 - ii. Discuss the nature and purpose of a corporate code of ethics. (9 Marks)
 - b. Risk management has been an issue with the newly constituted board of Health Pharmaceutical Company. As the chairman of the board, you are required to:

Discuss the ALARP framework in risk management with the newly constituted board. (5 Marks)
- (Total 20 Marks)**

QUESTION 4

- a. Discuss the argument in support of the two-tier board structure. (10 Marks)

- b. i. Discuss objective and subjective risk perception. (4 Marks)
 - ii. Explain, with examples, related and correlated risk factors. (4 Marks)
 - c. Explain briefly the implications of failure to understand relationships among risks. (2 Marks)
- (Total 20 Marks)**

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

QUESTION 5

Aniko, a purchasing manager in Lasmal Company, deals directly with suppliers based on purchase requisition from various departments. Recently, a purchase requisition was received from the production department in which the quality of materials required was specified. However, the supplier delivered materials of lower quality, which were accepted by the store keeper on the instruction of the Managing Director.

When Aniko objected to the acceptance of the sub-standard materials, his personal account was credited with ₦3 million by the supplier to prevent him from exposing the fraudulent transaction.

Required:

- a. i. Identify and explain briefly the technical term to describe the above scenario. (1½ Marks)
 - ii. Explain the necessary steps Aniko should take before reporting the fraudulent transaction. (9 Marks)
 - b. Explain the likely risks in exposing such a transaction. (4½ Marks)
- (Total 15 Marks)**

QUESTION 6

Ego Oil and Gas Limited is a company licensed to operate in Nigeria's downstream oil and gas sector. The company owns tank farms and filling stations across the six geo-political zones of the country. These include the North-East and South-South where there have been increased cases of terrorist activities, especially kidnapping.

The company recently suffered losses due to a fire outbreak at one of its tank farms and fraud at the Port Harcourt office in the South-South Zone. There is also a rumoured agitations by labour movement in the country which will further reduce the price of petroleum products. If this happens, the company will suffer severe revenue loss. In order to control and effectively manage risk, the company has decided to assess all its risks.

You are required to:

Design a risk map for the management of Ego Oil and Gas Limited and advise on the control measures for each risk category. **(Total 15 Marks)**

QUESTION 7

Mr. & Mrs. Phillips, your family friends, have just retired from the public service and are planning to set up a mushroom farm. They hope to use their gratuity and a loan sourced from their bank as initial capital for the business. Their bank manager requested them to present a business plan for this purpose. They approach you for advice on how to prepare a business plan, as they cannot afford to hire a consultant.

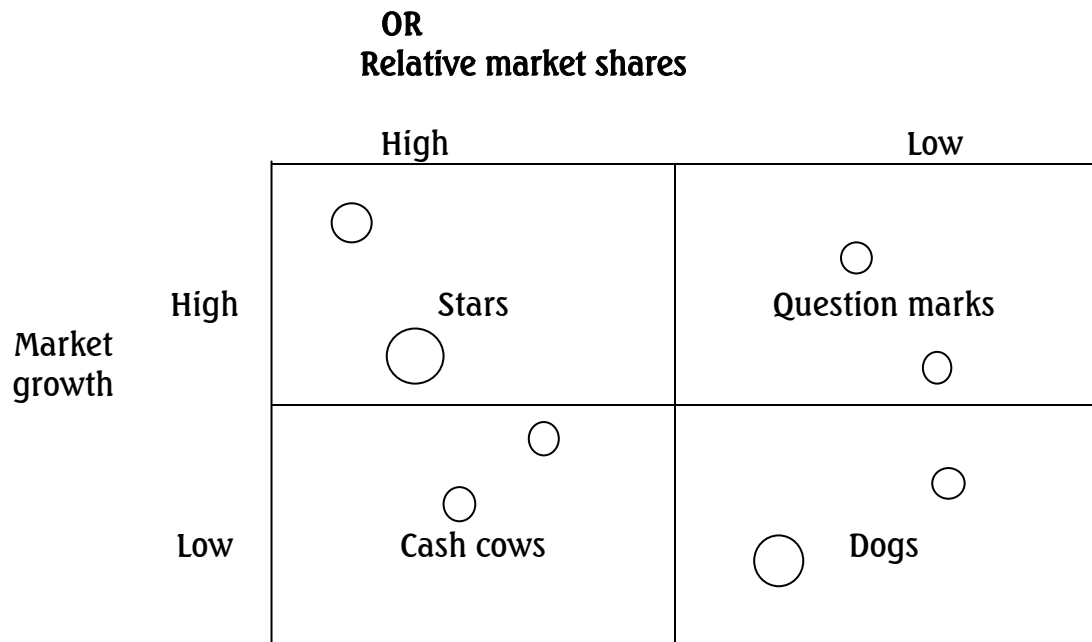
You are required to:

