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

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THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION - NOVEMBER 2017

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

On April 1, 2017 Higherhigher Limited acquired 60% of the equity share capital of Lowerlower Limited in a share exchange of two shares in Higherhigher for three shares in Lowerlower. The issue of shares has not yet been recorded by Higherhigher Limited. At the date of acquisition, shares in Higherhigher had a market value of ₦6 each.

Below is the summarised draft financial statements of both companies.

Statement of Profit or Loss and other Comprehensive Income for the year ended September 30, 2017

	Higherhigher Limited ₦'000	Lowerlower Limited ₦'000
Revenue	2,720,000	1,344,000
Cost of sales	(2,016,000)	(1,024,000)
Gross profit	704,000	320,000
Distribution costs	(64,000)	(64,000)
Administrative expenses	(192,000)	(102,400)
Finance costs	(9,600)	(12,800)
Profit before tax	438,400	140,800
Income tax expense	(150,400)	(44,800)
Profit for the year	288,000	96,000

Statement of Financial Position as at September 30, 2017

	Higherhigher	Lowerlower

	Limited	Limited
	₦'000	₦'000
Assets		
Non-current assets:		
Property, Plant & Equipment	1,299,200	403,200
Current assets	512,000	211,200
Total Assets	1,811,200	614,400
Equity & Liabilities		
Equity shares of ₦1 each	320,000	128,000
Retained earnings	1,132,800	208,000
	1,452,800	336,000
Non-current liabilities		
10% Loan notes	96,000	128,000
Current liabilities	262,400	150,400
Total equities and Liabilities	1,811,200	614,400

The following information is relevant:

(1) At the date of acquisition, the fair value of Lowerlower Limited's assets was equal to their carrying amounts with the exception of an item of plant which had a fair value of ₦64m in excess of the carrying amount and had a remaining life of five years at that date; using straight line depreciation method. Lowerlower Limited has not adjusted the carrying amount of its plant as a result of the fair value exercise.

(2) Sales from Lowerlower Limited to Higherhigher Limited in the post-acquisition period were ₦256m. Lowerlower Limited made a mark-up on cost of 40% on these sales. Higherhigher Limited had sold ₦166.4m (at cost to Higherhigher Limited) of these goods by September 30, 2017.

(3) Other than where indicated, profit or loss items are deemed to accrue evenly on a time basis.

(4) Lowerlower Limited trade receivables at September 30, 2017 include ₦19.2m due from Higherhigher Limited which did not agree with Higherhigher Limited's corresponding trade payables. This was due to cash in transit of ₦6.4m from Higherhigher Limited to Lowerlower Limited. Both companies have positive bank balances.

(5) Higherhigher Limited has a policy of accounting for any non-controlling interest at fair value. For this purpose fair value of the goodwill attributable to the non-controlling interest in Lowerlower Limited is ₦48m. The consolidated goodwill was not impaired as at September 30, 2017.

You are required to prepare:

a. Consolidated statement of profit or loss and other comprehensive income for the period ended September 30, 2017 (10 Marks)

b. Consolidated statement of financial position as at

September 30, 2017. (20 Marks)

(Total 30 Marks)

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

QUESTION 2

Quadri Top Nigeria Plc. prepares annual financial statements to September 30. At September 30, 2017 the company list of account balances were as follows:

	DR	CR
	₦'000	**₦'000**
Revenue		185,000
Production costs	103,500	
Inventory at October 1, 2016	17,375	
Distribution costs	13,500	
Administration expenses	18,250	
Loan Interest expenses	3,000	
Land at valuation	131,250	
Building – cost	100,000	
Plant and equipment at cost	160,000	
Accumulated depreciation - building at 1/10/16		26,625
Accumulated depreciation PPE at 1/10/16		31,000
Trade receivables	51,500	-
Trade payables		28,000
Bank overdraft		1,000
Issued ord. shares at 50k each (Sept.30, 2017)		175,000
Share premium at (Sept.30, 2017)		50,000
Revaluation surplus		37,500
Retained earnings		39,250
12% Loan notes (payable 2021)		25,000
	598,375	598,375

The following are relevant to the preparation of the financial statements for the year ended September 30, 2017.

(1) Inventory at September 30, 2017 amounted to ₦19.5m.

(2) Depreciation is to be provided on cost of the non-current assets as follows:
Building 2% per annum

Plant & equipment 20% per annum

80% of the depreciation is to be charged to cost of sales and 10% each to distribution cost and administrative expenses.

(3) Land is to be revalued to ₦125m.

(4) Accrued expenses and prepayments were

	Accrued Expenses	**Prepayments**
	₦'000	**₦'000**
Distribution cost	2,375	1,500
Administrative expenses	875	750

(5) During the year ended September 30, 2017, 100million ordinary shares were issued at 75k per share. The directors of Quadri Top declared an interim dividend of 2k per share in September 2017. No dividends were paid during the year.

(6) Loan interest is paid annually, on September 30 each year.

Required:

Prepare in accordance with IAS1:

i. Statement of profit or loss and other comprehensive income for the year ended September 30, 2017. (8 Marks)

ii. Statement of financial position as at September 30, 2017 (12 Marks)

(Total 20 Marks)

QUESTION 3

(a) The basic financial ratios can be grouped into the following broad categories.

- Profitability and efficiency
- Long term solvency and stability
- Short term solvency and liquidity
- Shareholders investment ratios

Required:

Briefly explain the main aims and give **TWO** examples of each category of the above financial ratios. (8 Marks)

(b) The following is the financial information extracted from the records of Nwokeke Nigeria Plc for the year ended March 31, 2017.

FINANCIAL INFORMATION EXTRACTS

	₦'000
Inventories:	
Raw materials	142,500
Work in progress	57,000

Finished goods	190,000
Purchases	475,000
Revenue	855,000
Cost of goods sold	712,500
Trade receivables	218,500
Trade payables	114,000

Additional Information

The directors of Nwokeke Nigeria Plc are of the opinion that the average cash operating cycles of companies that operate in the same industry as Nwokeke Plc is 75 days.

Required:

i. Explain the term cash operating cycle. (2 Marks)

ii. Calculate the cash operating cycle of Nwokeke Nigeria Plc. (4 Marks)

iii. Assess the performance of Nwokeke Nigeria Plc's cash management relative to the industry average performance. (2 Marks)

iv. Suggest **TWO** steps that should be taken by the directors of Nwokeke Nigeria Plc to improve the cash operating cycle of the company. (4 Marks)

(Total 20 Marks)

QUESTION 4

a. i Explain what is meant by the terms "associate" and "significant influence" (2 Marks)

ii. Explain the equity method of accounting which is used to account for investment in an associate. (2 Marks)

iii. Distinguish between joint operation and joint ventures. (2 Marks)

b. On October 31, 2013, Y Limited paid ₦70,000 to acquire 40% of the share capital of Z Limited (which became its associate). Draft financial statements of the two companies for the year to October 31, 2017:

Statement of comprehensive income for the year ended October 31, 2017

	Y Limited	**Z Limited**
	₦`000	**₦`000**
Operating profit	325	70
Dividend received from Z Ltd	10	-
Profit before tax	335	70

Income tax expense	(85)	(15)
Profit for the Year	250	55

STATEMENT OF FINANCIAL POSITION AS AT OCTOBER 31, 2017

	Y Limited	Z Limited
	₦`000	₦`000
Assets		
Non-current asset		
Property, plant & equipment	800	400
Investment in Z Ltd at cost	70	-
	870	400
Current asset	390	145
	1260	545
Equity		
Ordinary share capital	500	100
Retained earnings	605	360
	1105	460
Liabilities		
Current liabilities	155	85
	1260	545

Statement of Changes in equity (retained earnings only) for the year to October 31, 2017

	Y Limited	Z Limited
	₦`000	₦`000
Balance at October 31, 2016	355	330
Profit for the year	250	55
Dividend paid	-	(25)
Balance at October 31, 2017	605	360

The following information is also available:

(i) In the draft financial statements of Y Limited, the company's investment in Z Limited has been recognised at cost and the dividend received from Z Limited has been recognised as income. The financial statements, showed the situation as it would be without application of the equity method, either in the year October 31, 2017 or in previous year.

(ii) The retained earnings of Z Limited on October 31, 2013 were ₦50,000 and all of its assets and liabilities were carried at fair value. None of the companies has issued any share since that date.

(iii) During the year to October 31, 2017 Y Limited bought goods from Z Limited for ₦15,000, which had cost Z Limited ₦10,000. One-quarter of these goods were unsold by Y Limited at October 31, 2017.

Required:
Prepare the separate financial statements of Y Limited for the year ended October 31, 2017, incorporating the result of the associate Z Limited, using the equity method of accounting.

(14 Marks)
(Total 20 Marks)

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

QUESTION 5

a. It is a general application of the concept of prudence that the carrying amount of an asset should not be greater than its recoverable amount. IAS 36 Impairment of Assets gives guidance on the application of this principle particularly for non-current assets.

Under the rules in IAS 36, an asset must be written down to its recoverable amount when this is less than its carrying amount. The standard ensures that impairment loss is measured and recognised on a consistent basis.

Required:

Explain the need for the application of IAS 36 and the concept of recoverable amount as contained in the standards. (7 Marks)

b. The determination of related party status depends on the substance of the relationship, not just the legal form.

Required:

i. Define a "related party transaction" and give **TWO** examples of such transactions. (4 Marks)

ii. In the context of IAS 24-Related Party Disclosures, state **FOUR** conditions under which an entity can be said to be related to another. (4 Marks)

(Total 15 Marks)

QUESTION 6

a. Snow-Ball Nigeria Plc is a manufacturer of school bags that are sold in most Nigerian modern markets. The following transactions and errors occurred during the year ended October 31, 2017.

i. As at the beginning of the year, the remaining useful life of the plant and equipment of the company was reassessed as four years rather than seven years. (2 Marks)

ii. Bonuses of ₦24million, compared with ₦4.6million in the previous year had been paid to employees. The financial manager explained that a new incentive scheme was adopted whereby all employees shared in increased sales. (2 Marks)

iii. During the year the company was responsible for the formation of "Back to School Foundation". This foundation forms part of the company's social investment programme. The company contributed ₦14million to the fund. (2 Marks)

Required:

Briefly explain how each of the above transactions would be treated in the statement of profit or loss of Snow-Ball Nig. Plc for the year ended October 31, 2017, stating whether a separate disclosure is required or not.

Note: No calculation is required. (6 Marks)

b. The inventory balance of Papaya Nigeria Limited are as follows for the year ended March 31, 2017.

	₦'000
Opening Inventory	28,875
Closing Inventory	31,425

In the course of preparing the financial statements at March 31, 2017, the need for a number of adjustments emerged as stated below:

(i) The opening inventory was found to have been overstated by ₦3,135,000 as a result of error in the calculation of values in the inventory sheets.

(ii) Some items included in the closing inventory at the cost of ₦120,000 were found to be defective and were sold after the end of the reporting period for ₦78,000. Selling cost amounted to ₦4,500.

Required:

i. Explain how adjustment should be made for errors in the opening inventory according to IAS 8 – "Accounting policies changes in accounting estimates and errors. **NB**: No calculation is required. (2 Marks)

ii. State two disclosure required by IAS 8 in the financial statements as at March 31, 2017 for the adjustments above. **NB:** No calculation is required: (3 Marks)

iii. Show how the final figures for inventory should be presented in the statement of financial position as at March 31, 2017. (4 Marks)

(Total 15 Marks)

QUESTION 7

Manilla Nigeria Plc leased an equipment from Capa Finance Limited. The terms of the lease are as follows:

Inception of the Lease	January 1, 2015
Lease term	4 years; ₦788,640 per annum payable

	in arrears.
Present value of minimum lease payments	₦2,500,000
Useful life of the assets	4 years

Required:

a. Briefly explain the term "interest rate implicit in the lease "under IAS 17 (2 Marks)

b. Calculate the interest rate implicit in the above lease, using the table below. (4 Marks)

This table shows the present value of ₦1 per annum, receivable or payable at the end of each year for n years.

Years		**Interest Rate**	
(n)	**6%**	**8%**	**10%**
1	0.943	0.926	0.909
2	1.833	1.783	1.736
3	2.673	2.577	2.487
4	3.465	3.312	3.170
5	4.212	3.993	3.791

c. How should Manilla Nigeria Plc treat this type of lease transaction (give reasons for your answer). (3 Marks)

d. Briefly discuss the effect of classifying a lease incorrectly in the income statement and statement of financial position. (6 Marks)

(Total 15 Marks)

SOLUTION 1

HIGHER - HIGHER LTD GROUP

(a) **STATEMENT OF CONSOLIDATED PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED SEPTEMBER 30, 2017**

	₦'000
Revenue (W1)	3,136,000
Cost of sales (W2)	(2,304,000)
Gross profit	832,000
Distribution cost (W3)	(96,000)
Administrative expenses (W4)	(243,200)
Finance cost (W5)	(16,000)
Profit before tax	476,800
Income tax expense (W6)	(172,800)
Profit for the year	304,000
Attributable to:	
Equity holder of the parent (bal)	297,600
Non-Controlling Interest (W7)	6,400
	304,000

N.B URP = Unrealised Profit

WORKINGS

		₦'000	**₦'000**
W1	**Revenue**		
	Parents		2,720,000
	Subsidiary (1,344,000 x $^{6}/_{12}$)		672,000
	Intra-group sales		(256,000)
			3,136,000

		₦'000	**₦'000**
W2	**Cost of Sales**		
	Higher-Higher Ltd.		2,016,000
	Lower-Lower Ltd. (1,024,000 x $^{6}/_{12}$)		512,000
	Intra Group Sales		(256,000)
	URP on Inventory (w1a)		25,600
	Additional Depreciation (64,000 ÷ 5 years x $^{6}/_{12}$)		6,400
			2,304,000

		₦'000	**₦'000**
W2a.	URP on Inventory $(256m - 166.4m \times \frac{40}{140})$	=	25,600

OR

W2b. **CONSOLIDATION SCHEDULE FOR PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME**

	HH LTD	LL LTD	ADJUSTMENTS	CPL
	₦'000	**₦'000**	**₦'000**	**₦'000**
Revenue	2,720,000	672,000	(256,000)	3,136,000
Cost of sales	(2,016,000)	(512,000)	230,400	
			(6,400)	2,304,000
Gross profit	704,000	160,000	(32,000)	832,000
Distribution cost	(64,000)	(32,000)		(96,000)
Administration cost	(192,000)	(51,200)		(243,200)
Finance cost	(9,600)	(6,400)		(16,000)
Profit before tax	438,400	70,400	(32,000)	476,800
Income tax exp.	(150,400)	(22,400)		(172,800)
Profit for the year	288,000	48,000	(32,000)	304,000

W3		₦'000	₦'000
	Distribution Cost		
	Parent		64,000
	Subsidiary (64,000 x $^6/_{12}$)		32,000
			96,000

		₦'000	₦'000
W4	**Administrative expenses**		
	Parent		192,000
	Subsidiary (102,400 x $^6/_{12}$)		51,200
			243,200

W5	**Finance Cost**	₦'000	₦'000
	Parent		9,600
	Subsidiary (12,800 x $^6/_{12}$)		6,400
			16,000

W6	**Income tax expenses**	₦'000	₦'000
	Parent		150,400
	Subsidiary (44,800 x $^6/_{12}$)		22,400
			172,800

W7	**Non-controlling interests**	₦'000	₦'000
	Share of subsidiary's profit (96,000 x $^6/_{12}$)		48,000
	Unrealized profit		25,600

Depreciation adjustment	6,400
	16,000
NCI Consolidated = (16,000 x 40%)	6,400

B

HIGHER-HIGHER LTD GROUP
STATEMENT OF FINANCIAL POSITION
AS AT 30TH SEPTEMBER, 2017

	NOTE	**₦'000**
Property, plants & equipment	(W13)	1,760,000
Goodwill	(W8)	144,000
Current asset	(W9)	684,800
		2,588,800
Equity shares	(W14)	371,200
Share premium	(W10)	256,000
Retained earnings	(W11)	1,142,400
		1,769,600
Non-controlling interest	(W12)	195,200
Non-current liabilities:		
10% loan notes	(W15)	224,000
Current liabilities	(W16)	400,000
		2,588,800

WORKINGS

W8	**Goodwill**	**₦'000**	**₦'000**
	Investment at Cost		
	Shares $^{2}/_{3}$ (128,000 x 60%) x ₦6		307,200
	Less: Equity Share of Lowerlower Ltd.		
	(128,000 x 60%)	(76,800)	
	Pre-acquisition Profit (160,000 x 60%)	(96,000)	
	Fair Value Adjustment (64,000 x 60%)	(38,400)	(211,200)
	Parent Goodwill		96,000
	Non-Controlling Interest Goodwill (per question)		48,000
	Total Goodwill		144,000
W8a	**Pre-acquisition Profit**	**₦'000**	**₦'000**
	Profit at 30 September, 2016		208,000
	Earned in post acquisition period (96,000 x $^{6}/_{12}$)		(48,000)
			160,000
W9	**Current Assets**	**₦'000**	**₦'000**
	Higher-Higher Ltd.		512,000
	Lower-Lower Ltd.		211,200
	URP on Inventory		(25,600)

	Cash in Transit		6,400
	Inter Group Balance		(19,200)
			684,800

W10	**Share Premium**	**₦'000**	**₦'000**
	₦51,200 shares = (128,000 x 60% x $^2/_3$) issued by higher Ltd would be recorded as share capital of ₦51,200 and share premium of ₦256,000 (51,200 x 5)		

W11	**Retained Earnings**	**₦'000**	**₦'000**
	Per question Higher-Higher Ltd		1,132,800
	Add: Lower-Lower Ltd post-acquisition Profit (96,000 x $^6/_{12}$) - ($25{,}600_{URP}$ + $6400_{Depr.}$) x 60%		
			9,600
			1,142,400

W12	**Non-Controlling Interest**	**₦'000**
	Net Assets per Statement of Financial Position	336,000
	URP on Inventory	(25,600)
	Net Fair Value Adjustment (64,000 – 6,400)	57,600
		368,000
	Non-Controlling Interest – 368,000 x 40%	147,200
	Share of Goodwill per acquisition	48,000
		195,200

W13	**Property, plant and equipment**	**₦'000**
	Parent	1,299,200
	Subsidiary	403,200
	Fan value adj.	64,000
	Depreciation adj.	(6,400)
		1,760,000
W14	**Equity shares**	
	Parent	320,000
	Share exchange	51,200
		371,200
W15	**10% loan notes**	
	Parent	96,000
	Subsidiary	128,000
		224,000
W16	**Current liabilities**	
	Parent	262,400

Subsidiary	150,400
Cash in transit	(12,800)
	400,000

EXAMINER'S REPORT

The question tests candidates' knowledge of group accounts. Candidates are required to prepare for a simple group consolidated statement of profit or loss and other comprehensive income and consolidated statement of financial position.

All the candidates attempted the question and the performance was average as about 55% of the candidates obtained up to 50% of the marks allocated to the question.

Candidate's commonest pitfall was their inability to correctly calculate figures for goodwill, non-controlling interest and the consolidated retained earnings.

Candidates are advised to pay special attention to preparation of group financial statements while preparing for examination at the skills level.

MARKING GUIDE		MARKS	MARKS
a.	**Consolidated statement of Profit or Loss**		
-	Determination of revenue	1	
-	Determination of cost of sales	$3^1/_3$	
-	Determination of distribution cost	1	
-	Determination of administrative expenses	1	
-	Determination of finance cost	1	
-	Determination of profit before tax	$^1/_3$	
-	Determination of income tax expense	1	
-	Determination of profit for the year	$^1/_3$	
-	Profit for the year attributable to parent	$^1/_3$	
-	Profit for the year attributable to NCI	$^2/_3$	
			10
b.	**Consolidated Statement of Financial Position**		
-	Determination of PPE	$1^2/_3$	
-	Determination of goodwill	$4^1/_3$	
-	Calculation of current assets	$2^1/_3$	
-	Determination of equity	1	
-	Determination of share premium	1	
-	Determination of retained earnings	$1^2/_3$	
-	Calculation of non-controlling interests	$3^2/_3$	
-	Determination of non-current liabilities	1	
-	Determination of current liabilities	$1^1/_3$	
-	Calculation of pre-acquisition reserves	$1^1/_3$	

-	Total assets	$^1/_3$	
-	Total liabilities	$^1/_3$	
			20
	Total		30

SOLUTION 2

(a) **QUADRI TOP NIGERIA PLC**

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED SEPT. 30, 2017

	Notes	₦'000
Revenue		185,000
Cost of sales	(W1)	(128,575)
Gross profit		56,425
Distribution cost	(W2)	(17,775)
Administration expenses	(W3)	(21,775)
Finance cost	(W4)	(3,000)
Profit before tax		13,875
Income tax 30%		(4,162.5)
Profit for the year		9,712.5
Revaluation (loss)/reversal		(6,250)
Total comprehensive income		3,462.5

(b) **STATEMENT OF FINANCIAL POSITION**
AS AT SEPTEMBER 30, 2017

Non-Current Assets:		**₦'000**	**₦'000**
Property, plant and equipment	(W8)		293,375
Current Assets:			
Inventory		19,500	
Trade receivables		51,500	
Prepayments		2,250	73,250
			366,625
Equity and Liabilities:			
Ordinary shares of 50k each			175,000
Share premium			50,000
Revaluation reserves			31,250
Retained earnings	(W7)		41,962.5
			298,212.5
Non-Current Liabilities:			
12% Loan notes (payable 2021)			25,000
Current Liabilities:			
Trade payables		28,000	
Accruals	(W5)	3,250	
Bank overdraft		1,000	
Provision for tax		4,162.5	
Interim dividend payable		7,000	43,412.5
			366,625

WORKING NOTES:

W1 Cost of sales (COS)

	₦'000	₦'000
Inventory at October 1, 2016		17,375
Production Cost		103,500
		120,875
Inventory at September 30, 2017		(19,500)
		101,375
Depreciation:		
Building (2% x ₦100,000)	2,000	
Plant & Equipment (2% x ₦160,000)	32,000	
	34,000	
Share of COS (80% x ₦34,000)		27,200
		128,575

W2

Distribution cost:

Distribution cost (13,500 + 2.375 – 1,500	14,375
Depreciation (10% x 34,000)	3,400
	17,775

W3

Administration Cost:

Administration expenses (18,250+875-750)	18,375
Depreciation (10% x 34,000)	3,400
	21,775

W4

Finance cost = 12% x 25,000 =	3,000

W5

Accruals:	**₦'000**
Administration	2,375
Distribution	875
	3,250

W6

Prepayments:	**₦'000**
Administration	1,500
Distribution	750
	2,250

W7 STATEMENT OF CHANGES IN EQUITY

	Equity Shares ₦'000	Share Premium ₦'000	Rev. Res ₦'000	Ret. Earn. ₦'000	Total ₦'000
Bal. B/F	125,000	25,000	37,500	39,250	226,750
For the Year	50,000	25,000	(6,250)	9,712.5	78,462.5
Dividend	-	-	-	(7,000)	(7,000)
	175,000	50,000	31,250	41,962.5	298,212.5

W8 STATEMENT OF CHANGES IN PROPERTY, PLANT AND EQUIPMENT AS AT SEPTEMBER 30, 2017

	Land	Building	Plant & Equip.	Total
COST:	**₦'000**	**₦'000**	**₦'000**	**₦'000**
Bal. B/f	131,250	100,000	160,000	391,250
(A)	131,250	100,000	160,000	391,250
DEPRECIATION:				
Bal. B/f	-	26,625	31,000	57,625
Dep. for the year	-	2,000	32,000	34,000
Loss on revaluation	6,250	-	-	6,250
(B)	6,250	28,625	63,000	97,875
Carrying amount (A-B)	125,000	71,375	97,000	293,375

EXAMINER'S REPORT

The question tests candidates' understanding and knowledge of the preparation of published financial statements of an entity. The question requires candidates to prepare a statement of profit or loss and other comprehensive income and statement of financial position in accordance with IAS 1.

Over 90% of the candidates attempted the question and the performance was below average since only about 40% of the candidates were able to obtain up to fifty percent of the marks allocated to the question.

Candidates' commonest pitfall was their inability to present the required financial statements in a manner required for publication as provided in IAS 1. Also, some candidates did not show some relevant workings and notes to the financial statements.

Candidates are advised to prepare adequately for their examination using relevant materials like the pathfinder and ICAN Study Text.

MARKING GUIDE		**MARKS**	**MARKS**
A	**Statement of profit or loss**		
-	Determination of gross profit	$3^1/_2$	
-	Determination of distribution cost	$1^1/_2$	
-	Determination of administrative expenses	$1^1/_2$	
-	Determination of finance cost	$^1/_2$	
-	Determination of profit before tax and for the year	$^1/_2$	
-	Treatment of revaluation loss reversal	$^1/_4$	
-	Total Comprehensive income	$^1/_4$	
			8
b.	**Statement of financial position**		
-	Determination of PPE	4	
-	Determination of current assets	1	
-	Determination of equity	$3^1/_4$	
-	Determination of non-current liabilities	$^1/_4$	
-	Determination of current liabilities	3	
-	Total assets	$^1/_4$	
	Total liabilities	$^1/_4$	
			12
	Total		20

SOLUTION 3

a.

Classes of Financial Ratios	**Main Aims**	**Examples**
Profitability and Efficiency	- It is aimed at determining the performance of an organization - Concerned with relative efficiency in the utilization of company's assets	- Return on capital employed - Return on total assets - Gross profit margin - Net profit margin - Capital employed turnover - Total asset turnover - Return on shareholders' equity
Long term solvency and stability	- To determine a company's ability to meet its long term obligation - To show the degree	- Fixed interest cover - Fixed dividend cover - Total debt to equity - Gearing ratio

	of safety of a business from failure in the long term	- Debt to assets ratio
Short term solvency and Liquidity	- To determine the ability of a firm to meet its short term financial obligations.	- Current ratio - Acid test/quick ratio - Receivable turnover - Receivable collection period - Trade payable turnover - Trade payable payment period
Shareholder's investment ratios	- To determine the value of a company, consequently; - To enable for comparism between investment alternative before making decision.	- Earnings per share - Dividend per share - Price earnings ratio - Earnings yield - Dividend yield - Dividend payout ratio

b.i.

Cash Operating Cycle

The cash operating cycle is also called the working capital cycle, it is the average time of one cycle of business operations from the time that suppliers are paid for the resources they supply to the time that cash is received from customers for the goods (or services) that the entity makes (or provides) with those resources and then sells.

It can also be explained as the length of time between a firm's purchase of inventory and the receipt of cash receivable. It is the time required for a business to turn purchases into cash receipts from customers.

b. ii.

NWOKEKE NIGERIA PLC
CASH OPERATING CYCLE
FOR THE PERIOD MARCH 31, 2017

		DAYS	DAYS
Average Inventory Holding Period			
- Raw materials	(wi)	73	
- Work-in-progress	(wii)	29.2	
- Finished goods	(wiii)	97.3	199.5
Average receivable collection period	(wiv)		93.3
			292.8
Average payable period	(wv)		(87.6)
Working capital cycle			205.2

Working Notes:

(wi) Number of days in raw materials

$$= \frac{\text{Average RM inventory} \times 365 \text{ days}}{\text{Cost of sales}}$$

$$= \frac{142{,}500{,}000}{712{,}500{,}000} \times 365 \text{ days}$$

$$= \underline{73 \text{ days}}$$

(wii) Number of days in work-in-progress

$$= \frac{\text{Average WIP inventory}}{\text{Cost of Sales}} \times 365 \text{ days}$$

$$= \frac{57{,}000{,}000}{712{,}500{,}000} \times 365 \text{ days}$$

$$= \underline{29.2 \text{ days}}$$

(wiii) Number of days in finished goods

$$= \frac{\text{Average FG inventory}}{\text{Cost of Sales}} \times 365 \text{ days}$$

$$= \frac{190{,}000{,}000}{712{,}500{,}000} \times 365 \text{ days}$$

$$\underline{97.3 \text{ days}}$$

(wiv) Trade receivable collection period:

$$= \frac{\text{Average trade receivable}}{\text{Revenue}} \times 365 \text{ days}$$

$$= \frac{218{,}500{,}000}{855{,}000{,}000} \times 365 \text{ days}$$

93,3 days

(wv) Trade payable payment period:

$$= \frac{\text{Average trade payable}}{\text{Purchases}} \times 365 \text{ days}$$

$$= \frac{114{,}000{,}000}{475{,}000{,}000} \times 365 \text{ days}$$

87.6 days

b. (iii)

The cash management policy of Nwokeke Nigeria Plc as at March 31, 2017 is not encouraging as the cash operating cycle of 205.2 days is far more than the industry average performance of 75 days.

b. (iv)

Steps to be taken to improve Cash Operating cycle of Nwokeke Nig. Plc.

- Nwokeke Plc needs to reduce the raw materials inventory period e.g Just in time purchases
- The company needs to speed up the production process without compromising the quality of the goods produced by improving on the production method.
- The company may increase the period of credit taken from suppliers though the credit period already seems very long.
- The company needs to reduce finished goods inventory holding period e.g through JIT Production.
- Reducing receivable collection period by giving discount, prompt invoicing, and regular follow up.

EXAMINERS REPORT

This question is in two parts. Part (a) test candidate's knowledge of the different categories of financial ratios as they were required to state the main aim of each category with relevant examples. Part (b) test candidates understanding of the cash operating cycle of an entity.

Over 80% of the candidates attempted the question and the performance was below average as only about 30% of the candidates got up to 50% of the marks allocated to the question.

Candidates' commonest pitfall was their wrong calculation of the cash operating cycle and their poor assessment of the company's cash management performance.

Candidates are advised to study hard while preparing for the examination of the Institute.

MARKING GUIDE			MARKS	MARKS
a.	-	Correct explanation of the main aim of each of the four categories of the relevant financial ratios at 1 mark each		4
	-	Stating two correct examples each of the four categories of the relevant financial ratios at $^1/_2$ mark each		4
Bi	-	Explanation of cash operating cycle		2
ii	-	Correct Calculation of operating cycle:		
		Average inventory holding period	$1^1/_2$	
		Average receivable collection period	$^1/_2$	
		Average payable period	$^1/_2$	
		Calculation of Operating Cycle	$1^1/_2$	4
iii	-	Correct assessment of the cash management Performance of Nwokeke Nigeria Plc		2
iv	-	Stating two correct steps of improving the cash operating cycle of the company		4
		Total		20

SOLUTION 4

a.

i. An associate is an entity over which the investor has significant influence. Significant influence is the power to participate in the financial and operating policy decisions of the investee, without having control or joint control over those policies.

Significant Influence is normally assumed to exist if the investors own between 20% and 50% of the investee's ordinary shares excluding joint control.

ii. Under the equity method of accounting the investment made in the associate is recorded initially at cost. In each subsequent year, the investor's share of the associate's profit is added to the carrying amount of the investment and is also recognized as income in the investor's financial statements. Dividends received from the associate are subtracted from carrying amount of the investment. Only the investor's share of the associate's profit is shown in the investor's statement of comprehensive Income and only the investor's share of the associate net assets is shown in the investor's statement of financial position. These are items that are shown as a single line items and there is no need to account for non-controlling interest.

This differs from the acquisition method used for subsidiaries, whereby all of a subsidiary's assets, liabilities, income and expenses are incorporated on line by line basis into the consolidated financial statements and then the non-controlling interest (if any) is accounted for. Therefore, in the statement of financial position of the reporting entity (the investor) an investment in associate is measured at carrying amount, thus:

Carrying amount	₦
Cost of investment	X
Parent's share of post acquisition profits/(losses) of the associate (or JV)	X
Impairment of the investment recognised	(X)
	X

iii. A joint operation is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the assets, and obligations for the liabilities, relating to the arrangement. Those parties are called joint operators. While a joint venture is a joint arrangement where the parties that have joint control of the arrangement have rights to the net assets of the arrangement. These parties are called joint venturers.

b. **Y Limited Statement of Comprehensive, Income**

	₦'000	₦'000
Operating profit		325
Share of associate profit 40% x ₦55	22	
Unrealised profit (15-10) x 40% x ¼	(0.5)	21.5
Profit before taxation		346.5
Income tax exp. (₦85 + 40% of ₦15)		(91)
		255.5

Statement of Changes in Equity	₦'000
Balance b/f	355
Associate balance b/f: (₦330- ₦50)x40%	112
Profit for the year	255.5
	722.50

Statement of Financial Position as at October 30, 2017

Assets		₦'000
Non-current assets (PPE)		800
Investment in associate	(W1)	204
		1,004
Current assets	(W2)	379.5
		1,383.5
Equity and liabilities		
Ordinary share capital		500
Retained earnings	(W3)	722.5
		1222.5
Current liabilities (155+ Associate Tax 40% of ₦15)		161
		1,383.5

Workings

			₦'000
W.1	Investment in associates		
	Initial cost	70	
	Share of post-acquisition (40% of 330-50)	112	
	Share of profit for the year (40% of ₦55)	22	
		204	

		₦'000
W.2	Current assets	
	Parent	390
	Adjustment - for dividend receivable	(10)

	- Unrealised profit (40% of ₦5000) x ¼	(0.5)
		379.5

W.3	Retained earnings	**₦'000**
	Parent	605
	Share of post-acquisition	112
	Share of profit for the year	22
	Adjustment - dividend receivable	(10)
	- unrealised profit	(0.5)
	Associate tax (40% of ₦15)	(6)
		₦722.5

EXAMINER'S REPORT

This question tests candidates' knowledge of IAS 28. In part (a) candidates were required to explain the terms 'Significant influence' and equity method of accounting. They were also required to distinguish between joint operation and joint ventures. Part (b) required candidates to prepare separate financial statements using the equity method of accounting.

About 25% of the candidates attempted the question and the performance was very poor.

Candidate's commonest pitfall was their failure to correctly explain the relevant terms and wrong calculation of the carrying amount of the investment in associate.

Candidates are advised to emphasise application of relevant accounting standards at this level of the Institute's examinations rather than mere reading through the provisions of the various standards.

MARKING GUIDE			**MARKS**	**MARKS**
Ai	-	Correct explanation of 'associate' and 'significant influence'		2
ii	-	Correct explanation of equity method of accounting		2
iii	-	Distinguishing between joint operation and joint ventures		2
b	-	Presentation of separate financial statements:		
		Statement of comprehensive income		
		- stating the operating profit	$^1/_3$	
		- stating shares of associate's profit	1	
		- calculating profit before tax and for the year	$1^1/_3$	$2^2/_3$

-	Statement of changes in equity		
	- Stating opening balance of retained earning	$^1/_3$	
	- Stating shares of Associates opening post Acquisition	$^1/_3$ $\underline{^2/_3}$	
	- Stating group profit for the year		$1^1/_3$
-	Statement of financial position		
	- Stating the non-current assets (PPE)	$^1/_3$	
	- Determination of investment in associate	$2^1/_3$	
	- Determination of current assets	$2^1/_3$	
	- Stating the equity capital	$^1/_3$	
	- Determination of retained earnings	3	
	- Determination of current liabilities	1	
	- Total assets	$^1/_3$	
	- Total liabilities and equity	$\underline{^1/_3}$	$\underline{10}$
	Total		$\underline{\underline{20}}$

SOLUTION 5

a. **NEEDS FOR APPLICATION OF IAS 36 – IMPAIRMENT OF ASSETS**

IAS 16 has long required that property, plant and equipment should not be carried in the financial statements at more than its recoverable amount. Recoverable amount is defined as the higher of the amount for which it could be sold and the amount recoverable from its future use. However, there was very little guidance as to how and under what circumstances the recoverable amount should be identified or measured. IAS 36 gives such guidance.

Recoverable Amount

IAS 36 defines recoverable amount as the higher of fair value less costs of disposal and value in use. Fair value less costs of disposal is the amount at which an asset could be disposed off, less any direct selling costs. Value in use is the present value of the future cash flows obtainable as a result of an asset's continued use, including those resulting from its ultimate disposal.

The definition takes into account management's ability to choose whether to sell or keep the asset when provided with the information about fair value less costs of disposal and value in use. The decision is based on the cash flows that can be generated by following each course of action. An entity will not continue to use the asset if it can realise more cash by selling it and vice versa. This means that when an asset is stated at the higher-of net realisable value or value in use it is recorded at its greatest value to the entity.

bi. A related party transaction is a transfer of resources, services or obligations between parties that are connected or related, regardless of whether or not a price is charged.

Examples of such transactions include:

- Purchase or sale of goods;
- Purchase or sale of property and other assets;
- Rendering or receiving of services;
- Leases;
- Transfer of research and development;
- Transfers under license agreements;
- Transfers under finance arrangements (including loans and equity contributions in cash or in kind);
- Provision of guarantees or collateral;
- Commitments to do something if a particular event occurs or does not occur in the future, including executory contracts (recognized and unrecognized); and
- Settlement of liabilities on behalf of the entity or by the entity on behalf of another party

bii. Under IAS 24- Related Party Disclosures, an entity is related to a reporting entity if any of the following conditions applies:

- Both entities are members of the same group thus a parent and a subsidiary and fellow subsidiary are related parties;
- One entity is an associate or joint venturer of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member);
- Both entities are joint venturers of the same third party;
- One entity is a joint venturer of a third entity, and the other entity is an associate of the third entity;
- The entity is a post-employment defined benefit plan for the benefit of employees of either the reporting entity or an entity related to the reporting entity. If the reporting entity is in such a plan, the sponsoring employers are also related to the reporting entity
- The entity is controlled, or jointly controlled, by a person or a close member of that person's family who, has control, or joint control, over the reporting entity
- Has significant influence over the reporting entity or is a member of the key management personnel of the reporting entity or its parent

EXAMINER'S REPORT

This question tests candidates' knowledge and understanding of IAS 36 and IAS 24. Part(a) required candidates to explain the need for the application of IAS 36 and also to explain the concept of 'recoverable amount' Part(b) required candidates to define with examples 'related party transactions' and to state conditions under which entities are said to be related.

About 80% of the candidates attempted the question and the performance was poor as over 60% of the candidates who attempted the question obtained about one third of the marks allocated to the question.

Candidates commonest pitfall was their inability to correctly define or explain the relevant concepts.

Candidates are advised to study all the relevant standards examinable at this level of the Institute's examination.

MARKING GUIDE			**MARKS**
a.	-	Explanation of the need for the application of IAS 36	3
	-	Explanation of the concept of recoverable amount	4
b.i	-	Definition of related party transaction	2
	-	Two examples of related party transaction at one mark each	2
Ii	-	Four conditions leading to related party at 1 mark each	4
		Total	15

SOLUTION 6

a.i. A change in the useful life of plant and equipment is a change in accounting estimate and is applied prospectively.