Advise Mr. and Mrs. Phillips on the contents of a standard business plan. **(Total 15 Marks)**

SOLUTION 1

a.(i) Going by the BCG Matrix, Zidat's Products: Zidat Cola; Zidat Orange; Zidat Apple; Zidat Bitters; and Zidat Water, may be categorised into any of the following:

- Star
- Cash cow
- Question mark (also called 'problem child')
- Dog



Star

A star is the market leader with a high relative market share in a high-growth market. However, a considerable investment of cash is still required to maintain its leading position. Initially, they probably use up more cash than they earn, and at best are cash-neutral. Over time, stars should gradually become self-financing. At some stage in the future, they should start to earn high returns.

Cash cow

A cash cow is a product in a market where market growth is relatively lower and possibly even negative. It has a high relative market share and is the market leader. It should be earning substantial net cash inflows because it has high economies of scale and has become efficient through experience. Other companies will not mount an attack as they perceive that the market is old and near decline. Cash cows should be providing the business entity with the cash that it needs to invest in question marks and stars.

Question Mark

A question mark is a product with a relatively low market share in a high-growth market. Since the market is growing quickly, there is an opportunity to increase

market share, but initially it will require a substantial investment of cash to increase or even maintain market share.

A strategic decision that needs to be taken is whether to invest more heavily to increase market share in a growing market, seek a profitable position in the market, but not as market leader, or withdraw from the market because the cash flows from the product are negative.

The BCG analysis states that a firm cannot last long with a small market share as bigger companies will be able to apply great cost and price pressure as they enjoy economies of scale.

Dog

A dog is a product in a low-growth market that is not the market leader. It is unlikely that the product will gain a larger market share because the market leader will defend the position of its cash cow. A dog might be losing money and using up more cash than it earns. If so, it should be evaluated for potential closure.

However, a dog may be providing positive cash flows. Although the entity has a relatively small market share in a low-growth market (or declining market), the product may still be profitable. A strategic decision for the entity may be to choose between immediate withdrawal from the market (and perhaps selling the business to a buyer, for example in a management buyout) or enjoying the cash flows for a few more years before eventually withdrawing from the market.

It would be an unwise decision, however, to invest more capital in 'dogs', in the hope of increasing market share and improving cash flows, because gaining market share in a low-growth market is very difficult to achieve.

a.(ii) LIMITATIONS OF BCG MATRIX

The following are the weaknesses/limitations of BCG Matrix:

- **Difficulties in determining rate of market growth and market shares**
There is no specific benchmark for determining a growing market and a large market share. The model also fails to capture a market with average growth rate or business with average market share. Furthermore, there may be practical difficulties in deciding what exactly is high or low in a particular situation.
- **Difficulty in analysing some markets:**
It might be that the BCG matrix is better for analysing the performance of strategic business units (SBUs) and market segments. However, it is not so useful for analysing entire markets, which might consist of many different market segments.

- **The BCG Model is simplistic:**
The strategic evaluation of the attractiveness of a set of business requires examination of more than relative market share and industry's market growth. An assessment of the attractiveness of an SBU in terms of just two dimensions is bound to be misleading because there are a host of other relevant factors that should be taken into account. The attractiveness of an industry is determined by technology and other seasonal, competitive and historical factors aside from market growth and market share.
- **Invalidity of some assumptions**
Assumptions such as a high market share in a low growing market will tend to generate more cash flow may not be valid. This is because the capital investments needed by some high market share businesses in a low growth market industry are so substantial than the reverse, that is, a negative cash flow.
- The BCG growth model share fails to consider the wide range of factors that affect cash flow beyond market share and market growth.
- BCG matrix classifies businesses as low and high, but generally, businesses could also be medium.
- It might be difficult to identify which products are competing with one another.
- There might be problems with defining the geographical areas of the market.

a.(iii)

NEUTRAL POSITION: CALL FOR CAUTION IN ADOPTING BCG MATRIX

The company needs to exercise much care in adopting the BCG matrix to analyse the competitive strength of its products for the purpose of enhancing its overall profit.