Therefore, the carrying amount of the plant and equipment is written-off-over four (4) years rather than seven (7) years. All the effects of the change are included in profit or loss. The nature and the amount charged should be disclosed.

ii. The items should be expensed in profit or loss. However, given the nature and size, it may be disclosed separately.

iii. The contribution should be expensed in profit or loss. It should be disclosed separately, if it is material.

b.i The adjustment for the error in opening inventory should be made retrospectively. The inventory at beginning will be credited with the overstated amount of ₦3,135,000 while the retained earnings at the end of last period, being the opening retained earnings for the period, will be debited with same amount. This would be done in the statement of changes in equity.

ii. The nature of prior period error

The amount of the correction at the beginning of the earliest prior period in the statement.

If the retrospective restatement is not practicable for a prior period, an explanation of how and when the error has been corrected.

The amount of the correction for each financial statement item.

iii. **Final figures of Inventory in the Statement of Financial Position as at March, 31, 2017**

	₦'000	₦'000
Balance per information		31,425
Reduction to net realizable value		
original cost	120	
Net realizable value (78 - 4.5)	(73.5)	(46.5)
Closing inventory balance per SFP		312,378.5

EXAMINER'S REPORT

The question tests candidates' knowledge and application of the provisions of IAS 8 - changes in Accounting policies, estimates and corrections of errors.

Part 'a' of the question required candidates to show the disclosure requirements in respect of some specific transactions in the Financial Statements, while part 'b' tests corrections of errors in accordance with the requirements of IAS 8,

About 70% of the candidates attempted the question and performance was below average.

Candidates' commonest pitfalls include the following:

- **Inability to differentiate between changes in accounting policies and changes in accounting estimates**
- **Failure to determine when to make prospective or retrospective adjustments when correcting errors.**
- **Poor disclosure requirements in the financial statements after making necessary corrections.**

Candidates are advised to pay more attention to the applications of the provisions of all relevant Accounting Standards at this level of the Institute's examinations for better performance in future.

MARKING GUIDE **MARKS**

a.	Explanation of the treatment of transactions in the financial statement	
i	Correct explanation of the treatment of change in useful life of plant and equipment	2
ii	Correct explanation of the treatment of bonuses paid to employees	2
iii	Correct explanation of the treatment of ₦14million contribution to a foundation	2
b.i	Explanation of the adjustment needed to correct error of overstatement of opening inventory	2
ii	Stating two disclosure requirements of IAS 8 in the financial statements for correcting of errors	3
iii	Presentation of inventory in the statement of financial position.	4
	Total	15

SOLUTION 7

a. **Interest rate implicit**

The interest rate implicit in the lease is the discount rate that causes the aggregate present value of the minimum lease payments and the unguaranteed residual value to be equal to the sum of the fair value of the leased asset and any initial direct costs of the lessor at the inception of the lease. It is the Internal Rate of Return (IRR) of the cash flows from the lessor's viewpoint.

b. Calculation of Interest Implicit in the lease

'PV	=	Annuity	x	Cumulative Discount Factor CDF)
2,500,000	=	788,640	x	CDF
CDF	=	2,500,000 / 788,640		
	=	3.170		
	=	10%		

OR

Year	**Cashflow**	**DCF at 6%**	**PV**	**DCF at 10%**	**PV**
0	2,500,000	1.00	2,500,000	1.00	2,500,000
1-4	788,640	3,465	2,732,638	3.170	2,499,989
NPV			232,638		(11)

$$IRR = LR += \frac{NPV_{LR}}{NPV_{LR} - NPV_{HR}} \times (HR - LR)$$

$$= 6\% + \frac{232638}{232638 - (-11)} \times (10\% - 6\%)$$

$$= 6\% + 1 \times (4\%)$$

$$= 6\% + 4\%$$

$$IRR = 10\%$$

Where:

IRR = Internal rate of return

LR = Lower rate

NPV = Net present value

HR = Higher-rate

c. Manilla Nigeria Plc should treat the equipment as a **Finance Lease.** Reasons are:
   i. The lease term is for the useful life of the asset.
   ii. The present value of the minimum lease payment is considered the fair value of the asset.

d. Wrong classification of finance lease as operating lease will result in the following effects:

   - The financial statements will not fairly present the financial position of the entity.
   - The leased asset is not recognized in the statement of financial position, even though the substance of the lease is that the entity owns it.
   - The liability for the lease payment is not recognized in the statement of financial position.
   - The lease will become an off balance sheet finance.
   - Both assets and liabilities are understated.
   - Finance charge in the profit or loss is either over or understated.

EXAMINER'S REPORT

The question tests candidates knowledge of Lease – (IAS 17) and they were required to briefly explain the term 'Interest rate Implicit in Lease', calculate the appropriate interest rate implicit in the lease transactions from a given data, determine the correct type of lease based on the data available and to state the implications of incorrectly treating lease transactions in the financial statements.'

Only 25% of the candidates attempted the question and performance was poor as less than 10% of the candidates that attempted the question scored more than 50% of the marks allocated to the question.

The candidates' commonest pitfalls are as follows:

- **Inability to correctly explain interest rate implicit in lease transactions**
- **Wrong calculation of implicit interest rate and inability to explain the effects of wrong classification of lease in the Income statement and the statement of financial position.**

Candidates are advised to pay special attention on application of relevant accounting standard at this level of Institute's examination rather than mere reading through the provisions of various standards.

MARKING GUIDE		MARKS
a.	Explanation of ‘interest rate implicit in the leasing of an equipment	2
b.	Calculation of interest rate implicit in the lease transaction	4
c.	Stating correct treatment of the lease	1
	Giving any two correct reasons for the treatment	2
d.	Discussing the effect of classifying a lease incorrectly in financial statements giving any six points at 1 mark each	6
	Total	15

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – NOVEMBER 2017

AUDIT AND ASSURANCE

Time Allowed: $3^1/_4$ 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

a. International Standards on Auditing ISA 315 deals with the auditor's responsibility to identify and assess the risks of material misstatement in the financial statements, through understanding the entity and its environment, including the entity's internal control.

Required:

i. Explain the term "audit risk" (3 Marks)

ii. Identify and explain the key elements of audit risk (6 Marks)

iii. Explain why the auditor needs to understand the entity's internal controls as part of the audit process. (6 Marks)

b. Favour & Co. (Chartered Accountants) is the external auditors to Happy Limited, a company engaged in the production of pharmaceutical products. The company imports spare parts for the maintenance of its production plant from Taiwan, with a lead time of three months. Some of these spare parts are of high value and strategic, so must readily be available for repairs of plant to avoid production stoppage. As a result of this, the company maintains high level of the strategic spare parts in the store at every point in time. Also, these spares are specific to the current plant and may not fit into another plant.

As part of its plan to achieve efficiency and effectiveness in its operation, the company embarked on the construction of a new production plant with modern technologies which was completed and commissioned at the beginning of the financial year. With the completion of the new plant, the company decommissioned the old one. At the beginning of the financial year, there were still significant amount of the old spare parts in the store.

Johnson Adamu and Mark Onwuchekwa have been the Partner and Manager respectively, on this engagement for three years. Apart from the Partner and the Manager, the other members of the engagement team are new.

Prior to the commencement of the audit, the Manager called the team and described the location of the client's office and informed them that they were expected to complete the audit in three weeks. He further advised them to go with the prior year audit file for better understanding of the client's business. At the end of the risk assessment process, the team identified risks in revenue, property, plant and equipment and receivables based on prior year experience, and designed procedures to address these risks.

Required:

i. Identify and explain the key issues in the above scenario. (8 Marks)

ii. Describe why the auditor needs to understand the entity and its environment as part of his risk assessment. (7 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. Internal auditors work for and also report to management. The type of assignments they carry out are usually dictated by management. One of the assignments internal auditors may be required to carry out is "Value for money audit".

Required:

(i) Describe the term "value for money audit". (3 Marks)

(ii) Identify and explain the components of value for money audit. (6 Marks)

(iii) What are the challenges of value for money audit? (6 Marks)

b. The external auditor may rely on the work of the internal auditor to obtain audit evidence. State the factors to be considered by the external auditor before relying on the work performed by the internal auditor.

(5 Marks)

(Total 20 Marks)

QUESTION 3

Auditors' work on internal control is an important element of gathering audit evidence because it influences the direction of the audit work. As with all other significant audit evidence, it must be properly documented in the audit working papers, probably in the permanent audit file.

Required:

a. Explain in details the three methods that can be used in identifying, recording and analysing accounting system and internal controls of a company. (9 Marks)

b. When evaluating the general controls and application controls in a client's computer systems, the auditor needs to take account of the type of computer-based information system that the client is using.

Required:

Explain in details how the following computer-based information systems can generate audit risks for the auditor.

i. Microcomputer systems. (2 Marks)
ii. Online systems. (2 Marks)
iii. Electronic Data Interchange (EDI) Systems. (2 Marks)
iv. E-commerce. (2 Marks)

c. Explain the term "audit risks." (3 Marks)

(Total 20 Marks)

QUESTION 4

The opinion of an assurance provider must be an independent opinion given by a professional person with appropriate skills in assurance work.

You are required to:

a. Identify and explain briefly **FIVE** key areas where independence may be under threat. (10 Marks)

b. Explain in details the specific safeguards the auditor can put in place to reduce **THREE** of the threats identified in (a) above. (10 Marks)

(Total 20 Marks)

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

QUESTION 5

The balances for payables, receivables and bank accounts are usually material amounts in a company's statement of financial position. An important technique is the direct confirmation of the balances in these accounts.

You are required to:

a. Explain the main audit work expected to be carried out by you on receipt of the bank confirmation. (5 Marks)

b. Describe the audit procedures relating to confirmation of receivable balances. (5 Marks)

c. State and explain the steps the auditor should take if the management of an entity refuses to allow the auditor to send a confirmation request to its customers. (5 Marks)

(Total 15 Marks)

QUESTION 6

According to International Standards on Auditing ISA 240, the primary responsibility for the prevention and detection of fraud rests with those charged with governance of the entity and management. It is important that management, with the oversight of those charged with governance, place a strong emphasis on fraud prevention, which may reduce opportunities for fraud to take place, and fraud deterrence, which could persuade individuals not to commit fraud.

Required:

a. State and explain **TWO** types of fraud as identified in ISA 240. (6 Marks)

b. Describe the procedures performed by auditors to identify risk of material misstatements due to fraud (5 Marks)

c. State **FOUR** fraud risk factors (4 Marks)

(Total 15 Marks)

QUESTION 7

a. The Companies and Allied Matters Act (CAMA) CAP C20 LFN 2004 requires every company at each annual general meeting to appoint an auditor or auditors to audit the financial statements of the company, and to hold office from the conclusion of that annual general meeting (AGM) until the next one. However, the auditor may choose to resign his appointment during his tenure.

Required:

i. State **THREE** factors that could lead to the auditor's resignation. (3 Marks)

ii. Describe the procedures to be followed by the auditor as regards the provisions of the CAMA in the resignation of his appointment. (4 Marks)

b. It is a fundamental principle that members of the Institute of Chartered Accountants of Nigeria (ICAN) should carry out their work with professional competence and due care.

Required:

i. Explain the concept of "duty of care". (2 Marks)

ii. State the consequences of auditor's failure to apply skill and care in performance of his professional service. (6 Marks)

(Total 15 Marks)

SOLUTION 1

a.i **Audit Risk**

It is described as risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated. It is a function of the risk of material misstatement and detection risk. Audit risk is the risk that the auditor reaches an inappropriate or wrong conclusion on the area under risk. For example, if the auditor's benchmark for audit risk is 5%, it means that the auditor accepts that there will be a 5% risk that the audited item will be misstated in the financial statements and only 95% probability that it is materially correct.

ii. The audit risk model is represented in this formula: AR = IR x CR x DR

Where:	AR	=	Audit Risk
	IR	=	Inherent Risk
	CR	=	Control Risk
	DR	=	Detection Risk

The key elements of audit risks are identified and explained as follows:

Inherent Risk:

It is described as the susceptibility of an assertion about a class of transactions, account balance or disclosure to a misstatement that could be material, either individually or when aggregated with other misstatements, before consideration of any related controls. Inherent risk, which is the risk that items may be misstated as a result of their inherent characteristics may result from either the nature of the items themselves as well as the nature of the entity and the industry in which the entity operates.

Control Risk:

This is the risk that a misstatement that could occur in an assertion about a class of transactions, account balance or disclosure and which could be material, either individually or when aggregated with other misstatements, will not be prevented or detected and corrected, on a timely basis by the entity's internal control. Control risk is the risk that a misstatement would not be prevented or detected by the internal control system that the entity has in operation. In preparing an audit plan, auditor needs to make an assessment of control risk for different areas of the audit. Evidence of control risk can be obtained through 'tests of control'. Initial assumption of the auditor should be that control risk is very high and their existing internal controls are insufficient to prevent the risk of material misstatment.

Detection Risk:

This is the risk that the procedures performed by the auditor to reduce audit risk to an acceptable low level will not detect a misstatement that exists and that could be material, either individually or when aggregated with other misstatements. It is the risk that the audit testing procedures will fail to detect a misstatement in a transaction or in an account balance.

aiii. Internal control is the process designed and effected by those charged with governance, management, and other personnel to provide reasonable assurance about the achievement of the entity's objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations.

The auditor needs to understand the entity's internal controls because of the following reasons:

- To identify controls that are relevant to the audit. Although the entity's system of internal controls is made up of various controls designed to achieve reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations, not all the controls may be relevant in addressing the risks identified by the auditor. He therefore needs to understand the controls with a view to identifying the ones that are relevant to the audit.

- To evaluate the design, implementation and operating effectiveness of the relevant controls. whether the controls have been properly designed, implemented and operated effectively throughout the period of intended reliance.

- The auditor's understanding of the internal control will enable him determine the controls and will also enable him determine the extent of substantive procedures to perform in addressing the risks identified.

- Appropriate understanding of the internal control system by the auditor helps to determine the type of audit opinion.

- Knowledge of the entity's internal control is a major part of the knowledge of the client and the environment, which assists the auditor to determine the audit strategy. It is also required by ISA 315.

b. i Key audit issues identified in the above scenario as it relates to the audit of Happy Limited are as follows:

- Failure to identify the risk relating to the key event that happened in the year under review:

  In the year under review, the company decommissioned the old plant. This created impairment risk on the spare part inventory that were specific to the old plant as it was clear in the scenario that these parts cannot be used in other plants. This risk was not identified by the team.

- Lack of proper briefing of the engagement team:
  It is obvious from the scenario that the engagement team was not properly briefed regarding the audit. Audit engagements are Partner-led, hence there should have been an engagement team discussion, where the Partner should share his experience with the team including

proper briefing on the events that happened in the current year, and the impact of such events- on the audit. This resulted in a poor risk assessment which contributed to the team not being able to identify a key audit risk during the risk assessment process.

- Reliance on prior year information without ascertaining whether there were changes in the prior year:

  Although, the Manager advised the team to review prior year file to acquaint themselves with prior year information about the client, there is no evidence that they checked the continued relevance of the information to current year's audit.

- Lack of involvement of the Engagement Partner and Manager in the risk assessment process:

  Senior members of the engagement team (Partner and Manager) are responsible for providing strategic direction to the engagement team to ensure proper risk assessment, efficient and effective performance of the audit. This was clearly missing on this engagement.

ii. The auditor needs to understand the entity and its environment as part of his risk assessment process because of the following reasons:

- To enable him understand and identify the specific risks of material misstatements that could arise from the nature of the industry in which the entity operates;

- Through the understanding of the entity and its environment, the auditor will ascertain the appropriateness of accounting policies adopted by the entity in the treatment of significant and unusual transactions.

- Understanding the entity and its environment helps the auditor to Identify areas where special audit consideration may be necessary, for example, related party transactions, the appropriateness of management's use of the going-concern assumption, complex or unusual transactions, or considering the business purpose of transactions;
- The auditor obtains an understanding of the entity's performance measures which assists him in considering whether these result in pressures on management that may have increased the risks of material misstatements; and

- To enable the auditor reach the conclusion that the audit should give particular attention to areas with high audit risks and material misstatements.

EXAMINER'S REPORT

Part (a) of the question tests candidates on audit risk, while part (b) asks candidates to analyse a given scenario and explain the key issues in the given scenario; and the need for the auditor to understand the entity and the environment as part of his risk assessment. It is a compulsory question, consequently attempt of the question is 100%.

Candidates generally exhibited poor understanding of the requirements of the question except for a(i) and a(ii) where the performance was average. Marks earned therefore were well below average. Their greatest pitfall was mix-up of the requirements of a(iii) with that of b(ii).

Candidates are advised to make better use of the Institute's Study Text and sharpen their analytical skills. Candidates should also understand the requirements of a question very well before attempting it.

MARKING GUIDE		**MARKS**	**MARKS**
a. i	Definition of audit risk		3
ii	Identification of each element		
	1 Mark each for 3 points	3	
	Explanation of each element		
	1 mark each	3	6
iii	Definition of internal controls	2	
	Reasons for understanding Internal Control		
	1 mark each (maximum 4 points)	4	
			6
b. i	For each key issue identified and explained 4 points at 2½ marks each		10
ii	1 point for each of the 5 points mentioned		5
	Total		30

SOLUTION 2

a i. The term "value for money audit" is described as a means of assessing organisation's performance in getting good value for the money that an entity has spent. It focuses on each component of value for money and identifying where performance could be improved. It originated in public sector as a way of assessing financial performance in the public sector organisations. The conventional profit-based measures are not appropriate because the objectives of these organisations are not usually to make profit. However, the concept of value for money audit has now been widely adopted by commercial organisations as a means of assessing performance on a broader basis than just profit and it provides a link between money spent and the overall objective.

ii. "Value for money" is obtained from the combination of the following components:

Economy

Economy means not spending more than is necessary to obtain the required resources. At a very basic level, it means buying supplies from the cheapest suppliers of materials of the desired quality, avoiding excessive salary payments to employees and unnecessary spending on other items of cost. This is measured by comparing money spent with inputs acquired.

Efficiency

Efficiency means getting a high volume of output from the resources that are used. The efficiency of employees is often referred to as 'productivity'. Efficiency can be achieved by making better use of equipment (reducing non-use or idle time), improving employee productivity, making better use of available accommodation or getting better use out of marketing spending, etc. This is measured by comparing inputs used with outputs achieved.

Effectiveness

This relates to achieving the objectives of the entity with the available resources. Using resources efficiently has no value if the resources are not used in a way that achieves objectives. For example, a manufacturing company may improve efficiency and produce a larger quantity of output with its available machines. However, if the extra output cannot be sold, the organisation will not achieve its objective of increasing profit. Effectiveness is measured by comparing outputs achieved with the entity's objectives.

iii. The challenges of value for money audit include the following:

- **Difficulties in Measurement**: It is not always easy to measure efficiency or effectiveness. Whereas it is relatively easy to measure the output of a manufacturing activity, it is not so easy to measure the output of a service department in an organisation, such as the human resources department, the training department or even the internal audit department itself;

- **Possible over-emphasis on cost savings**: Value for Money audit often focuses on ways of reducing costs. It is often possible to reduce costs by finding ways to improve economy and possibly efficiency. However, this is likely to lead to a quality problem. By cutting costs, the quality of output may fall, and customers may stop buying the products that the entity produces.

- **Challenges with calculating Value for Money measures**: Auditors may assess economy, efficiency and effectiveness by making comparisons with other organisations, or with other departments in the same organisation. In order to be meaningful, all performance measures should be calculated on a comparable basis and there may be challenges since measurement of economy, efficiency and effectiveness is not regulated by professional standards as an example.

b. In determining whether the work of the internal auditor can be relied upon by the external auditor to obtain audit evidence, the external auditor shall evaluate whether:

   i. The work was performed by internal auditor having adequate technical training and proficiency;

   ii. The work was properly supervised, reviewed and documented;

   iii. Adequate audit evidence has been obtained to enable the internal auditor to draw reasonable conclusions;

   iv. Conclusions reached are appropriate in the circumstances and any reports prepared by the internal auditor are consistent with the results of the work performed;

   v. Any exceptions or unusual matters disclosed by the internal auditor are properly resolved; and

   vi. The extent to which the internal audit functions, organisational status and relevant policies and procedures support the objectivity of the Internal Auditor.

EXAMINER'S REPORT

The question is in two parts. Part (a) tests value for money audit, while part (b) tests reliance on Internal Auditor's work by the external auditor.

About 90% of the candidates attempted the question. Candidates' understanding in part(a) was fair but surprisingly poor in part (b though the area tested in part (b) is a common auditing area.

Candidate's performance was fair, especially for part (a). The candidates answered the question out of context, especially in parts a(iii) and (b). These areas are well treated in the Institute's Study Text.

Candidates are advised to study well for the examinations, and also make good use of the Institute's Study Text. They should properly harness and relate their points to the requirements of the question.

MARKING GUIDE		**MARKS**	**MARKS**
a. i	3 marks for explanation		3
ii	½ mark each for 3 points	1½	
	1½ mark each for explaining 3 points	4½	
			6
iii	1 mark for each of the 3 points	3	
	1 mark for explaining each of 3 challenges	3	
			6
b.	1 mark for each of 5 points		5
	Total		20

SOLUTION 3

a. The three (3) methods that can be used in identifying, recording and analyzing accounting system and internal controls of a Company are described as follows:

i. **Narrative Notes:**
Narrative notes are written description of the internal control system and the controls that are in place. They are used mainly to make a record of the control activities involved in processing transactions. They are simple to prepare; but can become lengthy. Narrative notes may be time-consuming to prepare initially. When narrative notes are long, it may also be time-consuming to update them when the system or the controls change. Ideally, narrative notes should be written clearly but should not be longer than necessary to provide a full description.

ii. **Systems Flowcharts:**

Systems flowcharts provide representation of accounting systems in the form of a diagram. For each transaction, they show the documents generated, the processes applied to the documents and the flow of the documents between the various departments involved. Flowcharts therefore, show the flow of work by showing how documents are transferred within a system (and filed) and how they are used. As they are in form of diagram, flowcharts present an immediate visual impact of the system which can help the auditors to identify weaknesses in the controls more easily than by reading narrative notes. However, some expertise is needed to draw a good flowchart and to use it to assess the effectiveness of controls. Although flowcharts work well with standard accounting systems and transactions, they may not be appropriate for documenting specialised areas of accounting.

iii. **Questionnaires:**

Questionnaires are widely used by auditors to document systems. Questionnaires which can be prepared in advance as standard documents are also ideally suited for use by the auditors in an electronic form which means that standard questionnaires are available and ready for use on the auditor's computer. A questionnaire is a list of questions about controls in a particular aspect of operations or accounting. There are two main types of questionnaires. These are (i) Internal Control Questionnaire (ICQ), which requires "Yes or No" answer and it is designed to establish whether appropriate controls that meet specific objectives exist; and (ii) Internal Control Evaluation Questionnaire (ICEQ) which is meant to draw up a small number of key control questions is designed to establish whether major weaknesses may exist in a control system.

The ICEQ contains a shorter list of questions for which "Yes or No" answer is required. Choosing which type of questionnaire to use is a matter of preference for the auditors or the audit firm.

b.i **Microcomputer Systems:**

It is a system where the client company uses a number of desktop computers located throughout the organization, rather than a large centralized computer-based information system with a mainframe computer or minicomputer. Companies may use a microcomputer system because it is more efficient and cost-effective than a centralized system with a large single computer. Microcomputer system can often be operated or programmed by the client's operating staff with little technical training. Microcomputer systems may generate problems of audit risk for the auditor because of many reasons which include:

- Difficulty in ensuring adequate physical security due to presence in many different locations;

- Many different locations can cause corruption of integrity of data and files;

- Programs may be written by the users and this may cause processing and software problems; and

- The auditor will want to see adequate documentation for software systems. When software is purchased off-the-shelf, documentation should be provided by the software supplier.

ii. **Online Systems:**

These are computer-based information systems that allow users direct access to centrally-held data and programs through remote terminals linked together in a network. Entities use on-line systems because they can offer several benefits such as:

- Immediate entry of transactions into the system like in a retails outlet;
- Immediate updating of master files like inventory records; and
- Enquiry systems which provide immediate answers to price and other enquiries from customers.

Although, online systems can be efficient and effective for the client entity, it can create concerns about audit risk for the auditor. It is however advisable to put adequate controls (mixture of both general and application controls) in place to minimize the risks that can arise from the use of online processing systems by the client.

Relevant Audit Risks include:

- Unauthorised access to programs and data files due to different locations;

- Lack of audit trail; and

- Unauthorised access to the 'Network Server'.

iii. **Electronic Data Interchange (EDI) Systems:-** They are systems that allow the electronic transmission of business documents such as purchase orders, invoices or payroll information. They may operate within the organization for example, the sales department may send copies of customer orders to the Accounts department. They may also operate externally for example, payroll data submitted to external agency and computer bureau for processing or sending a purchase order electronically to a supplier. Electronic Data Interchange system may create the following additional problems for the auditor;

- Lack of paper audit trails where a transaction can be followed through the stages of its processing by going from one paper document to another;

- Any computer failure may have an increased impact on the client's organization because of increased level of dependency on the computer systems of the organization and possibly on outsiders;

- There is a risk of possible loss or corruption of data in the process of transmission; and

- There are security risks associated with the transmission of data as unauthorized individuals may be able to read transmitted data.

iv. **E-Commerce:**

E-commerce is any commercial activity that takes place via connected computers over a public network like a mail order company selling goods over the internet. As the volume and materiality of transactions being executed through e-commerce channels continues to grow in society, the auditor must ensure they have considered the associated audit risks and consequently plan and perform their audit procedures accordingly. Some of the areas the auditor will consider will include:

- The skills and knowledge needed by the auditor to understand the effect of e-commerce on the entity's activities. The more complex the e-commerce activities, the greater the skills and knowledge required by the auditor;

- The extent of the knowledge of the business needed by the auditor will be determined by the environment covered by the e-commerce activities of the client;

- Additional business risks arising from e-commerce systems like loss of transaction integrity as a result of use of inappropriate accounting policies; and

- Internal controls may exist within the e-commerce system but there may not be an adequate audit trail for transactions on the client's website.

c. **Audit Risks**

They are risks that the auditors may express inappropriate audit opinion when the financial statements are materially misstated. They are functions of the risks of material misstatements and detection risks. Audit risks are the risks that the auditors reach inappropriate or wrong conclusion on the area under risk. For example, if the auditor's benchmark for audit risk is 5%, it means that the auditors accept that there will be a 5% risk that the audited item will be misstated in the financial statements and only 95% probability that it is materially correct.

EXAMINER'S REPORT

Part (a) of this question tests the methods of recording and analysing a company's accounting system and Internal Control. Part (b) tests on how some specified

computer based systems can generate audit risks for the auditor. Part(c) tests Audit risks.

Less than 25% of the candidates attempted the question ostensibly because of the Information Technology (IT) requirements of part (b).

Understanding of the question by the candidates who attempted it was poor, especially part (b). The marks earned in this question are consequently low. The commonest pitfall is candidates shying away from specific sections of the syllabus.

Candidates are advised to cover adequately all sections of the syllabus especially the IT part which is essential in the current business and professional dispensation.

MARKING GUIDE		**MARKS**	**MARKS**
a	Three methods of identifying recording and analysing accounting system		
	3 marks each x 3		9
b	How computer base system can generate Audit risks		
i	2 points x 1 mark	2	
ii	2 points x 1 mark	2	
iii	2 points x 1 mark	2	
iv	2 points x 1 mark	2	8
c	Explanation of Audit risks		3
	Total		20

SOLUTION 4

a. Key areas where independence may be under threat:
   (i) Fees and pricing;
   (ii) Family and personal relationships;
   (iii) Close business relationships;
   (iv) Financial Interests;
   (v) Loans and guarantees;
   (vi) Employment or former employment with assurance clients;
   (vii) Long association of senior personnel with assurance clients;
   (viii) Provision of non-audit services;
   (ix) Gifts and hospitality; and
   (x) Actual and threatened litigation.

   i. **FEES AND PRICING:**
   Relative size of fees
   Where the total fees generated from an assurance client represent a large proportion of an assurance firm's total fees, the dependence on that client

and concern about the possibility of losing that client may create a self-interest threat.

Overdue fees

If fees from an assurance client remain unpaid for a long time, a self-interest threat may arise. This will certainly be the case if a significant part of the overdue amount is not paid before the next year's report is issued.

Pricing

When an assurance firm obtains an assurance engagement at a significantly lower level than that charged by the previous firm, or quoted by other firms (known as 'low-balling'), a self-interest threat arises.

Contingent fees

Contingent fees are fees that are calculated on a pre-determined basis, relating to the outcome or result of a transaction or the work performed. A contingent fee may be an engagement on a 'no win no fee' basis that the audit firm will receive a percentage amount of the money it succeeds in saving or making for the client. Contingent fees billing system is not allowed by the Institute of Chartered Accountants of Nigeria.

(ii) **FAMILY AND PERSONAL RELATIONSHIPS**

Family and personal relationships between a member of the assurance team and a director, officer or certain employee of the client may create self-interest, familiarity or intimidation threats, depending on the specific circumstances.

The significance of these threats will depend on:

- The member's responsibilities on the assurance engagement;
- The closeness of the relationship; and
- The role of the family member at the assurance client.

(iii) **CLOSE BUSINESS RELATIONSHIPS**

A commercial or common financial interest between an assurance firm or a member of the assurance team and a client or its management may create self interest and intimidation threats.

(iv) **FINANCIAL INTERESTS**

A financial interest in an assurance client exists where shares or debt instruments are held either directly or indirectly. A direct financial interest is one held by an individual or the assurance firm or by a trust controlled by them. An indirect financial interest is one held by an individual or the assurance firm via a trust not controlled by them. Such a holding may create self-interest threat.

(v) **LOANS AND GUARANTEES**

This threat arises when an assurance firm obtains loans from a client who is not in the business of banking or similar business or furnishes guarantees to or on behalf of a client. This threat is more where the amount involved is material.

(vi) **EMPLOYMENT OR FORMER EMPLOYMENT WITH ASSURANCE CLIENTS**

Where client employs staff who previously worked for an assurance firm or a member of the assurance team resigns and obtains employment in a client's office, significant self-interest, familiarity or intimidation threats could arise. This will be the case particularly if strong personal or financial links remain between the individual and the remaining members of the assurance team or the assurance firm.

However, the level of seniority of the person involved is a major factor that will determine whether there is threat to the firm's independence.

(vii) **LONG ASSOCIATION OF SENIOR PERSONNEL WITH ASSURANCE CLIENTS**

Using the same senior personnel on an assurance engagement over a long period of time may create a familiarity threat. The level of threat will depend upon:

- The length of time that the individual has been on the assurance team;
- The role of the individual on the assurance team;
- The structure of the firm; and
- The nature of the assurance engagement.

(viii) **PROVISION OF NON-ASSURANCE SERVICES**

The independence of an assurance firm may be threatened when the firm carries out a large amount of non-assurance work for an entity that is also its assurance client. This is particularly true where an audit firm carries out non-audit services for its audit client.

(ix) **GIFTS AND HOSPITALITY**

Accepting gifts or hospitality from an assurance client may create self-interest and familiarity threats.

(x) **ACTUAL AND THREATENED LITIGATION**

In some cases, a client entity (or some of its shareholders) may threaten the audit firm with litigation as a result of something the audit firm, or a member of the audit team, has (or has not) done. Actual or threatened ligation could create self-interest or intimidation threats.

The significance of the threat will depend on the materiality of the litigation, the nature of the engagement and whether the litigation relates to a previous assurance engagement.

b. Specific safeguards the auditor can put in place to reduce THREE of the threats identified in (a) above are:

(i) **FEES AND PRICING**

Possible safeguards include:

- Discussing the extent and nature of fees with the audit committee or other appropriate persons at the client's office;

- Taking steps to reduce dependency on that client (for example, by refusing lucrative non-audit services or accepting it and resigning as auditor);

- Having external quality control reviews

- Consulting a third party, such as the Institute of Chartered Accountants of Nigeria or another professional colleague; and

- Involving an additional professional accountant who did not take part in the assurance engagement to provide advice or to review the work performed.

(ii) **FAMILY AND PERSONAL RELATIONSHIPS**

The most appropriate safeguard is to remove the individual from the assurance team.

(iii) **CLOSE BUSINESS RELATIONSHIPS**

Safeguards are:

- Terminate the business relationship;
- Reduce the level of the relationship so that the financial interest becomes immaterial and the relationship insignificant;
- Refuse the assurance engagement;
- Eliminate the transactions or reduce the volume of transactions;

- Remove the individual from the assurance team; and
- Discuss the issue with the audit committee or appropriate senior management at the client.

(iv) **FINANCIAL INTERESTS**

- Dispose any direct financial interest.
- Dispose any indirect financial interest or reduce the holding to such a level that it is no longer material.
- Remove the individual from the assurance team.
- Resign from the audit assignment.

If holdings are acquired by an individual as a gift or inherited:

- They should be disposed as soon as practicable, or
- The individual should be removed from the assurance team.

(iv) **LOANS AND GUARANTEES**

Safeguards:

- Loan should be immaterial; and
- Loan from client should be avoided unless client is a Bank or allied business and it is in the ordinary course of business on normal terms.

(vi) **EMPLOYMENT OR FORMER EMPLOYMENT WITH ASSURANCE CLIENTS**

- The individual concerned must not be entitled to any benefits or payment from the firm, unless these are fixed or under pre-determined arrangements.

- Any amounts owed to the individual must not be so significant that they could threaten independence.

- The individual must no longer take part (or appear to take part) in the firm's business.

- 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.

- Modifying the assurance plan (perhaps to increase the amount of work on the area the ex-team member will be involved with).

- Assigning an assurance team of sufficient expertise compared to the individual who has left (i.e. a team which will not be intimidated by the ex-team member).

- Arranging for an additional professional accountant to review the work done.

- Carrying out a quality control review of the engagement.

(vii) **LONG ASSOCIATION OF SENIOR PERSONNEL WITH ASSURANCE CLIENTS**

- Rotating senior staff of the assurance team; for example changing the audit engagement partner or quality control partner every seven years, then precluding them from further participation until a further period of two years 'cooling off' has elapsed.

- Arranging for an additional professional accountant to review the work done by the senior staff.

- Carrying out independent quality reviews.

- Abiding with Securities and Exchange Commission requirement that an assurance firm cannot audit a public interest entity continually for more than ten years.

(viii) **PROVISION OF NON-ASSURANCE SERVICES**

- The service should not be performed by a member of the audit team.
- The firm having policies and procedures such that an individual is prevented from making any management decision on behalf of the client.
- Requiring the source data for accounting entries to be originated by the client.
- Requiring the underlying assumptions to be originated and approved by the client.
- Obtaining the client's approval for any change to the financial statements.
- The client acknowledging responsibility for the result of the work.
- An additional professional accountant reviewing the work done.
- The client confirming their understanding of and approving the underlying assumptions and methodologies used.

(ix) **GIFTS AND HOSPITALITY**

- Gifts or hospitality should only be accepted where the value is clearly insignificant.
- Those in positions to influence the conduct and outcome of the audit and their immediate family members shall not accept hospitality from the audited entity unless it is reasonable in terms of its frequency, nature and cost.

(x) **ACTUAL AND THREATENED LITIGATION**

- Disclosing the extent and nature of the litigation to the audit committee or senior management of the client entity.

- If the litigation involves a member of the assurance team, removing that individual from the assurance team.

- Appointing an additional professional accountant to review the work done and assess the nature of the litigation threat.

EXAMINER'S REPORT

The questions tests candidates' knowledge on professional Code of Ethics relating to Independence of professional accountants on an assurance assignment.

About 90% of the candidates attempted the question. Majority of them did not understand part (a) with a linkage effect on follow-up in part (b). The performance was generally poor with some exceptional fair performances.

Candidate's commonest pitfall was treating of threats in place of key areas as the primary points.

Candidates should read and understand the requirements of a question before attempting it.

MARKING GUIDE		MARKS	MARKS
a	Five key areas identified 5 x 1 mark each	5	
	Five areas explained 5 points x 1 mark each	5	
			10
b	4 safeguards x 1 mark	4	

3 safeguards x 1 mark x 2 each	6	10
Total		20

SOLUTION 5

a. The main audit work expected to be carried out on receipt of the bank confirmation are as follows:

i. Agree the opening balance with the closing balance of the previous audited financial statements;
ii. Agree the confirmed balance with the reconciliation statement for accuracy;
iii Review the bank confirmation for ownership of accounts;
iv. Confirm that balances have been properly presented in the financial statements;
v. Review the bank confirmation to ascertain completeness and validity of transactions; and
vi. Relate other information contained in the confirmation letter to other areas of the audit, like accrued bank charges provided for in the financial statements.

b. Audit procedures relating to confirmation of receivable balances

i Review the accounting policies as regards receivables;
ii. Review the schedule of receivables to confirm classification;
iii. Test for age analysis of receivables for adequate provision for impairment losses;
iv. Test for existence of receivables by circularisation;
v. Confirm the effectiveness of Internal Controls over receivables;
vi. Test for proper disclosure of receivables in the financial statements; and
vii. Obtain representation of management.

c. The following are the steps the auditor will take if the management of an entity refuses to allow him to send a confirmation request to its customers:

i. Enquire into and validate the reasons for such refusal;
ii. Consider the implication of the refusal on risk assessment and other audit procedures;
iii. Perform alternative audit procedures like checking the payment history, post audit date and related transactional records; and
iv. Where the auditor considers the materiality of the transactions and its impact on the financial statements, he may modify his opinion on the basis of limitation to audit scope.

EXAMINER'S REPORT

The question tests candidates' knowledge of substantive audit procedures on current assets, namely:

(a) Audit work on receipt of bank confirmation;
(b) Audit procedure on confirmation of receivable balances; and
(c) Audit procedures if management refuses to allow sending a confirmation request.

Understanding of Parts (a) and (b) was poor while that of part (c) was average.

Performance was relatively poor for (a) and (b) and average for (c)
The commonest pitfall is their inability to apply audit principles to practical scenarios.

Candidates are admonished to apply their knowledge to practical situation.

MARKING GUIDE		**MARKS**	**MARKS**
a.	Audit procedures - Bank confirmation		
	5 points x 1 mark		5
b.	Audit procedures – Receivable 5 point x 1		5
c.	5 steps/procedures x 1		5
	Total		15

SOLUTION 6

(a) Fraud is an intentional act by one or more persons, involving the use of deception to gain an unjust or illegal advantage. The two types of fraud as identified in International Standards on Auditing ISA 240 are:

i) **Fraudulent financial reporting**

Fraudulent financial reporting is a deliberate misrepresentation, misstatement or omission of financial statement data for the purpose of misleading the reader and creating a false impression of an organisation's financial position. This could be perpetrated through:

- Forging or altering accounting records or supporting documentation which form the basis of the financial statements;

- Misrepresenting or intentionally omitting events or transactions from the financial statements; and

- Intentionally misapplying accounting principles.