This is because while the BCG matrix might be helpful for analysing the performance of strategic business units (SBUs) and market segments, it has a number of flaws hindering it from accurately predicting the prospects of products in the market:

Justifications for Call for Caution

- The BCG Matrix based on the wrong assumption that the competitive strength of a product in the market depends on its market share and that the attractiveness of a market for new investment depends only on the rate of sales growth in the market. It is false that unless a market is growing quickly, it is not worthwhile to invest more money in it. It might still be worthwhile to invest in a market with a low growth rate.

- It fails to take into consideration other factors, apart from market share and market size, that determine what a company should do with a product. These include strength of competition, cost base and brand strength.
- It does not provide a good account of how to understand the nature of any given market.
- It does not provide a good means of defining what is meant by 'high rate' and 'low rate' of growth in the market as well as what is meant by 'high' market share and 'low' market share.

Nevertheless the BCG Matrix has some advantages which include:

- It provides help to a company in directing its investments across the corporate portfolio of the firm. It also identifies and describes how best a company can use its corporate cashflow along the life cycles of individual products;
- The matrix provides simple but useful guidelines for checking for consistency among business unit requesting for resource and the likely opportunity for a business unit to use those resources effectively so as to increase profitability;
- The BCG Model brings to focus important differences among businesses and helps to illustrate the rationale behind corporate plan to invest fund;
- It helps a company to benefit from the cashflows generated from "cash cow" Products;
- It assists organizations to identify "star" products on which to invest more;
- The matrix enables a company to identify "dog" products that should be withdrawn from the market; and
- It helps organizations to determine if a product classified as a "question mark" product can become a star or cash cow product.

OR

ADOPTION OF BCG MATRIX

The BCG matrix should be adopted because:

- It provides help to a company in directing its investment across the corporate portfolio of the firm;
- It also identifies and describes how best a company can use its corporate cash flow along the life cycles of individual products;

- The matrix provides simple but useful guidelines for checking for consistency among business units requesting for resources and the likely opportunity for a business unit to use those resources effectively so as to increase profitability;
- The BCG Model brings to focus important differences among businesses and helps to illustrate the rationale behind corporate plan to invest fund;
- It helps a company to benefit from the cash flows generated from “cash cow” products;
- It assists organizations to identify “star” products on which to invest more;
- The matrix enables a company to identify “dog” products that should be withdrawn from the market; and
- It helps organizations to determine if a product classified as a “question mark” product can become a star or cash cow product.

OR

NON-ADOPTION OF BCG MATRIX

The BCG matrix should not be adopted because:

- BCG matrix classifies businesses as low and high, but generally businesses could be medium also;
- Market is not clearly defined in this model;
- High market share does not always lead to high profits as there are high costs also associated with high market share;
- Growth rate and relative market share are not the only indicators of profitability. Other indicators of profitability include low cost of production, favourable government policy in form of subsidies, tax returns, etc;
- It might be difficult to identify which products are competing with one another;
- There might be problems defining the geographical area of the market; and
- The BCG matrix is not useful for analysing entire market which might consist of different market segment.

b. Key Difference between Market Development strategy and Product Development strategy

Market Development Strategy

- i. Market development is a growth strategy that identifies and develops new market segments for existing products.
- ii. Market development strategy involves opening up of new market for existing products.
- iii. Market development strategy is the act of selling a product in new geographical market.

Product Development Strategy

- i. This is a strategy in which businesses develop new products or product categories and market them in existing markets, i.e, to the same customer base.
- ii. It involves an introduction of innovative and unique products into the existing market.
- iii. It entails the production of new products or so many products lines for an existing market.

EXAMINER'S REPORT

The question tests candidates' understanding of the BCG Matrix and Ansoff's Growth Matrix. All the candidates attempted the question, being compulsory. Overall performance was slightly above average. Most of the candidates did well in (ai) and (b) but performed poorly in (aii) and (aiii).

Commonest pitfall was candidates' inadequate understanding of the strengths and weaknesses of the BCG Matrix. Many candidates were also unable to advise the company on whether or not to adopt the matrix.

Apart from paying close attention to the details of ICAN's Study Text, candidates should also understand how theories and concepts should be applied to practical situations.