Fraudulent financial reporting often involves management override of controls.

ii) **Misappropriation of assets**

Asset misappropriation fraud occurs when people who are entrusted to manage the assets of an organisation steal from it. This could happen through:

- Embezzling receipts (for example, diverting them to personal bank accounts);
- Stealing physical assets (such as inventory) or intellectual property (for example, by selling "trade secrets" to a competitor);
- Causing an entity to pay for goods and services not received (for example, by the creation of fictitious suppliers); and
- Putting an entity's assets to personal use.

b. Procedures performed by the auditor to identify risks of material misstatements due to fraud include:

i) Make enquiries of management in respect of:

- Their assessment of the risk of material fraud;
- The process in place for identifying and responding to the risks of fraud;
- Any specific risks of fraud identified or likely to exist; and
- Any communications within the entity in respect of fraud (including those to employees regarding management's views on business practices and ethical behaviour).

ii) Make inquiries of management and others within the entity as to whether they have knowledge of any actual, suspected or alleged frauds and to obtain views about the risks of fraud.

iii) Evaluate any unusual or unexpected relationships identified while performing analytical procedures which might indicate a risk of material fraud.

iv) Evaluate information obtained from other risk assessment procedures to see if any fraud risk factors are present.

v) Review transactions with related parties to ascertain their nature and whether they have been carried out at arm's length

c. It is particularly important in relation to fraud that the auditor maintains an attitude of professional scepticism to enable him identify indicators of fraud during the cause of his audit. Some of the fraud risk factors are:

   i) The need to meet the expectations of third parties, for example, the entity is trying to obtain additional finance;

   ii) Management being remunerated through profit-related performance or results related bonuses;

   iii) The entity's profitability being under threat, for example, due to increased competition or rapid changes in technology;

   iv) The nature of the industry or the entity's operations providing opportunities for fraud, for example, complex transactions or significant accounting estimates;

   v) An ineffective control environment;

   vi) Low morale amongst staff or poor communication and/or enforcement of ethical standards by management;

   vii) Personal pressure on staff to misappropriate assets, for example, personal financial problems or the threat of redundancy;

   viii) Opportunity to misappropriate assets for example, large amounts of cash held or processed, highly portable/valuable inventory such as jewels or precious stones; and

   ix) Poor internal control over assets, for example, lack of segregation of duties.

EXAMINER'S REPORT

The question is in three parts and tests candidates on fraud provisions of ISA 240. About 50% of candidates attempted it.

Understanding displayed was below average though the question is direct. Performance was considered below average.

Candidate's commonest undoing was mix-up of solutions.

Candidates are advised to study well and answer questions in line with examiner's requirements.

MARKING GUIDE		MARKS	MARKS
a	Each type fraud mentioned and explained 3 marks each		6
b	1 mark for each procedure mentioned – maximum of 5		5
c	1 mark for each fraud risk factor stated – maximum of 4		4
	Total		15

SOLUTION 7

a.

i. An Auditor can resign his appointment during his period of office due to the following reasons;

- Lack of integrity demonstrated by management and/or those charged with governance;
- Where significant fees for the services provided by the auditor remain unpaid;
- The audit firm can no longer maintain its independence; and
- The audit is no longer profitable to the audit firm.

ii. The procedures for the resignation of the current auditors as regards the provisions of the Companies and Allied Matters Act CAP C 20 LFN 2004 are:

- The resignation should be made to the company at its registered office in writing. The company should submit this resignation letter to the appropriate regulatory authority;

- The auditor should prepare a statement of the circumstances. This sets out the circumstances leading to the resignation, if the auditor believes that these are relevant to the shareholders or creditors of the company. If no such circumstances exist, the auditor should make a statement to this effect;

- The company should send this statement to the Corporate Affairs Commission within 14 days of receipt; all persons entitled to receive a copy of the company's financial statements (principally, the shareholders) unless the Commission rules that the Auditor is seeking to defame the company with needless publicity; and

- The auditors may require the directors to call a meeting of the shareholders in order to discuss the circumstances of the auditors' resignation.

b. Duty of care

i. Every professional Accountant is required to discharge his duty with reasonable degree of skill and care. He has a duty to maintain his professional knowledge and skill at such a level that a client or employer receives competent service, based on current developments in practice, legislation and techniques.

This implies that the audit work performed by an auditor for a client must be adapted to the specific circumstances and characteristics of the client.

Members should act diligently and in accordance with applicable technical and professional standards.

ii. If the auditor fails to exercise adequate degree of care, a number of consequences may follow. These include:

- There may be legal claims against the auditor in the law of contract or the law of tort;

- There may be disciplinary proceedings against the auditor by the Institute of Chartered Accountants of Nigeria; and

- The auditor or audit firm may earn a reputation in the business community for poor standards of work, and may therefore lose clients.

EXAMINER'S REPORT

The question is in two parts. Part (a) deals with the resignation of auditors while part (b) tests candidates on fundamental principle of due care.

About 95% of the candidates attempted the question, but their understanding was average.

Candidates' commonest pitfall was non-exhibition of understanding of the question properly. For instance many candidates did not state the consequences before the impact of the consequences in the case of b(ii)

Candidates are advised to relate solutions to the requirements of the question and the Institute's Study Text for their studies.

MARKING GUIDE		**MARKS**	**MARKS**
a.i	1 mark for each point stated x 3	3	
Ii	1 mark for each procedure described x 4	<u>4</u>	
			7
b.i	2 marks for explanation	2	
Ii	2 marks for each consequence		
	(Maximum of 3 points)	<u>6</u>	
			<u>8</u>
	Total		<u>15</u>

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – NOVEMBER 2017

TAXATION

Time Allowed: $3^1/_4$ 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

Alhaji Dansaki Mohammed, living in Kano, commenced business on May 1, 2012, making up his accounts to September 30 annually.

The Statement of his Profit or Loss Account for the first 17 months ended September 30, 2013 is as follows:

	₦'000	₦'000
Gross Profit		19,300
Less:		
Repairs and maintenance	1,500	
Local transport and travelling	2,450	
Salaries and wages	6,500	
Provision for bad debts	1,350	
Preliminary expenses	960	
Depreciation	1,630	
Bank interest and charges	1,520	
Legal and professional charges	1,380	
General expenses (Allowable)	1,870	
Clearing expenses on motor vehicle	685	
Bad debts	2,800	
		22,645
Net Loss		(3,345)

You are also given the following additional information:

(i) Bad debts:

	₦
Amounts written off	1,850,000
Loan to absconded employee	950,000
	2,800,000

(ii) The following qualifying capital expenditures were acquired on:

		₦
30/10/2015	Building	5,500,000
1/1/2016	Motor Vehicles	3,800,000
1/5/2016	Furniture and Fittings	1,900,000

(iii) Legal and professional charges were:

	₦
Fines for contravention of the law	350,000
Legal expenses for tax appeal	185,000
Audit and accountancy charges	845,000
	1,380,000

(iv) Provision for bad debts was calculated as 5% of balance of trade debtors as at September 30, 2013.

(v) Salaries and wages:

	₦
Senior staff	3,500,000
Junior staff	2,400,000
3 children of Alhaji Dansaki in higher institutions	600,000
	6,500,000

You are required to:

a. Identify **FIVE** deductions not allowable for the purpose of ascertaining the income of an individual for tax purposes. (5 Marks)

b. Compute the Adjusted Profit of Alhaji Dansaki Mohammed for the period ended September 30, 2013. (6 Marks)

c. Compute the capital allowances for the first **THREE** years of assessment. (11 Marks)

d. Assuming the right of election was not exercised, compute the Total Profits for the relevant years of assessment. (8 Marks)

(Total 30 Marks)

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

QUESTION 2

Sun, Moon and Star are partners in the firm of MONSTAR & Co, for a very long time. The firm makes up its accounts to December 31 of every year.

Below are the extracts from the Statement of Profit or Loss for the year ended December 31, 2016:

	₦'000	₦'000
Net profit for the year		37,500
After charging:		
Partners' salaries	18,600	
Bad debts	4,500	
Repairs and maintenance	1,850	
Depreciation	5,450	
Car expenses	12,300	
Rent and rates	6,000	
Loss on sale of property, plant and equipment	2,450	
Interest on loan and overdraft	4,340	
Interest on Capital	1,985	
Professional charges	3,600	
Donations	1,850	

Additional information:

(i) Salaries were paid to the partners as follows:

		₦
Sun	-	6,800,000
Moon	-	6,100,000
Star	-	5,700,000

(ii) The partners are entitled to interest rate of 10% on capital contributed by them. The balance on their Capital Accounts as at December 31, 2016, are as follows:

	₦
Sun	6,500,000
Moon	7,850,000
Star	5,500,000

(iii) Bad debts consist of the following:

	₦
Bad debts written off	3,600,000
General provision for the year	1,800,000
Bad debts previously written	

off now recovered	(900,000)	
	4,500,000	

(iv) Interest on loan and overdraft:

	₦	₦
Interest on loan to partners		
- Sun	1,250,000	
- Moon	850,000	2,100,000
Interest on bank term loan		1,260,000
Interest on overdraft		980,000
		4,340,000

(v) Repairs and maintenance included the sum of ₦640,000 spent on Moon's younger brother's car during the year.

(vi) Capital allowances for the year amounted to ₦3,480,000.

(vii) Profit sharing ratio of the partners – Sun, Moon & Star is 2: 2: 1 respectively.

(viii) Each of the partners has two wives and all their children were gainfully employed except their last children on whom they spent ₦500,000 each as maintenance allowance.

(x) Life assurance premiums paid during the year are as follows:

	₦
Sun	690,000
Moon	720,000
Star	580,000

You are required to calculate:

a. The Adjusted Profit of the firm for the year ended December 31, 2016. (9 Marks)

b. The Gross Income of each of the partners for the relevant year of assessment. (3 Marks)

c. Each partner's tax liability. (8 Marks)

(Total 20 Marks)

QUESTION 3

a. Identify and explain types of loss reliefs and their treatments. (6 Marks)

b. Ologbojo Nigeria Plc has been in the business of importing GLUE for some time. Due to recent economic meltdown and recession in the country, the company has been making losses for many years but made a good recovery in 2016.

The Adjusted Profits for the relevant years are as follows:

	₦'000
Year ended December 31, 2011 (Loss)	950,000
Year ended December 31, 2012 (Loss)	650,000
Year ended December 31, 2013 (Loss)	1,260,000
Year ended December 31, 2014 (Loss)	125,000
Year ended December 31, 2015 Profit	136,000
Year ended December 31, 2016 Profit	1,240.000

Capital allowances for the years are as given below:

Assessment Year	₦
2012	65,000
2013	102,500
2014	85,000
2015	120,000

You are required to:
Compute the tax liabilities of the company for the relevant assessment years. (14 Marks)
(Total 20 Marks)

QUESTION 4

a. Any good tax system must be based on certain principles.

Required
Illustrate with examples, **THREE** principles as laid down by Adam Smith. (6 Marks)

b. Identify and discuss **FOUR** categories of individuals exempted from the rule of residence regarding payment of Personal Income Tax (PIT). (4 Marks)

c. Mr. Demilade is the Chairman and Chief Executive Officer of a business outfit. He was recently approached by officials of Federal Inland Revenue Service (FIRS) over non-payment of taxes. He insisted that his company has been paying taxes but the tax officials demanded that he should show evidence of payment, that is, Tax Clearance Certificate (TCC), which he could not provide. He could only show copies of bank lodgements to the bank on taxes remitted to the tax office.

You have been appointed by Mr. Demilade to present a report on Tax Clearance Certificate. Specifically, **you are required to EXPLAIN**:

i. What a Tax Clearance Certificate (TCC) is. (2 Marks)

ii. **FOUR** contents of TCC. (4 Marks)

iii. **FOUR** transactions that require the use of TCC (4 Marks)

(Total 20 Marks)

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

QUESTION 5

Derik has been out of Nigeria for some years. While working in one of the European countries, he was only familiar with Income and Value Added Taxes. On returning to Nigeria, he incorporated a trading company known as Derikay Limited and has been in operation for 23 months without registering its business with the tax authorities.

The Federal Inland Revenue Service, acting on intelligence information, recently conducted a monitoring exercise on the operations of Derikay Limited and scrutinized the company's payment vouchers, bank statements, invoices, rent and contract agreements. The Revenue came up with demand notices for Companies Income Tax (CIT), Tertiary Education Tax (TET), Withholding Tax (WHT) and Value Added Tax (VAT).

Except for Income and Tertiary Education taxes, which he seems to agree with, Derik felt his company should not have been assessed on VAT and WHT because these were already deducted on invoices.

You are required to explain to Derikay Limited:

a. Nature of Withholding Tax. (4 Marks)

b. Penalties for non-deduction and non-remittance of Withholding Tax in accordance with Section 82 of CITA 2004 (as amended). (4 Marks)

c. State the principles behind double taxation relief and Withholding Tax rate. (2 Marks)

d. Identify **FIVE** differences between Value Added Tax and Withholding Tax. (5 Marks)

(Total 15 Marks)

QUESTION 6

The most important thing about tax is that it is a pecuniary burden laid upon individuals, persons or property to support the government and is a payment enacted by legislative authority.

In the light of the above, **you are REQUIRED to:**

a. Identify and discuss **FIVE** reasons for the imposition of tax in Nigeria. (5 Marks)

b. Determine the tax authority in charge of administration of Personal Income Tax in Nigeria. (2 Marks)

c. Identify **FOUR** members of the tax authority in charge of Personal Income Tax and state **FOUR** of their duties. (8 Marks)

(Total 15 Marks)

QUESTION 7

a. Section 92 of Personal Income Tax Act, 2004 LFN (as amended) establishes the Joint State Revenue Committee for each state of the Federation.

You are required to:

i. Identify **FOUR** members;

ii. Discuss **THREE** functions of the committee. (5 Marks)

b. Mr. Salami died in 2014 leaving all his properties 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 for the year ended December 31, 2015	14,000,000
Capital Allowances	3,000,000
Rent	8,000,000

Remuneration of the trustees has been fixed at ₦18,000 monthly. The sums 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)

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

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

(a) **The deductions not allowable for the purpose of ascertaining the income of an individual for tax purposes are as follows:**

i. Domestic or private expenses;

ii. Capital withdrawn from a trade, business, profession or vocation and expenditure of a capital nature;

iii. Any loss or expenses recoverable under an insurance or contract of indemnity;

iv. Rent or cost of repairs to any premises or part of premises, not incurred for the purpose of producing the income;

v. Taxes on incomes or profits levied in Nigeria or elsewhere, except as provided in the Act;

vi. Pension contribution not approved under the Pension Reform Act;

vii. Depreciation of property, plant and equipment;

viii. Any sum reserved out of profits, except for provision for bad and doubtful debts incurred by the business;

ix. Any expenses of any description incurred within or outside Nigeria, for the purpose of earning management fees, unless prior approval of the arrangement has been obtained from the Minister; and

x. Management fees on an arrangement entered into after the commencement of the Act as the Minister may allow.

(b)

ALHAJI DANSAKI MOHAMMED
COMPUTATION OF ADJUSTED PROFIT
FOR THE PERIOD ENDED SEPTEMBER 30, 2012 (17 MONTHS)

	₦'000	₦'000
Net loss as per accounts		(3,345)
Deduct: Disallowable expenses:		
General provision for bad debts	1,350	
Depreciation	1,630	
Preliminary expenses	960	
Clearing expenses on vehicles	685	
Legal and professional charges	535	
Salaries and wages	600	5,760
Adjusted Profit		2,415

Note:

Legal and professional charges:	₦
- Fines for contravention of the law	350,000
- Legal expenses for tax appeal	185,000
	535,000

(c)

Alhaji Dansaki Mohammed
Computation of Capital Allowances for the Relevant Years

	Building	Motor Vehicle	Furniture	Total
I. A	**15**	**50**	**25**	
A. A	**10**	**25**	**20**	
	₦	₦	₦	₦
A.Y 2017				
Cost	5,500,000	3,800,000	1,900,000	
Initial allowance	(825,000)	(1,900,000)	(475,000)	(3,200,000)
Annual allowance	(467,500)	(475,000)	(285,000)	(1.227,500)
TWDV c/f to A.Y. 2018	4,207,500	1,425,000	1,140,000	4,427,500
A.Y 2018				
Annual Allowance	(467,500)	(475,000)	(285.000)	(1,227.500)
TWDV c/f to A.Y. 2019	3,740,000	950,000	855,000	
Annual Allowance	(467,500)	(475,000)	(285,000)	1,227,500
TWDV c/f to A.Y. 2020	3,272,500	475,000	570,000	

Given the fact that the qualifying capital expenditure were acquired after the period ended September 30, 2013, no capital allowances on same are claimable.

(d) ALHAJI DANSAKI MOHAMMED

COMPUTATION OF ADJUSTED PROFIT

	₦
A.Y. 2012 (1/5/12 – 31/12/12)	
Adjusted Profit ($^{8}/_{17}$ x ₦2,415,000)	1,136,471
Less: Capital allowances	0
Total Profit	1,136,471
A.Y. 2013 (1/5/12 – 30/4/13)	
Adjusted Profit ($^{12}/_{17}$ x ₦2,415,000)	1,704,706
Less: Capital allowances	0
Total Profit	1,704,706
A.Y. 2014 (1/10/12 – 30/9/13)	
Adjusted Profit ($^{12}/_{17}$ x ₦2,415,000)	1,704,706
Less: Capital allowances for the year	0
Total Profit	1,704,706

EXAMINER'S REPORT

The question tests candidates' knowledge of ascertaining the income tax liability of individuals and computation of capital allowances.

Candidates had a fair understanding of the question and performance was average. The commonest pitfall was the inability of the candidates to identify disallowable expenses and the placement of assets in relevant years.

Students are advised to pay attention to these areas of the syllabus.

MARKING GUIDE

		Marks	Marks
(a)	Deductions not allowable (1 mark each for any point subject to a maximum of 5 points)		5
(b)	Heading	1	
	Net loss per accounts	½	
	Disallowable expenses: (½ mark each for six expenses)	3	
	Adjusted Profit	1	
	Breakdown of legal and other professional charges	½	6

(c)	For stating no capital allowances are claimable on the qualifying capital expenditure because same were acquired after the period ended September 30, 2013		11
(d)	Heading	½	
	Correct assessment year	1½	
	Adjusted profits for three years (1/2 mark for each year)	1½	
	Capital allowances for three years (1/2 mark for each year)	1½	
	Total profits for three years (1 mark for each year)	3	8
			30

SOLUTION 2

(a)

MONSTAR & CO
COMPUTATION OF ADJUSTED PROFIT
FOR THE YEAR ENDED DECEMBER 31, 2016

	₦'000	₦'000
Net Profit for the year		37,500
Add: Disallowable expenses:		
Depreciation	5,450	
Loss on sale of property, plant and equipment	2,450	
Donations	1,850	
Interest on capital	1,985	
Partners' salaries	18,600	
Repairs and maintenance (Moon's brother car)	640	
General provision for bad debts	1,800	32,775
Adjusted Profit		70,275
Deduct:		
Interest on capital	1,985	
Partners' salaries	18,600	(20,585)
		49,690
Capital allowances		(3,480)
Computed Income		46,210

(b) **COMPUTATION OF GROSS INCOME OF EACH OF THE PARTNERS**

	Sun	Moon	Star	Total
	₦'000	₦'000	₦'000	₦'000

Share of computed income	18,484	18,484	9.242	46,210
Interest on capital	650	785	550	1,985
Salaries	6,800	6,100	5,700	18,600
Interest on loan	1,250	850	0	2,100
Gross income	27,184	26,219	15,492	68,895

(c) **COMPUTATION OF INCOME TAX LIABILITY OF EACH PARTNER**

	Sun	Moon	Star	Total
	₦'000	₦'000	₦'000	₦'000
Gross income	27,184	26,219	15,492	68,895
Consolidated Relief Allowance (Higher of ₦200,000 or 1% of Gross income + 20% of Gross income)	(5,709)	(5,506)	(3,253)	(14,468)
	21,475	20,713	12,359	54,427
Tax exempt items:				
Life assurance premium	(690)	(720)	(580)	(1,990)
Chargeable Income	20,785	19,993	11,659	52,437

TAX LIABILITIES

	Sun	Moon	Star
	₦	₦	₦
First ₦300,000 @ 7%	21,000	21,000	21,000
Next ₦300,000 @ 11%	33,000	33,000	33,000
Next ₦500,000 @ 15%	75,000	75,000	75,000
Next ₦500,000 @ 19%	95,000	95,000	95,000
Next ₦1,600,000 @ 21%	336,000	336,000	336,000
Next ₦17,279,060 @ 24%	4,220,400		
Next ₦16,402,710 @ 24%		4,030,320	
Next ₦8,316,480 @ 24%			2,030,160
Tax liability of each partner	4,780,400	4,590,320	2,590,160

EXAMINER'S REPORT

The question tests candidates' knowledge of the computation of partners' tax liability.

The candidates had a good understanding of the question and performance was good. The commonest pitfall was the failure of some candidates to identify expenses that are disallowable.

Candidates are advised to get familiar with disallowable expenditures in the ascertainment of taxable income.

MARKING GUIDE

		Marks	Marks
(a)	Heading	½	
	Net profit	½	
	Disallowable expenses (1/2 mark each for seven expenses)	3½	
	Total of disallowable expenses	½	
	Adjusted profit	½	
	Interest on capital	½	
	Partners' salaries	½	
	Subtotal	1	
	Capital allowances	½	
	Computed income	1	9
(b)	Share of computed income	¾	
	Interest on capital	¾	
	Salaries	¾	
	Interest on loan	¾	3
		1	
(c)	Consolidated Relief allowance		
	Life assurance premium	1	
	Tax payable for each band based on the graduated tax table at 1/3 mark each subject to 18 points	6	8
			20

SOLUTION 3

(a) **Types of Loss Reliefs**

The different types of loss relief are as follows:

i. **Current Year Loss Relief**
This is one of the methods of relieving losses. It is applicable to only individuals. In this case, losses incurred from a particular source of income can be relieved against other sources.

In order to enjoy this relief, a written claim must be made within 12 months after the end of the year of assessment in which the loss arises. It is important to note that the Current Year Loss Relief is applicable to a loss incurred only in the first year. Any unrelieved loss can only be set off against profit from the source from which the loss was incurred.

ii. **Carry Forward Loss Relief**
This relief is available only against profit from the same source of income where the loss originally occurred. It does not require approval before the relief can be granted. The relief also applies to both individuals and corporate bodies.

(b)

OLOGBOJO NIGERIA PLC
COMPUTATION OF INCOME TAX LIABILITIES
FOR 2012 – 2015 ASSESSMENT YEARS

		₦'000
A.Y. 2012 (1/1/2011 – 31/12/2011)		
Loss for the year		(950,000)
Capital allowances for the year		(65)
Unrelieved loss and capital allowances c/f		(950,065)
Companies Income Tax		NIL
Tertiary Education Tax		NIL
A.Y. 2013 (1/1/2011 – 31/12/2012)		
	₦'000	₦'000
Loss for the year		(650,000)
Add: Unrelieved loss b/f		(950,000)
		(1,600,000)
Capital allowances for the year	103	
Capital allowances b/f	65	(168)
Unrelieved losses and capital allowances c/f		(1,600,168)
Companies Income Tax		NIL
Tertiary Education Tax		NIL
A.Y. 2014 (1/1/2013 – 31/12/2013)		
Loss for the year		(1,260,000)
Add: Unrelieved losses b/f		(1,600,000)
		(2,860,000)

Capital allowances for the year	85	
Capital allowances b/f	165	(253)
Unrelieved losses and capital allowances c/f		(2,860,253)
Companies Income Tax		NIL
Tertiary Education Tax		NIL

A.Y. 2015 (1/1/2014 – 31/12/2014)

Loss for the year		(125,000)
Add: Unrelieved losses b/f		(2,860,000)
		(2,985,000)
Add: Capital allowances for the year	120	
Capital allowances b/f	253	(373)
Unrelieved losses and capital allowances c/f		(2,985,373)
Companies Income Tax		NIL
Tertiary Education Tax		NIL

A.Y. 2016 (1/1/2015 – 31/12/2015)

	₦'000	₦'000
Profit for the year	136,000	
Losses brought forward	(2,985,000)	
Unrelieved losses c/f	(2,849,000)	(2,849,000)
Add: Capital allowances:		
For the year	0	
B/f from A.Y. 2015	373	(373)
Losses and Capital allowances c/f for A.Y 2017		(2,849,373)
Companies Income Tax liability		NIL
Tertiary Education Tax liability		NIL

A.Y 2017 (1/1/2016 – 31/12/2016)

Profit for the year	1,240,000	
Losses brought forward	(2,849,000)	
Unrelieved losses c/f	(1,609,000)	(1,609,000)
Capital allowances:		
Brought forward from A.Y 2016	373	

For the year	0	(373)
Losses and Capital allowances c/f to A.Y 2018		(1,609,373)
Companies Income Tax		NIL
Tertiary Education Tax		NIL

EXAMINER'S REPORT

The question tests candidates' knowledge of loss reliefs and how it affects the tax liabilities of businesses.

Candidates had a good understanding of the question and performance was also good.

The commonest pitfall was the poor presentation of the solution to the question by some candidates. Candidates are advised to pay attention to presentation in future examinations.

MARKING GUIDE

		Marks	Marks
(a)	Current year loss relief	3	
	Carried forward loss Relief	3	6
(b)	A.Y. 2012		
	Loss for the year	½	
	Capital allowances	½	
	Companies Income Tax (CIT)	¼	
	Tertiary Education Tax (TET)	¼	
	A.Y. 2013		
	Loss for the year	½	
	Unrelieved loss b/f	½	
	Capital allowances for the year	½	
	Capital allowances b/f	½	
	CIT	¼	
	TET	¼	
	A.Y. 2014		
	Loss for the year	½	
	Unrelieved loss b/f	½	
	Capital allowances for the year	½	
	Capital allowances b/f	½	
	CIT	¼	
	TET	¼	

<u>A.Y. 2015</u>	
Loss for the year	½
Unrelieved loss b/f	½
Capital allowances for the year	½
Capital allowances b/f	½
CIT	¼
TET	¼
<u>A.Y. 2016</u>	
Profit for the year	½
Losses brought forward	½
Capital allowances for the year	½
Capital allowances b/f	½
CIT	¼
TET	¼

A.Y. 2017

Profit for the year	½	
Losses brought forward	½	
Capital allowances for the year	½	
Capital allowances b/f	½	
CIT	¼	
TET	¼	14
		20

SOLUTION 4

(a) The principles of a good tax system according to Adam Smith are:

(i) **Equity**
This affirms that every taxable person should be taxed according to his ability, that is, the rich should pay more, while the poor pay less.

(ii) **Certainty**
The time of payment, the manner of payment, the amount to be paid should be certain and clear to the taxpayer. The determination of tax liability should not be left to the whims and caprices of tax officials.

(iii) **Convenience**
The social and economic standing of the taxpayer must be taken into consideration, that is, the time of payment should not be inconvenient to the taxpayer.

(iv) **Administrative efficiency**
The process of levying and collection must be administratively efficient, transparent and must not cause economic distortion to the taxpayer.

(v) **Simplicity**
The tax system should be simple to understand by the taxpayers.

(vi) **Productivity**
The tax system should bring in sufficient revenue to the government. The cost of administering the tax should be less than the revenue such tax will generate.

(vii) **Flexibility and stability**
A good tax system should be flexible enough to accommodate changes to be effected by any government of the day. This

flexibility, however, must be balanced with the need to have a stable tax system.

(b) **Categories of individuals exempted from the rules of residence include:**

(i) Individuals in full-time employment with the armed forces;

(ii) Nigerian Diplomats;

(iii) Foreign Diplomats; and

(iv) An employee whose remuneration is subject to Nigerian tax, but who is not deemed to be resident in a territory for that year.

(c) i. A Tax Clearance Certificate is issued by the relevant tax authority, that is, the Federal Inland Revenue Service in respect of companies and the State Boards of Internal Revenue in respect of individuals.

It shows the tax position of the individual to whom it is issued. The certificate is issued only upon application by the taxpayer. In issuing the certificate, the relevant tax authority would have satisfied itself that, the tax assessed on the income of the applicant for the 3 years immediately preceding the current year of assessment, has been fully paid, that no tax is due on such income or that the applicant is not liable to tax for any of the three years.

ii. Contents of a Tax Clearance Certificate are:

- Name, address and Taxpayer's Identification Number (TIN) of the company;
- Chargeable income;
- Tax payable;
- Tax paid;
- Nature of business;
- Type of Assessment Best Of Judgment (BOJ), Self Assessment, etc); and
- Expiry date

iii. Transactions that require a Tax Clearance Certificate include:

- Application for Government loan for industry or business;
- Registration of motor vehicle;
- Application for firearms licence;
- Application for foreign exchange or exchange control permission to remit funds outside Nigeria;
- Application for Certificate of Occupancy;

- Application for award of contracts by government, its agencies and registered companies
- Application for approval of building plans;
- Application for trade licence;
- Application for transfer of real property;
- Application for import or export licence;
- Application for agent licence;
- Application for pools or gaming licence;
- Application for registration as a contractor;
- Application for distributorship;
- Confirmation of appointment by government, as Chairman or member of public board, institution, commission, company or to any other similar position made by the government;
- Stamping of guarantor's form for Nigerian passport;
- Application for registration of a limited liability or of a business name;
- Application for allocation of market stalls;
- Appointment or election into public office;
- Change of ownership of vehicle by vendor; and
- Application for plot of land.

EXAMINER'S REPORT

The question tests candidates' knowledge of the use and content of Tax Clearance Certificate.

The candidates demonstrated a good understanding of the question and performance was good.

The commonest pitfall of some candidates was the inability to present their solutions clearly.

Candidates are advised to pay attention to clear presentation.
MARKING GUIDE

		Marks
(a)	Principles of a good tax system (2 marks each for any principle subject to a maximum of 3 points)	6

(b)	1 mark each for the people (4) exempted from the rules of residence	4
(c)	i) Tax Clearance Certificate	2
	ii) Contents of a Tax Clearance Certificate subject to (1 mark each subject to a maximum of 4 points)	4
	iii)Transactions that require a Tax Clearance Certificate (1 mark each for any point subject to a maximum of 4 points)	4
		20

SOLUTION 5

(a) **Nature of Withholding Tax**

Withholding tax is a tax deducted at source from payments made to a taxable person for the supply of goods and services. It is not another form of tax, but simply an advanced payment of tax, as the withholding tax deducted at source is off-settable against any subsequent tax liability that may be due in respect of other income. In certain cases, the withholding tax deducted at source is the final tax in the hands of the recipients.

A taxpayer has no option as to whether to pay it or not as the person making the payment is statutorily required to deduct. Failure to deduct attracts sanctions. It is an advanced payment of income tax and can therefore be utilised as tax credit against income tax liability of the year to which the income relates. It represents the final tax in certain cases.

(b) **Penalty for Non-deduction and Non-remittance of Withholding Tax**

Section 82 of CITA, CAP C21 LFN 2004 (as amended), specifies that where any person who being obliged to deduct tax under Sections 78 (deduction of tax from interest, etc). 79 (deduction of tax on rent), 80 (deduction of tax from dividend) or 81 (deduction of tax at source) of this Act fails to deduct or having deducted fails to pay to the Board within 21 days from the date the amount was deducted or the time the duty arose, shall be guilty of an offence and shall be liable to a penalty of 10% per annum of the tax withheld or not remitted, as the case may be.

Similarly, failure to deduct or having deducted, fail to remit to the Revenue, Withholding tax withheld from payments due to individuals, is an offence punishable on conviction with a fine of ₦5,000, in addition to the tax deductible or deducted, but not remitted, plus interest at the prevailing commercial rate.

(c) **Principle Behind Double Taxation Relief and Withhold Tax(WHT) Rate**

The principle behind Double Taxation Relief is to avoid being taxed more than once. Where there is a double taxation treaty between Nigeria and any other country, the resident of such a country, in receipt of income in Nigeria, will be entitled to double taxation relief at the rates contained in the double taxation treaty. The withholding tax rate is reduced to 7.5% for dividend, interest and royalty for recipients of a country which had double tax treaty with Nigeria.

(d) **Five Differences Between Value Added Tax (VAT) and Withholding Tax (WHT)**

The major differences between VAT and WHT are as shown in the table below:

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

EXAMINER'S REPORT

The question tests candidates understanding of transaction taxes and double taxation reliefs.

Candidates displayed a good understanding of the question and performance was good.

The commonest pitfall by some candidates was their lack of adequate knowledge of double taxation relief.
Candidates are advised to pay attention to the provisions relating to double taxation relief.

MARKING GUIDE

		Marks	Marks
(a)	Nature of Withholding Tax		4
(b)	Penalties for non-deduction and non-		

	remittance of withholding tax	4
(c)	Principles behind double taxation relief	2
(d)	Difference between VAT and WHT ($^1/_2$ mark each subject a maximum of 10 points)	5
		15

SOLUTION 6

(a) Reasons for the imposition of tax in Nigeria include:

Revenue generation
The primary objective of taxation is to raise money to meet government expenditures. Thus, taxation has also been employed to raise sufficient revenue to satisfy the needs of government, such as provision of services like defence, health services education and ensuring law and order. Revenue from taxation can also be spent on capital projects, otherwise called capital expenditure, creating a social and economic infrastructure, which will improve the social life of the people and also enable the economy of the country to grow.

Redistribution of income and wealth
This can be looked at from two angles. The first is the doctrine that taxation should be based on the ability to pay, so that the burden of taxation ought to be heavier for rich than for the poor, with the taxes collected being used to pay the social services for the less fortunate. This is achieved by the graduation or "progressiveness" of the rates at which the taxes are levied.

i) This objective sees the present distribution of wealth as being unjust and so attempts to reverse the situation by fixing taxes at concessionary rates in favour of the poor.

ii) High taxes on the income and wealth of the rich can produce either incentive or disincentive effects. Sometimes, a tax payer's spendable income is reduced through taxation, so he is compelled to work harder in order to maximize this income. Taxes that produce incentive effects therefore increase productivity. On the other hand, a high marginal tax rate can produce a disincentive effect which makes the worker take to leisure rather than to extra work. This disincentive effect is an indication of economic inefficiency and waste

Management of the economy
Taxation is important in the planning of savings and investments and by harmonizing it with development strategy and changing economic structure. The government can use taxation as a powerful fiscal weapon to plan and develop a country.

Harmonisation of economic objectives
Harmonisation of diverse trade or economic objectives of different countries can be achieved through a good tax system. For example, tax system can be employed by member states of Economic Committee of West African States (ECOWAS) so as to achieve the philosophy of the single market (free movement of people and goods) within the region.

Taxation is a device to improve gross national income, induce economic development and influence favourable balance of payments with other countries.

(b) Tax authorities in charge of administration of Personal Income Tax in Nigeria are:

(i) **State Board of Internal Revenue (SBIR)**
Section 87 of PITA, 2004 and PIT (Amendment) Act, 2011 established the State Board of Internal Revenue whose operational arm is known as the State Internal Revenue Service (SIRS).

(ii) **Federal Inland Revenue Service (FIRS)**
For other categories of individuals such as:

- Members of the Armed Forces; and
- Individuals resident in Abuja

(c) The State Board of Internal Revenue for each state of the Federation comprises:

(i) The Executive head of the State Internal Revenue Service as Chairman;

(ii) The Directors and Heads of departments within the State Internal Revenue Service ;

(iii) A Director from the State Ministry of Finance;

(iv) The Legal Adviser to the State Internal Revenue Service;

(v) Three other persons nominated by the Commissioner for Finance, on their personal merit; and

(vi) The Secretary of the State Internal Revenue Service, who shall be an ex-officio member.

Functions of the State Board of Internal Revenue

The State Board Internal Revenue shall be responsible for:

(i) Ensuring the effectiveness and optimum collection of all taxes and penalties due to the government under the relevant laws;

(ii) Doing all such things be deemed necessary and expedient, for the assessment and collection of the tax and shall account for all sums so collected, in a manner to be prescribed by the Commissioner;

(iii) Making recommendations, where appropriate, to the Joint Tax Board (JTB) on tax policies, tax reform, tax legislations, tax treaties and exemptions as may be required, from time to time;

(iv) Generally controlling, the management of the State Service on matters of policy, subject to the provisions of the law setting up the State Internal Revenue Service; and

(v) Appointing, promoting, transferring and imposing discipline on employees of the State Internal Revenue Service.

EXAMINER'S REPORT

The question tests candidates' knowledge of general principles of taxation.
Candidates displayed a fair understanding of the question and performance was average.
The commonest pitfall was the inability of some candidates to list the composition of the State Board of Internal Revenue (SBIR).

Candidates are advised to cover areas relating to general principles of taxation in future.

MARKING GUIDE

		Marks	Marks
(a)	Reasons for the imposition tax in Nigeria (1 mark each for each of the 5 points)		5
(b)	Tax authority in charge of administration of personnel income tax		
	- State Board of Internal Revenue	1	
	- Federal Inland Revenue Service	1	2
(c)	Members of the tax authority		
	(State Board of Internal Revenue)		
	1 mark each for each point subject to a maximum of 4 points)	4	

Functions of the Board		
1 mark each for each point subject to a maximum of 4 points	4	8
		15

SOLUTION 7

(i) **Members of Joint State Revenue Committee (JSRC)**

JSRC comprises:

(a) The Chairman of the State Internal Revenue Service as the Chairman;

(b) The Chairman of each of the Local Government Revenue Committees;

(c) A representative of the Bureau on Local Government Affairs not below the rank of a Director;

(d) A representative of Revenue Mobilisation Allocation and Fiscal Commission, as an observer;

(e) The State Sector Commander of the Federal Road Safety Commission, as an observer;

(f) The Legal Adviser of the State Internal Revenue Service; and

(g) The Secretary of the Committee who shall be a staff of the State Internal Revenue Service.

(ii) **The functions of the Joint State Revenue Committee shall be to:**

(a) Implement the decisions of the Joint Tax Board;

(b) Advise the Joint Tax Board and the State and Local Governments on revenue matters;

(c) Harmomise tax administration in the State;

(d) Enlighten members of the public generally on State and Local Government revenue matters; and

(e) Carry out such other functions as may be assigned to it by the Joint Tax Board.