Marking Guide		Marks	Marks
ai.	Identification of categories of product	4 x ½	2
	Explanation of each of the categories identified	4 x 1½	6
ii.	Weakness of the BCG matrix	5 x 2½/5	11
iii.	Should the matrix be adopted	1	1
	Problems with the matrix	4 x 1	4
bi.	Market development strategy	1 x 3 = 3	
	Product development strategy	<u>1 x 3 = 3</u>	<u>6</u>
	Total		<u>30</u>

SOLUTION 2

- a. The importance of effective corporate governance codes to corporations include:
- i. Protecting investors from unethical or dishonest behavior by company management through the provision of reliable information about companies;
 - ii. Preventing the collapse of stock markets;
 - iii. Securing the investments of shareholders;
 - iv. It responds positively to the pressure from institutional investors in countries that insist on companies having well-developed corporate governance codes or rules;
 - v. Good corporate governance practices are considered to be an application of good business ethics; and
 - vi. Good corporate governance contributes to efficiency and effectiveness of a company leadership and management.
- b. Two basic approaches of corporate governance are:
- i. **Rules-Based Approach**
Under this approach, companies are required by law to comply with the established rules of good corporate governance. However, the rules might apply only to some types of companies, e.g. major stock market companies.

Advantages of Rules-Based approach includes:
 - Companies do not have the choice of ignoring the rules; and
 - Investors' confidence in the stock market might be improved if companies are required to comply with recognised corporate governance rules.
Disadvantages of Rules-Based Approach includes:
 - The same rules might not be suitable for all companies; and
 - Some aspects of corporate governance cannot be regulated easily by rules.
 - ii. **Principles-Based Approach to Corporate Governance**
This approach is premised on the understanding that a single set of rules is inappropriate for every company.

Other matters of concern to this approach are:
 - Corporate governance codes should only apply in principle to all major companies;

- Guidelines or provisions should be issued with the code to suggest how the principles should be applied;
- As a general rule, companies are expected to comply with the guidelines or provisions; and
- There are differences in the ways these principles are applied in practice.

There is no conclusive evidence to suggest that one approach is better than the other.

c. The main aspects of Sarbanes-Oxley Act are as detailed below:

i. **CEO/CFO certification (Sec. 302)**

The certification is applicable to all US and foreign companies. The certificate must be signed by the CEO/CFO of the company.

ii. **Assessment of internal control (Sec. 404)**

The Act required the Securities and Exchange Commission (SEC) to establish rules that require companies to include an internal control report in each annual statement. External auditors are also required to prepare an 'attestation report' on company's assessment of its internal control system.

iii. **Loans to Executives**

The act prohibits companies (other than banks) from lending money to any director or senior executive.

iv. **Forfeiture of Bonuses**

If the company's financial statements have to be re-stated due to non-compliance with accounting standards and rules, any bonuses paid to the CEO and CFO in the previous twelve months must be paid back to the company.

v. **Insider Dealing**

Directors and Senior Executives are not allowed to trade in shares of their company during any black - out period.

vi. **Audit Committees**

Companies with a stock market listing must have an audit committee consisting entirely of members who are independent of the company.

vii. **Non-audit work by Auditors**

Under the act, Auditors are not allowed for example, to do book-keeping work for an audit client or provide valuation services or perform any management functions for the company.

viii. **Protection of Whistleblowers**

The Act provides protection for any employee who 'blows the whistle' on illegitimate activities in a company. It also prevents a company from taking any punitive action against an employee that blew a whistle, such as terminating his or her employment.

ix. **Audit Standards**

Audit firms must have quality control standards in place and retain working papers for at least seven years. Auditors must review internal control systems as part of the audit to ensure they reflect client transactions.

Auditors must also provide reasonable assurance that transactions are recorded in a manner that will permit the preparation of GAAP – compliant financial statements.

EXAMINER'S REPORT

The question tests candidates' knowledge of Corporate Governance Codes and the basic approaches of Corporate Governance. Many of the students (61% - 80%) attempted the question but overall performance was poor. Only 20% of candidates scored above 50% in the question.

Commonest pitfalls include inadequate understanding of Corporate Governance Codes, insufficient explanation of the two approaches of Corporate Governance and inadequate grasp of the Sarbanes-Oxley Act.

Candidates are advised to read ICAN's Study Text and Pathfinder very well and ensure that they have a good understanding of their contents.

Marking Guide		Marks	Marks
a.	Importance of Corporate Governance	5 x 1	5
b.	Two basic approaches of Corporate Governance		
	Rules-Based definition	1 x 1	
	- Advantages	2 x 1	
	- Disadvantages	2 x 1	
	- Principles based – definition	1 x 1	
	- Principles based - other points	3 x 1	
	- More acceptable approach	<u>1 x 1</u>	
c.	Any five out of nine main governance aspects/key Provisions of Sarbanes – Oxley Act	<u>5 x 1</u>	10
			<u>5</u>
			<u>20</u>

SOLUTION 3

a.i Professional behaviour is commonly associated with:

- ✓ **Integrity:** an accountant must act with integrity and be honest and straightforward in his professional and business dealings. This means that an accountant is expected not to lie in all circumstances and should not be involved in any form of fraudulent activities.
- ✓ **Objectivity:** an accountant must not allow his professional or business judgments to be affected by bias, conflict of interest or undue influence from others.
- ✓ **Professional competence and due care:** an accountant has a duty to maintain professional knowledge at a level that enables him to provide competent professional service to his clients or employer. This includes a requirement to be conversant with developments in areas of accounting that are relevant to his work, such as International Accounting Standards (IAS), International Financial Reporting Standards (IFRS), International Standards on Auditing (ISA), Tax laws etc.
- ✓ **Confidentiality:** accountants must respect the confidentiality of information obtained in the course of their work. This applies to the confidentiality of information within a firm or employer's organisation as well as confidentiality of information about clients.
- ✓ **Professional behavior:** accountants are required to avoid any action that would discredit the accountancy profession and ensure that they comply with all relevant laws and regulations.

ii. **Nature and purpose of a corporate code of ethics**

Nature

- ✓ A corporate code of ethics is a code of ethical behaviour, issued by the board of directors of a company. It is a formal written statement and should be distributed or easily available to all employees. The decisions and actions of all employees in the company must be guided by the code.
- ✓ The effectiveness of a code of ethics depends on the leadership of the company – its directors and senior managers. These officials must be seen to comply with the ethical code; otherwise other employees will see no purpose in complying with the code themselves. The culture of a company drives its ethical behaviour and a code of ethics provides useful guidance.

- ✓ It has been suggested that there are three reasons why companies might develop a code of ethics. These reasons are progressive, which means that companies might begin by having a code of ethics for the first reason, but then progress to the second and third reasons as they gain experience with implementing the code and appreciating its potential benefits. These reasons are presented below.

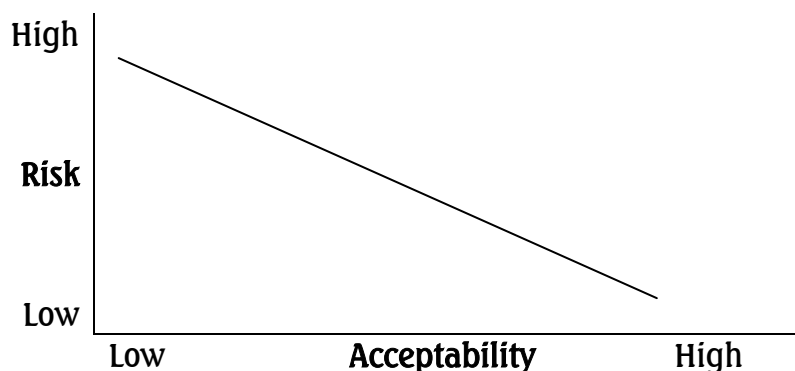
Purpose/Reason for Corporate Code of Ethics

- ✓ **Managing for compliance:** A company wants to ensure that all its staff comply with relevant laws and regulations, and conduct themselves in a way that the public expects. For example, companies providing a service to the general public need to ensure that their employees are polite and well-behaved in their dealings with customers.
- ✓ **Managing stakeholder relations:** A code of ethics can help to improve and develop the relations between a company and its stakeholders, by improving the trust that stakeholders have in the company. The code might therefore include the ethical stance of the company on disclosing information to stakeholders and the investing public (openness and transparency) and on respecting the rights of stakeholders.
- ✓ **Creating a value-based organization:** A company might recognise the long-term benefits of creating an ethical culture and encouraging employees to act and think in a way that is consistent with the values in its code of ethics.
(It could be argued that an ethical company, like a well-governed company, is more likely to be successful in business in the long term. However, there is no firm evidence to prove this point, and it is therefore a matter of opinion.)

b. The ALARP principle in risk management

The ALARP principle is the “as low as reasonably practicable principle”.