(b)

Mr. Salami's Trust
Computation of Amounts Due to the Beneficiaries for 2016 Year of Assessment

	Shola	Bimbo	Tiwa	Motherless	Total
	₦	₦	₦	₦	₦
Ratio	3	2	1		6
Share of distributable income	2,741,625	1,827,750	913,875	0	5,483,250
Fixed Annuity				178,000	178,000
Discretionary Payment	60,000	72,000	80,000	0	212,000
Amounts due for the beneficiaries	2,801,625	1,899,750	993,875	178,000	5,873,250

Workings

Mr. Salami's Trust

Computation of Distributable Income for 2016 Year of Assessment

	₦	₦
Profit for the year ended		14,000,000
Capital Allowances		(3,000,000)
		11,000,000
Rent		8,000,000
		19,000,000
Allowable expenses:		
Remuneration of Trustees (₦18,000 by 12)	216,000	
Trustee's administrative expenses	116,500	
Annuity	178,000	(510,500)
Computed Income		18,489,500
Discretionary payments		(212,000)
Distributable Income		18,277,500
30% of distributable income amongst the beneficiaries		(5,483,250)
Net distributable income in the hand of the Trustee		12,794,250

EXAMINER'S REPORT

The question tests candidates' knowledge of the membership of the Joint State Revenue Committee and computation of incomes in the hands of beneficiaries for taxation of the income of a trustee.

Some candidates displayed poor knowledge of the question and performance was poor. The commonest pitfall was the inability of some candidates to correctly compute what is due for a beneficiary in the taxation of trust incomes.

Candidates are advised to pay attention to the rules governing the taxation of trust incomes.

MARKING GUIDE

		Marks	Marks
(a)i	Members of the Joint State Revenue Committee (¾ mark each for any point subject to a maximum of 4 points)	3	
Ii	Functions of the Committee ($^2/_3$ mark each for any point subject to a maximum of 3 points)	2	5
(b)	Share of distributable income ($^1/_2$ mark x 3)	1½	
	Fixed Annuity	½	
	Discretionary payments ($^1/_2$ mark x 4)	2	

Amounts due to the beneficiaries (1/2 mark x 4)	Marks	Marks
	2	
Workings:		
Profit for the year	½	
Capital allowance	½	
Rent	½	
Remuneration of Trustees	½	
Trustee's administrative expenses	½	
Annuity	½	
Discretionary payments	½	
30% of distributable income amongst the beneficiaries	½	10
		15

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – NOVEMBER 2017

PERFORMANCE MANAGEMENT

Time Allowed: $3^1/_4$ 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

Top Foods Limited (TFL) manufactures specialty meat pies, which it sells to fast food shops. The only variable costs are raw materials and labour. The raw materials consist of 3 grades of raw meat. The standard cost of the raw materials used in the manufacture of each 100 kilograms of specialty meat pie is as follows:

Raw material	**kg**	**Std. Price/Kg**
		₦
X	25	200
Y	60	300
Z	40	400
	125	900

There is a normal loss of raw materials during production, equivalent to 25% of output.

It takes 5 labour hours to process the input of 125kg. Labour is normally paid ₦180 per hour. Idle time is expected to be 10% of hours paid: this is not reflected in the rate of ₦180 above. Idle time is normally adjusted in the labour rate when computing standard cost and the relevant variances.

In preparing its budget for 2016, the company assumed that there would be a market in the country for 250,000kg of specialty meat pie and that TFL's product would have a 40% share of this market. The budget also assumed a selling price that gives contribution margin ratio of 36%.

However, during 2016 both TFL and its competitors were adversely affected by diminishing consumer confidence in meat products. The actual total market size was only 220,000 kg of specialty meat pie (instead of the anticipated 250,000 kg) and TFL sold only 66,000 kg of its products.

The managing director of TFL recently explained how his company attempted to respond to the difficulties which it faced in 2016: "First, we reduced our selling price from ₦625 to ₦613; this was a modest price reduction in comparison with those of our smaller competitors. Second, we took advantage of falling market prices for some of the types of meat which we use as raw material for our product. With benefit of hindsight, we should perhaps have done more to increase the consumers' confidence in the safety and quality of meat products in general and our own product in particular".

The price of actual raw materials used by TFL in 2016 were as follows:

Raw material	**Qty (Kg)**	**Price per kg**
X	17,600	₦170
Y	38,400	₦280
Z	24,000	₦390

The company had no opening or closing inventory of raw materials or finished product.

3,000 labour hours were paid for, costing ₦576,000; 2,600 labour hours were worked.

You are required to:

a. Prepare a standard cost card per kilogram of the specialty meat pie, showing clearly the contribution and the selling price per kg. (6 Marks)

b. Compute the company's budgeted and actual contribution for 2016. (4 Marks)

c. Compute the following variances for the company:
   i. raw materials price; raw materials mix and raw materials yield; (6 Marks)
   ii. sales price and sales volume. (3 Marks)

<u>Note:</u> Already calculated variances are as follows: labour rate - ₦36,000(A), labour efficiency - ₦140,000(F), idle time variance - ₦20,000(A).

d. Use the above variances to prepare a reconciliation of the budgeted contribution with the actual contribution. (4 Marks)

e. Evaluate critically the performance of the company in 2016, supporting your answer with reference to the variances you have calculated and the ones given in the note (c) above. (7 Marks)

(Total 30 Marks)

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

QUESTION 2

Roda Limited operates two departments to produce its unique products. The 'K' brand is produced in one department and the 'T' label is produced in the other. The two departments are referred to as E and P respectively.

In recent years, demand for the K brand has been falling and the firm has made the decision to shut down department E. However, the timing of the closure is yet to be agreed. A budget for department E for the year ending June 30, 2017 has been prepared as follows:

Budget for Department E for the year ending June 30, 2017

Direct Costs	**Total**	**Per Case of output**
	₦'000	**₦**
Material C	5,000	50
Material V	1,000	10
Packaging material	3,000	30
Labour	10,000	100
Overheads		
Variable	5,000	50
Fixed	4,000	40
Total Cost	28,000	280
Less: Sales Revenue (100,000 cases)	25,000	250
Budgeted Net Profit (Loss) for Year	(3,000)	(30)

The Managing Director (MD) of Roda Limited suggests that as the budget indicates that department E will be in a loss-making position next year, it should be closed down immediately. The firm's Accountant says that he thinks that a flexible budget should be drawn up, showing the contribution of this department to fixed overheads and profit, before a decision is finally made. He arranged for a flexible budget to be prepared based on activities of 80,000, 100,000 and 120,000 cases, the latter quantity being the maximum that the department can produce. The following information is available in addition to that contained in the original budget:

(i) **Direct Materials**

Each case of the final product requires a kilogram of material C and there are 100,000 kilograms of C in stock. This material originally cost ₦5,000,000 but today has no resale value. Unless it is used to manufacture product K next year it will have to be disposed of at a cost of ₦100,000 to the firm for every 10,000 kilograms which have to be dumped. Additional material C can be obtained by importing it from abroad at a cost of ₦100 per kilogram.

- The stock of material V would be sufficient to produce 120,000 cases of the product. However, this could also be used in the production of the standard product, which requires the same amount of material V to produce one case as the K brand does. The original cost of the material V in stock was ₦500,000 and this now has a market cost of ₦2,400,000.
- Sufficient packaging material to pack 100,000 cases of K is in stock. As this has been overprinted with product K information, only half the value of this could be salvaged for use with the standard product. There have been no price changes associated with packaging materials and scrapping costs would be negligible.

(ii) **Variable Overheads and Machinery**

The machinery used in department E is 10 years old. It originally cost ₦10,000,000 and is currently being depreciated using the straight-line method over a 20 year-period. No scrap value is expected at the end of the life of the machinery. Depreciation is recovered by including it in the variable overheads. The market value of the machinery on 1st July, 2016 was ₦6,000,000. This value would fall during the next year through use only, at a rate of ₦100 per 10 cases produced.

Variable overheads for department E vary in proportion to output.

(iii) **Fixed Overheads**

The fixed overhead recovery rate includes occupancy costs and general expenses which cannot be reduced in the year ahead, even if department E is closed. It also includes the salary of the departmental manager at ₦500,000 per annum. He is over the retiring age, although he is prepared to continue if department E remains open.

(iv) **Price Elasticity**

The Marketing Director estimates that the price which could be obtained for the quantities suggested for the flexible budget would be as follows:

Qty (Cases)	Price obtainable per case
80,000	₦300
100,000	₦250
120,000	₦200

Required:

a. Prepare the flexible budgets required by the MD and state clearly any assumptions that you make. Show your workings. (18 Marks)

b. Advise the MD at what level of production the department should operate in the year to 30 June, 2017 and what decision criterion he should use if immediate closure is to be considered. (2 Marks)

(Total 20 Marks)

QUESTION 3

XYZ Nigeria Limited is considering the use of Activity-Based Costing (ABC) approach in its overhead recovery. The Company manufactures 2 products known as Standard and Deluxe.

Details of Production for the two products are given below:

	Standard	Deluxe
Annual production in units	24,000	24,000
Direct labour time per unit in hours	4	5
Number of Special Parts per unit	2	8
Number of set ups per batch	2	6
Number of sales invoices issued per year	100	480
Number of separate materials issued per batch	2	2
Batch size units	2000	100

The analysis of the overhead costs provided the following information:

S/N	Overhead cost analysis	Amount (₦)	Cost driver
1	Set up costs	585,600	Number of set ups
2	Special part handling costs	480,000	Number of special parts
3	Customer invoicing costs	232,000	Number of invoices
4	Material Handling cost	504,000	Number of batches
5	Other overheads	864,000	Labour hours
	Total	2,665,600	

Required:

a. Use the traditional approach to determine the direct labour hourly rate for the company. (3 Marks)

b. Use the direct labour hour rate to compute the overhead rate attributable to a unit of Standard and Deluxe products. (2 Marks)

c. Determine the cost driver rate using the ABC approach. (10 Marks)

d. Compute the overhead rate per unit of each product using the ABC approach. (5 Marks)

(Total 20 Marks)

QUESTION 4

Tees Limited is a small company engaged in the production of plastic tools for the garden. The sub-total on the spreadsheet of budgeted overheads for a year reveals the following.

	Moulding Department	Finishing Department	General Factory Overhead
Variable overhead ₦'000	800	250	525
Fixed overhead ₦'000	1,250	425	875
Budgeted activity			
Machine hours (000)	400	300	
Practical activity			
Machine hours (000)	600	400	

For the purpose of allocation of general factory overhead, it is agreed that the variable overheads accrue in line with the machine hours worked in each department. General factory fixed overhead is to be reallocated on the basis of the practical machine hour capacity of the two departments.

It has been a long standing company practice to establish selling prices by applying a mark-up on full manufacturing cost of between 25% and 35%.

A possible price is sought for one new product which is in a final development stage. The total market for this product is estimated at 100,000 units per annum. Market research indicates that the company could expect to obtain and hold about 10% of the market. It is hoped the product will offer some improvement over competitors' products, which are currently sold at between ₦45 and ₦50 each.

The product development department has ascertained that the direct material content is ₦12.50 per unit. Each unit of the product will take one labour hour (two machine hours) in the moulding department and one and half labour hours (one and half machine hours) in finishing. Hourly labour rates are ₦2.50 and ₦2.75 for moulding department and finishing department respectively.

Management estimate that the annual fixed costs which would be specifically incurred in relation to the product are supervision ₦10,000, depreciation of a recently acquired machine ₦60,000 and advertising ₦13,500. It may be assumed that these costs are included in the budget given above. Given the state of development of this new product, management do not consider it necessary to make revisions to the budgeted activity levels given above for any possible extra machine hours involved in its manufacture.

Required:

a. Prepare full cost and marginal cost information which may help with the pricing decision. (15 Marks)

b. Comment on the cost information and suggest a price range which should be considered (5 Marks)

(Total 20 Marks)

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

QUESTION 5

SKD Holdings Limited makes two products Doughnut and Meat Pie whose contribution margins are ₦100 and ₦115 per unit respectively. The production process passes through three machines M-1, M-2 and M-3 whose maximum available hours are 800 hours, 600 hours and 720 hours respectively. Doughnut requires 8 hours, 10 hours and 4 hours on machines M-1, M-2 and M-3 respectively per unit while Meat Pie requires for every unit 10 hours, 6 hours and 12 hours on machines M-1, M-2 and M-3 respectively.

The period charge is ₦5,000.

Required:

a. Formulate the linear programming model (6 Marks)

b. Discuss briefly the uses of linear programming in Performance Management and indicate whether there are any limitations in using this kind of model. (9 Marks)

(Total 15 Marks)

QUESTION 6

Ntams Communications Limited provides the following related services: Computer upgrading, servicing, and repair facility to a variety of business and personal computer users. The company has four departments, namely; Finance and Accounts department and Services and Administration department are under the General Manager Services, while the Computer Repairs and Maintenance department and Program Maintenance department are under General Manager Operations. The management team of the company has managed the business to date using a standard costing and budgetary control system. However, the team has of recent been discussing the possible use of alternative performance measurement systems such as the “Balanced Scorecard”.

Another issue which concerns the management of Ntams Communications Limited is the quality of the service provided for clients. The company’s General Manager Operations has suggested that the company should introduce Total Quality Management (TQM) but the management team of the company is unsure how to do this and the likely costs and benefits of its introduction.

Required:

a. Explain the concept of the Balanced Scorecard and how it may be used by Ntams Communication Limited to improve performance measurement. (7 Marks)

b. i. Explain briefly the concept of Total Quality Management in the context of Ntams Communications Limited specifying scope of its coverage in the four departments. (4 Marks)

ii. Discuss the likely costs and benefits that would arise if Ntams Communications Limited introduced a TQM policy. (4 Marks)

(15 Marks)

QUESTION 7

Ubachuks Ltd. manufactures and sells a single product. The following data has been extracted from the current year's budget:

Item	Amount
Contribution per unit	₦8
Total weekly fixed costs	₦10,000
Weekly Profit	₦22,000
Contribution to Sales Ratio	40%

The company's production capacity is not fully utilized in the current year and three possible strategies are under consideration. Each strategy involves reducing the unit selling price on all units sold with a consequential effect on the volume of sales.

The detailed effect of each strategy is as follows:

Strategy	Reduction in unit selling Price	Expected increase in weekly sales volume over Budget
	%	%
A	2	10
B	5	18
C	7	25

The company does not hold inventory of finished goods.

Required:

Calculate:

a. The selling price per unit of the product for the current year. (2 Marks)

b. The weekly sales in units and value for the current year. (3 Marks)

c. The current year's break-even point in units and value. (4 Marks)

d. Determine, with a statement, which one of the three strategies should be adopted by the company in order to maximize its weekly profits. (6 Marks)

(Total 15 Marks)

Formulae

Learning curve

$Y = ax^b$

Where Y = cumulative average time per unit to produce x units
a = the time taken for the first unit of output
x = the cumulative number of units produced
b = the index of learning = log LR/log2
LR = the learning rate as a decimal

Demand curve

$P = a - bQ$

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

a = price when Q = 0

$MR = a - 2bQ$

The linear regression equation of Y on X is given by

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

where

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

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

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

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

Annuity Table

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

Where r = discount rate

n = number of periods

Discount rate (r)

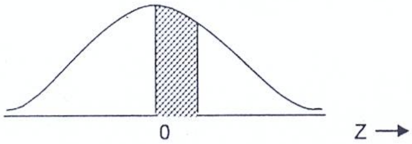
Periods

(n)	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%	
1	0·990	0·980	0·971	0·962	0·952	0·943	0·935	0·926	0·917	0·909	1
2	1·970	1·942	1·913	1·886	1·859	1·833	1·808	1·783	1·759	1·736	2
3	2·941	2·884	2·829	2·775	2·723	2·673	2·624	2·577	2·531	2.487	3
4	3·902	3·808	3.717	3·630	3.546	3.465	3·387	3·312	3·240	3·170	4
5	4·853	4·713	4·580	4·452	4·329	4·212	4·100	3·993	3.890	3·791	5
6	5·795	5·601	5·417	5·242	5·076	4·917	4·767	4·623	4.486	4·355	6
7	6·728	6.472	6·230	6·002	5·786	5·582	5·389	5·206	5·033	4·868	7
8	7·652	7·325	7·020	6·733	6·463	6·210	5·971	5·747	5·535	5·335	8
9	8·566	8·162	7·786	7.435	7·108	6·802	6·515	6·247	5·995	5·759	9
10	9·471	8·983	8·530	8·111	7·722	7·360	7·024	6·710	6.418	6·145	10
11	10·368	9·787	9·253	8·760	8·306	7·887	7.499	7·139	6·805	6.495	11
12	11·255	10·575	9·954	9·385	8·863	8·384	7·943	7·536	7'161	6·814	12
13	12·134	11·348	10·635	9·986	9·394	8·853	8·358	7·904	7·487	7·103	13
14	13·004	12·106	11·296	10·563	9·899	9·295	8·745	8·244	7·786	7·367	14
15	13·865	12·849	11·938	11·118	10·380	9·712	9·108	8·559	8·061	7·606	15

(n)	11%	12%	13%	14%	15%	16%	17%	18%	19%	20%	
1	0·901	0·893	0·885	0·877	0·870	0·862	0·855	0·847	0·840	0·833	1
2	1·713	1·690	1·668	1·647	1·626	1·605	1·585	1·566	1·547	1·528	2
3	2.444	2.402	2·361	2·322	2·283	2·246	2·210	2·174	2·140	2·106	3
4	3·102	3·037	2·974	2·914	2·855	2·798	2·743	2.690	2·639	2.589	4
5	3·696	3·605	3·517	3·433	3·352	3·274	3·199	3·127	3·058	2·991	5
6	4·231	4·111	3·998	3·889	3·784	3·685	3·589	3.498	3.410	3·326	6
7	4·712	4·564	4.423	4·288	4·160	4·039	3·922	3·812	3·706	3·605	7
8	5·146	4·968	4.799	4·639	4.487	4·344	4·207	4·078	3·954	3·837	8
9	5·537	5·328	5·132	4·946	4·772	4·607	4.451	4·303	4·163	4·031	9
10	5·889	5·650	5.426	5·216	5·019	4·833	4·659	4.494	4·339	4·192	10
11	6·207	5·938	5·687	5.453	5·234	5·029	4·836	4·656	4.486	4·327	11
12	6·492	6·194	5·918	5·660	5·421	5·197	4·988	4·793	4·611	4.439	12
13	6·750	6.424	6·122	5·842	5·583	5·342	5·118	4·910	4·715	4·533	13
14	6·982	6·628	6·302	6·002	5·724	5.468	5·229	5·008	4·802	4·611	14
15	7·191	6·811	6.462	6·142	5·847	5·575	5·324	5·092	4·876	4·675	15

NORMAL DISTRIBUTION

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



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

Item	Qty	Price ₦	Cost/Value ₦
Material X	0.25kg	200	50
Material Y	0.60kg	300	180
Material Z	0.40kg	400	160
Total input	1.25kg		
Normal loss (20%)	(0.25kg)	-	-
Output	1.00		390
Labour	0.05hr	200*	10
Total variable costs			400
Contribution			225**
Standard selling price			625