Common sense suggests that low risk is more acceptable than high risks. The following diagram illustrates this relationship.



- i. The diagram does not illustrate that all risks should be avoided. It suggests rather that there is an acceptable level of risk in a given circumstance to achieve a given objective. It is important to remember that risk and return are usually linked in a positive way so that higher returns are often associated with higher risks.
- ii. ALARP is a term that is associated with safety precautions. It stands for "as low as reasonably practicable" and derives from UK Health and Safety legislation.
- iii. The ALARP principle holds that it is usually impossible (or, if it is possible, it is grossly expensive) to eliminate all risks but any residual risk should be as low as reasonably practicable. A risk is said to be ALARP when the cost involved in reducing it further would be grossly disproportionate to the benefit gained.
- iv. ALARP should not be thought of as a simple quantitative measure of cost against benefit because any safety improvement would not be worthwhile only if the costs were disproportionately more than the benefit achieved. This is a matter of judgment and might vary from country to country.

EXAMINER'S REPORT

The question tests candidates' knowledge of professional ethics, especially the ethical demand for accountants to be professional in the execution of their duties. It also tests their understanding of the nature and purpose of a corporate code of ethics. Almost all the candidates attempted the question.

Commonest pitfall is candidates' lack of understanding of the basic principles of professional ethics and the nature/purpose of Corporate Code of Ethics.

They also displayed a weak capacity to present an adequate explanation of the ethical principle of professionalism.

Candidates are advised to study ICAN's Study Text well.

Marking Guide		Marks	Marks
a.	i. Acting professionally	6 x 1	6
	ii. The nature of code of ethics	3 x 1	3
	The purpose of code of ethics	3 x 2	6
b.	ALARP Principle	5 x 1	5
			20

SOLUTION 4

a. **The two-tier board structure**

A two-tier board structure consists of a management board and a supervisory board.

The **management board** is responsible for the oversight of management and business operations. It consists entirely of executive directors and its chairman is the company's chief executive officer (CEO).

The **supervisory board** is responsible for the general oversight of the company and the management board. It consists entirely of non-executive directors who have no executive management responsibilities in the company. Its chairman is the chairman of the company, who is the most significant figure in the corporate governance structure.

The responsibilities of the management board and supervisory board should be clearly defined. For instance, a function of the chairman of the company (and supervisory board) is to work closely with the CEO. As chairman of the management board, the CEO reports to the chairman of the company. If there is a good relationship between the CEO and chairman, the chairman will speak for the company's management at meetings of the supervisory board.

Advantages of a two-tier board structure

- i. It separates two different roles of the board. The management board is responsible for operational issues whereas the supervisory board is able to monitor the performance of management generally, including the executive directors on the management board.
- ii. It is an appropriate structure for a company that recognises the interests of different stakeholder groups. These stakeholders interests can be represented on the supervisory board without having a direct impact on the management of the company.
- iii. The legal duties of non-executive directors on the supervisory board can be different from the legal duties of executive directors on the management board. This is sensible because independent directors are part-time appointments and are not involved in the management of the company. In a unitary board, the legal duties of non-executive directors and executive directors are the same.
- iv. It will be more appropriate in a complex business environment whereby it will be impossible for the executive director to oversee all factors to be considered in making decision. With the presence of non-executive director, there will be easy collaboration and consolidation of ideas to yield a concrete decision which will be in the best interest of shareholders.

- v. Any conflict of interest among the directors can easily be identified and resolved before it serves as a detriment to shareholders' interest.

b.i Objective and subjective risk perception

There is an objective perception of risk when it is possible to assign accurate and reliable values to the likelihood and impact of a risk with a high degree of certainty. It should be noted that the degree of certainty with which values can be assigned to risks varies with the nature of risks in question.

If both variables of impact and likelihood can be measured accurately, (where hard information is available) the risk is described as having been objectively assessed.

However, in many cases, it is difficult to assign a value to either likelihood or impact with any degree of accuracy. In such cases, risk perception is subjective as judgements must be used.

Assessment of a risk based on objective measurement of likelihood and impact is usually better and more robust than if based on subjective judgement. This will affect the risk management strategy.

bii. Related and correlated risk factors

Related risks are those that are often present together at the same time.

Risks might also be correlated. This means that they vary together. Risks might be positively correlated (both go up or down together) or negatively correlated (one falls as the other increases). Correlation might be due to the risks having a common cause or because one type of risk might give rise to the other.

Failure to understand the relationship between risks, if there is one, could lead to:

- i. Inappropriate risk response strategy; and
- ii. Wasting of resources on those risks that can easily be tackled by the company.

EXAMINER'S REPORT

The question tests candidates' understanding of the types of board structure and nature, types and relationship among risks. About 40% of the candidates attempted the question and their performance was well below average.

Commonest pitfall was the misinterpretation of the demands of the question and inadequate understanding of the distinction between the unitary and two-tier board structures.

Candidates are advised to ensure that they have a clear understanding of the important distinctions made in ICAN's Study Text.

Marking Guide		Marks	Marks
a.	Two-tier structure identification		2
	Explanation of two-tier structure		2
	Advantages of two-tier structure		6
bi.	Objective and subjective risk perception		
	Objective risk perception		2
	Subjective risk perception		2
ii.	Related and correlated risk factors		
	Related risk factors		2
	Correlated risk factors		2
c.	Relationship between risks		<u>2</u>
	Total		<u>20</u>

SOLUTION 5

- a.
 - i. Whistle blowing means reporting suspicion of illegal or improper behavior to a person in authority. The scenario here presents an ethical dilemma faced by Aniko: on whether or not to report a perceived fraudulent practice or activity.
 - ii. The following should be put into consideration before blowing the whistle:
 - ✓ The correctness of the facts, i.e., are all the facts correct or could they have been misinterpreted;
 - ✓ Is there sufficient evidence to justify blowing the whistle?
 - ✓ Aniko should double-check that he had thought about the situation objectively and has neutral emotion;
 - ✓ He should discuss events in confidence with an independent confidential third party, e.g., a professional helpline or legal advisor;
 - ✓ He should think about the impact that blowing the whistle may have on the whistleblowers' career. Is the risk of being victimized and bullied outweighed by the benefits of proceeding with blowing the whistle?;
 - ✓ He should double-check company policy and whistle blowing procedures in the staff handbook;
 - ✓ He should follow the company's procedure at all times;
 - ✓ He should establish whether there is an opportunity to discuss events confidentially with the human resources department;

- ✓ Is there an internal audit department that could be made aware of relevant events and then take the responsibility of reporting the issue?; and
- ✓ He should consider if there is a legal obligation to blow the whistle. E.g. in many countries, there is a legal obligation to report the discovery of money laundering or terrorist activities.

b. The risks of whistle blowing are:

i. On the part of the individual

- ✓ **Victimisation:** From experience in many organisations, when an individual reports an illegal or unethical conduct, the individual is often victimised by colleagues and management.
- ✓ **Loss of Job:** if the transaction is exposed by Aniko to the management or internal auditor, it could lead to his dismissal for going against the consent and decision of the Managing Director. Alternatively, it could later lead to further complications for the Managing Director if Aniko is still working in the organization.
- ✓ **Loss of personal benefit such as allowance and promotion:** if the transaction is disclosed by Aniko which is against the Managing Director's decision, the latter could inform the accountant to withhold the allowance and some other benefits that ought to accrue to Aniko pending the time he will comply with his decision.
- ✓ **Job rotation to irrelevant or minor department:** one of the consequences of disclosing the transaction could be that Mr Aniko will be moved or relocated to another branch or different department within the organisation which is not related to his career pursuit.

ii. On the part of the company

- ✓ **Encouraging whistle blowing:** The company will be saddled with the problem of how to encourage reporting of illegal or illegitimate transactions.
- ✓ **Protecting whistleblowers:** In such case of unethical behaviour, the company will need to take up the responsibility of protecting honest whistleblowers.
- ✓ **Discouraging unfounded allegations:** The company will be faced with the problem of how to discourage malicious and unfounded allegations

EXAMINER'S REPORT

The question tests candidates understanding of the nature, requirements and risks associated with whistle blowing. About 40% of the candidates attempted the question and performance was poor.

Commonest pitfall was the inability of the candidates to identify and explain the technical term relevant to the scenario given. They were also unable to discuss the requirements and risks related to whistle blowing.

Candidates are advised to develop the skill of identifying the principles, theories and concepts relevant to specific cases. They should also pay close attention to the details of ICAN's Study Text and Pathfinder.

Marking Guide

	Marks	Marks
a (i) Identification of the relevant technical term	1	
Explanation of the technical term	$\frac{1}{2}$	1 $\frac{1}{2}$
(ii) Steps to be taken before alarm is raised	6x1 $\frac{1}{2}$	9
b. Identifying risks on the part of the individual & company	$\frac{1}{2}$	
Any four points 1 mark each	4	4 $\frac{1}{2}$
		<u>15</u>

SOLUTION 6

- a. The format of a simple risk map is shown below:

High impact Impact/size of Potential loss	High impact	High impact Low probability Consider the need for control measures, Such as insurance	High impact High probability Take immediate action to control the risk
	Low impact	Low impact Low probability Review periodically	Low impact High probability Consider the need for control action
		Low probability/ Frequency	High probability/ Frequency

Low probability or Frequency of the risk materialising

The control measures as applicable to EGO Oil and Gas Ltd. For each category of risk are as follows:

Although, in practical terms; it may be difficult to assess the frequency of some of the risks that EGO Oil and GAS Ltd. is experiencing/may experience but it is apt to give a broad categorisation of risks in a business environment.

- b.
 - i. **High Impact low Probability:** Some of these risks can be controlled via insurance policies.
 - ii. **High Impact High Probability:** The organisation should take immediate action to control the risk.
 - iii. **Low Impact Low Probability:** Periodic review is required because changes in the firms operating environment can make these risks more probable and damaging.
 - iv. **Low Impact High Probability:** For this category of risk, the management should consider the need for control action. This is because a change in the business environment may change the status of these risks.

EXAMINER'S REPORT

The question tests candidate's ability to employ a risk map to categorise risks and advise on the control measures for each category of risks. About 60% of the candidates attempted the question and their overall performance was poor. Only 20% of the candidates scored above 50% in the question.

Commonest pitfall was their lack of adequate understanding of the requirements of the question.

Candidates should ensure that they study all the components of the syllabus and the contents of ICAN's Study Text and Pathfinder.

Marking Guide		Marks	Marks
a.	Properly drawn and labelled risk map	9	9
b.	Category of risk, Advice and Example	4 x 1½	<u>6</u>
	Total		<u>15</u>

SOLUTION 7

The component and contents of a business plan are as follows:

a. TITLE PAGE

The title and any sub-title should define the plan/report and ensure it is easily distinguishable from others

- i. Author
- ii. Organisation's name
- iii. Reference numbers (if any)
- iv. Date

b. TABLE OF CONTENTS

INTRODUCTION

This prepares the readers on why the report is being written. It addresses the following:

- i. Subject of the report;
- ii. Purpose of the report; and
- iii. Methods used in gathering information.

c. EXECUTIVE SUMMARY

The executive summary should include:

- i. What the report is about;
- ii. The relevant problems; and
- iii. Recommendation/Conclusion.

d. BODY OF REPORT

The body of report should be split into sections with logical headings and sub-headings e.g.

- i. Business descriptions
 - Overall mission and objectives.
 - History & ownership.
 - Products and services.
- ii. Business Environment analysis
 - PEST Analysis report.
 - SWOT Analysis report (Strengths, Weaknesses, Opportunities & Threats).
 - Competitor analysis.

- iii. **Operating Plans**
 - Marketing plan.
 - Operations plan.
- e. **MANAGEMENT SUMMARY**
 - i. Management personnel and their background.
 - ii. Organisation chart.
- f. **FINANCIAL PLAN**
 - Financial information e.g. cashflow statements, income statements, statement of financial position & risk factors .
- g. **CONCLUSIONS & RECOMMENDATIONS**
 - i. To follow logically from the rest of the plan.
 - ii. Draw conclusions that are justified by evidence.
 - iii. Make recommendations based on discussions.
& conclusions
- h. **APPENDICES**
 - i. Appendices should include detailed information that will throw more light to the report.
 - ii. CVs of key management of board members.

EXAMINER'S REPORT

The question tests candidate's ability to design an adequate business plan. Almost all the candidates attempted the question. Overall performance was slightly above average.

Commonest pitfall was that many of the candidates merely itemised the sections a business plan should have without providing the details that should be under each section.

Candidates are advised to have a good grasp of all the sections of business plan.

Marking Guide	Marks
Title page	2
Table of Contents	½
Introduction	2
Executive Summary	2
Body of report	3½

Management summary	1½
Financial plan	1
Conclusions & recommendation	1½
Appendices/Biography	<u>1</u>
Total	<u>15</u>