* $= 180 \times {}^{10}/_{9} =$ ₦200
** $= {}^{36}/_{64} \times 400 =$ ₦225

Workings

(i) Contribution = SP - VC

Let SP = x

CMR = 0.36 (given)

$$CMR = \frac{CM}{SP/Unit}$$

$$i.e. \frac{CM}{SP/Unit} = 0.36$$

$$i.e. \frac{CM}{x} = 0..36$$

$$\therefore CM = 0.36x$$

But CM = SP = N400
$\therefore$ 0.36x = x – 400
i.e. x – 0.36x = 400
i.e. 0.64x = 400
i.e. x = $\frac{400}{0.64} =$ ₦625
$\therefore$ SP = ₦625/Unit

(b) Budgeted and Actual contribution for 2016

	Budget	Actual
Selling price (₦)	625.00	613.00

Variable Cost (₦)	(400.00)	(358.79)
Contribution/Kg (a) (₦)	225.00	254.21
Sales volume (b)	100,000kg	66,000kg
Contribution (a x b)	₦22,500.00	₦16,778.00

Workings

	₦
Actual variable cost/unit	
Material X (17,600 x 170)	2,992,000
Material Y (38,400 x 280)	10,752,000
Material Z (24,000 x 390)	9,360,000
Labour	576,000
TVC	23,680,000

VC/unit = $\frac{₦23,680,000}{66,000}$ = ₦ 358.79

(c) (i) Material Price Variance = AQ used (SP – AP)

Material	SP	Ap	Diff	AQ	Variance
	₦	₦	₦	₦	₦
X	200	170	30	17,600	528,000 (F)
Y	300	280	20	38,400	768,000 (F)
Z	400	390	10	24,000	240,000 (F)
					1,536,000 (F)

Material Mix Variance = SSP (RSQ – AQ) where

SSP = Standard Selling Price
RSQ = Required Standard Quantity
AQ = Actual Quantity

Material	Actual Mix	Standard Mix	Diff	SP	Variance
				₦	₦
X	17,600	$^{25}/_{125}$ x 80,000 = 16,000	1600	200	320,000 (A)
Y	38,400	$^{60}/_{125}$ x 80,000 = 38,400	-	300	-
Z	24,000	$^{40}/_{125}$ x 80,000 =25,600	1600	400	640,000 (F)
					320,000 (F)

Material Yield Variance = AY – SY

Actual yield	66,000
Standard yield (100/125 x 80,000)	(64,000)
Difference (a)	2,000

Standard yield price (50 + 180 + 160) (b)	₦390/kg
Material yield variance (a x b)	₦780,000 (F)

Alternative Method

Note: The yield variance can also be calculated as follows:

Material	Std qty in std mix (a)	Act. Qty in std mix (b)	Variance (a – b)	Total variance (a – b) x SP
	Kg	Kg	Kg	₦00
X	16,500	16,000	500 (F)	100 (F)
Y	39,600	38,400	1,200 (F)	360 (F)
Z	26,400	25,600	800 (F)	320 (F)
	82,500	80,000		780 (F)

(ii) Sales Price Variance = Actual sales (Standard Price – Actual Price)
= 66,000kg (₦625 – ₦613)
= 792,000 (A)

Sales Volume Variance = Standard Contribution/unit (BSV – ASV)
= ₦225 (100,000 – 66,000)
= ₦7,650,000 (A)

Where
BSV = Budgeted Sales Volume
ASV = Actual Sales Volume

(d) Reconciliation of Budgeted and Actual Contribution

			₦'000
Budgeted contribution			22,500
Sales price variance			(792)
Sales volume variance			(7,650)
			14,058
Cost variances	Favourable	Adverse	
	₦'000	₦'000	
Material price variance	1,536		
Material mix variance	320		
Material yield variance	780		
Labour rate variance		36	
Labour efficiency variance	140		
Idle time variance		20	
	2,776	56	2,720
Actual contribution			16,778

(e) - There is no doubt that the performance of the company was adversely affected by the diminishing consumer confidence in meat products, which caused the company to reduce price from ₦625 to ₦613 per kg.

However, the variance calculated showed that only about 10% of the unfavourable sales volume variance can be blamed on the reduction in price i.e. sales price variance of ₦792,000 (A) out of total sales volume variance of ₦7,650,000 (A).

- The unfavourable sales volume variance was caused by the company's loss of market share to other meat pie producers.
- The other variances computed suggests that the loss of market share was caused by wrong strategies used to address the situation i.e. taking advantage of falling prices of the types of meat used as raw materials by using more of the cheaper ones and less of the costlier ones (Y & Z).
- Though, the falling market prices for the materials represent a cost saving with a favourable material price variance of ₦1.536million, this might have led to poorer product quality.
- It would have been more appropriate for the company to focus on reassuring customers about product quality rather than cost savings, to increase market size.
- The favourable materials yield variance also represents a cost saving having the same effect on product quality as the use of more of cheaper materials.
- From the Managing Director's comments, it appears that an unfavourable selling price variance was probably smaller than that of the competitors, which made the competitors to gain more market share.
- The reduction in selling price and market share caused a total favourable costs variance of ₦2.72million, but an adverse total sales variance (sales price and sales volume) of ₦8.442million and consequently a drastic reduction from the budgeted contribution of ₦22.5million to an actual contribution of ₦16.778million i.e. a reduction of ₦5.722million.

EXAMINER'S REPORT

This is a compulsory question that tests candidates understanding of standard costing, variance analysis and reconciliation of budgeted profit with actual profit.

Between 80% and 100% of the candidates attempted the question.

Candidates had very poor understanding of the requirements of the question. Candidates' commonest pitfall was their inability to pick the correct figures in

arriving at the standards to compare with actual in order to arrive at the correct variance. Also, more than 80% of the candidates could not correctly evaluate the performance of the company.

Candidates are advised to always prepare adequately and familiarise themselves with the ICAN Study Text and other relevant text.

Marking Guide

		Mark	Total Marks
a.	Standard cost card/unit		
	Contribution	2½	
	Variable costs	2½	
	Selling price	1	6
b.	Budgeted & Actual contribution		
	Budgeted	1½	
	Actual	1½	
	Workings	1	4
ci.	Material Price Variance	2	
	Material Mix variance	2	
	Material yield variance	2	6
ii.	Sales price variance	1½	
	Sales volume variance	1½	3
d.	Reconciliation		4
e.	Performance evaluation		7
			30

SOLUTION 2

a) Flexible Budget For Department E for the Year ended 30, 2017

Cases	Notes	80,000 ₦'000	100,000 ₦'000	120,000 ₦'000
Material C	1	(800)	(1,000)	1,000
V	2	1,600	2,000	2,400
Packing material	3	1,200	1,500	2,100
	4	8,000	10,000	12,000
Labour	5	500	500	500
Manager Machinery = ₦10	6	800	1,000	1,200
per case Variable cost at ₦45	7	3,600	4,500	5,400
per unit		14,900	18,500	24,600
Total relevant cost	8	24,000	25,000	24,000
Sales revenue		9,100	6,500	
Total contribution				(600)

b) On the basis of opportunity costs, the department makes a positive contribution at all levels of output except at 120,000 cases. The budget indicates that production should continue next year at the volume of 80,000 cases. However, other factors should be taken into consideration, such as whether the facilities in the department could be used in some other way which would be more profitable. It may be better to plan alternative uses for department E's resources immediately.

Workings

1. **Material C**: If the firm disposes of all the material, it will cost the firm ₦1,000,000. However, if it uses Material C, it will save ₦800,000 on disposal costs as far as the production of 80,000 cases is concerned, and all the disposal costs if either of the other levels is produced. Thus, if 120,000 cases are produced, an additional amount of material C for 20,000 cases at ₦100 per case will have to be purchased at a cost of ₦2,000,000.

   Thus for the output level of 120,000 cases, the total relevant cost will be

	₦'000
Disposal cost avoided	(1,000)
Additional material bought	2,000
Net relevant cost	1,000

2. **Material V:** The relevant cost of material V is the replacement cost and for the various output levels, the total cost will be

			₦
i) 80,000:	$\frac{80,000}{120,000} \times ₦2,400,000$	=	1,600,000
ii) 100,000:	$\frac{100,000}{120,000} \times ₦2,400,000$	=	2,000,000
iii) 120,000:	$\frac{120,000}{120,000} \times ₦2,400,000$	=	2,400,000

3. **Packing Material**: For the quantity in inventories, the relevant cost is half of the book value, that is ₦15 (₦30 ÷ 2). Thus for 80,000 cases this is:

80,000 × ₦15	=	₦1,200,000
and for 100,000 cases: 100,000 × ₦15	=	₦1,500,000

But for the 120,000 cases, an additional amount of packaging material to produce 20,000 cases at full cost of ₦30 would be required, that is

20,000 × ₦30	=	₦600,000.

Thus:

		₦
80,000 cases		1,200,000
100,000 cases		1,500,000
120,000 cases ... ₦1,500,000 + 600,000	=	2,100,000

4. **Labour**: As no information has been given about labour availability, the necessity to work overtime, etc, it has been assumed that labour costs vary in proportion to output.

5. **Manager and other fixed overheads**: At any of the three levels of output, ₦500,000 would have to be spent on the manager's salary. If the department was closed, this expenditure would still be incurred.

6. **Machinery:** Loss in value is ₦100 per 10 cases or ₦10 per case produced.

7. **Variable cost** – Depreciation is already included in the given variable cost. As depreciation does not involve any movement of cash, it must be identified and removed from the variable cost.

   Annual depreciation is ₦10m ÷ 20 years = ₦500,000

   Per unit = ₦500,000 ÷ 100,000 = ₦5 (Note that the budget given in the question is for 100,000 cases).

   Therefore, cash unit variable cost = ₦50 – ₦5 = ₦45

8. **Sales revenue**

No of cases	80,000	100,000	120,000
Selling price (₦)	300	250	200
Total revenue (₦'000)	24,000	25,000	24,000

EXAMINER'S REPORT

This question tests candidates' understanding of flexible budgeting and relevant costing.

Between 41% and 60% of the candidates attempted the question.

Majority of the candidates did not understand the salient concepts of the question.

Candidates' commonest pitfall is their inability to understand the necessary adjustments of the relevant costs allocated to the various levels of activity.

Candidates are advised to study every aspect of the syllabus.

Marking Guide

		Marks	Total Marks
(a)	Preparation of flexible budget:		
	Calculation of Material C	1½	
	Calculation of Material V	1½	
	Packaging material	1½	
	Labour	1½	
	Manager's salary	1½	
	Machinery depreciation	1½	
	Variable cost	1½	
	Total relevant cost	1½	
	Sales revenue	1½	
	Total contribution	1½	
	Workings – Any 12 of 18 ticks at ¼ mark per tick	3	18
(b)	Point of choosing of 80,000 cases	1	
	Point on alternative use of facilities e.g. stocks or machinery	1	
			2
			20

SOLUTION 3

XYZ NIGERIA LTD. – ABC APPROACH TO COSTING/PROFITABILITY
WORKINGS

a) Overhead absorption rate using direct labour hours (using the traditional method)

$$= \frac{\text{Total overhead}}{\text{Total labour hours for the two products}}$$

$$= \frac{₦2,665,600}{(24,000 \times 4) + (24,000 \times 5)}$$

$= \frac{₦2,665,600}{216,000} = ₦12.34$

b) Direct labour hourly overhead rate of each unit of product

	Standard	Deluxe
Direct labour hours per unit	4	5
Direct labour rate per hour	₦12.34	₦12.34
Overhead per unit	₦49.36	₦61.70

c) Computation of cost driver rate using the ABC approach.

S/N	Cost pool	Cost driver	Standard driver volume	Deluxe driver volume	Total driver volume	Overhead Costs ₦	Cost Driver rate ₦
1	Set up	Set up per batch	24	1,440	1,464	585,600	400.00
2	Special part handling	No of special Parts	48,000	192,000	240,000	480,000	2.00
3	Customer invoices	Number of invoices	100	480	580	232,000	400.00
4	Material handling	Number of batches	12	240	252	504,000	2,000.00
5	Other overheads	Labour hours	96,000	120,000	216,000	864,000	₦4.00
Total						2,665,600	

d. Overhead cost per unit using the ABC approach.

S/N	Cost pool	Cost driver rate	Driver value for standard	Driver value for Deluxe	Total cost for standard	Total cost for Deluxe	Unit cost for standard	Unit cost for deluxe
		₦			₦	₦	₦	₦
1	Set up	400.00	24	1,440	9,600	576,000	0.40	24.00
2	Special part handling	2.00	48,000	192,000	96,000	384,000	4.00	16.00
3	Customer invoices	400.00	100	480	40,000	192,000	1.67	8.00
4	Material handling	2,000.00	12	240	24,000	480,000	1.00	20.00
5	Other overheads	₦4.00	96,000	120,000	384,000	480,000	16.00	20.00
Total					553,600	2,112,000	23.07	88.00

EXAMINER'S REPORT

This question tests candidates' understanding of traditional and ABC approach to overhead absorption.

Between 80% and 100% of the candidates attempted the question.

Majority of the candidates did not understand the salient concepts of the question, hence the very poor performance.

Candidates' commonest pitfall was their inability to identify the relevant cost drivers using the ABC approach.

Candidates are advised to learn and understand basic rudiments and principles of the topic being tested.

Marking Guide

			Marks	Total Marks
(a)	Direct labour hourly rate for the company			
	Traditional Approach			
	DLHR for standard		1	
	DLHR for Deluxe		1	
	Total O/H ÷Total labour hrs for the 2 products		1	3
(b)	D LH per unit standard		¼	
	D LH per unit deluxe		¼	
	D LR per hour standard		¼	
	D LR per hour deluxe		¼	
	Overhead per unit standard		½	
	Overhead per unit deluxe		½	2
(c)	Cost pool			
		Standard drive volume	$^1/_3$	
		Deluxe drive volume	$^1/_3$	
	Set up	Total drive volume	$^1/_3$	
		Cost drive rate	1	
		Standard drive	$^1/_3$	
	Special part	Deluxe drive	$^1/_3$	
		Total drive	$^1/_3$	
		Cost drive	1	
			$^1/_3$	
	Customer	Standard drive		
	Invoices	Deluxe drive	$^1/_3$	
		Total drive	$^1/_3$	

	Cost drive	1	
	Standard drive	$^{1}/_{3}$	
Material handling	Deluxe drive	$^{1}/_{3}$	
	Total drive	$^{1}/_{3}$	
	Cost drive	1	
Other overhead	Standard drive	$^{1}/_{3}$	
	Deluxe drive	$^{1}/_{3}$	
	Total drive	$^{1}/_{3}$	
	Cost drive	1	10

(d)		Total cost Standard	1/5	
	Set up	Total cost Deluxe	1/5	
		Unit cost standard	¼	
		Unit cost deluxe	¼	
		Total cost Standard	1/5	
	Special Part	Total cost Deluxe	1/5	
		Unit cost standard	¼	
		Unit cost deluxe	¼	
	Customer invoices	Total cost Standard	1/5	
		Total cost Deluxe	1/5	
		Unit cost standard	¼	
		Unit cost deluxe	¼	
		Total cost Standard	1/5	
	Material handling	Total cost Deluxe	1/5	
		Unit cost standard	¼	
		Unit cost deluxe	¼	
		Total cost Standard	1/5	
	Other overhead	Total cost Deluxe	1/5	
		Unit cost standard	¼	
		Unit cost deluxe	¼	
	Total column Material handling	Unit cost Standard		
		Unit cost Deluxe	¼	
			¼	5
				20

SOLUTION 4

(a) **TEES LIMITED**
FULL COSTING APPROACH

	₦
Direct Material	12.50
Direct labour	
M = 1 x ₦2.50	2.50
F = 1.5 x ₦2.75	4.13
Variable overheads:	
M = 2 x ₦2.75	5.50
F = 1.5 x ₦1.58	2.37
Total variable cost	27.00
Add fixed overhead	
M = 2 x ₦4.44	8.88

F = 1.5 x ₦2.58	3.87
Full manufacturing cost	39.75

MARGINAL COSTING APPROACH

	₦	₦
Variable manufacturing cost		27.00
Add: Incremental fixed costs		
Supervision (₦10,000/10,000)	1.00	
Depreciation (₦60,000/10,000)	6.00	
Advertising (₦13,500/10,000)	1.35	8.35
Total Incremental Cost		35.35

Workings

(i) Computation of Variable Overhead Absorption Rate

	Moulding ₦'000	Finishing ₦'000
Allocated	800	250
Re-allocated $\left(\frac{400}{700}:\frac{300}{700}\right)$	300	225
	1,100	475
Budget	400	300
VOAR	₦2.75	₦1.58

(ii) Computation of Fixed Overhead Absorption Rate

	Moulding ₦'000	Finishing ₦'000
Allocated	1,250	425
Re-allocated $\left(\frac{600}{1000}:\frac{400}{1000}\right)$	525	350
	1775	775
Budget	400	300
FOAR	₦4.44	₦2.58

(a) Determination of selling price using Full Costing Approach

	Mark-up Range		
	Low	Middle	Upper
	25%	30%	35%
	₦	₦	₦
Full cost/unit	39.75	39.75	39.75
Add Mark-up	9.94	11.93	13.19
Selling price	49.69	51.68	53.66

Marginal Cost Approach

	Mark-up Range		
	Low	Middle	Upper

	25%	30%	35%
	₦	₦	₦
Total incremental cost	35.35	35.35	35.35
Add Mark-up	8.84	10.61	12.37
Selling price	44.19	45.96	47.72

Comments:

The cost information above provides a range of bases for a pricing decision.

Variable manufacturing cost:

The variable manufacturing cost is ₦27 per unit. At a price below this level, there would be no contribution to fixed overheads. Since the prevailing market price is between ₦45 and ₦50, such a low price might suggest to customers that the product is of inferior quality.

Incremental total cost:

The incremental total cost per unit is ₦35.35. Management must select a price above this level to be sure of covering all costs associated with this product. This unit rate depends on achieving an annual sales volume of 10,000 units.

Full manufacturing cost:

The full manufacturing cost per unit is ₦39.75. A price based on this cost will ensure that all costs are covered on the long run, if the annual sales volume of 10,000 units is achieved. Since competitors' prices range between ₦45 and ₦50, it seems possible that the company can compete with a price calculated on a full cost – plus basis.

The range of prices suggested, using company's usual mark-up of between 25% and 35%, is between ₦49.69 and ₦53.66. Given the current price range of the competitors' products and the fact that the product is expected to offer some improvement over competitors' products, a price towards the upper end of the suggested range would be appropriate.

In general, the price charged for a product should exceed its cost. There are a number of different cost – based approaches to pricing and each is appropriate in different circumstances.

Full – cost plus pricing involves adding a profit margin to fully absorbed total cost of a product. In certain situations, for example if a company has spare capacity, it may be appropriate to use marginal cost as the basis for pricing. Alternatively if the lowest possible price is sought, perhaps for strategic reasons, a minimum price based on relevant costs may be used as the basis for a pricing decision. However, management must not lose sight of the need to cover fixed costs on the long run.

Whichever cost basis is used, it is important to appreciate that a cost-based price merely provides a starting point for informed management decisions and pricing negotiations.

Cost is only one of the factors to bear in mind when making a price-setting decision. Other factors to consider will include the following:

- The organization's objectives;
- The market in which the organization operates; and
- The effect which price has on the volume of demand for its goods.

EXAMINER'S REPORT

The question tests candidates' understanding of overhead absorption, treatment of fixed and variable costs under full cost and marginal costing approaches and price determination.

Between 41% and 60% of the candidates attempted the question and performance was very poor.

Their commonest pitfall was inability to show understanding of the concept being tested.

Candidates are advised to study hard and familiarise themselves with the ICAN Study Text and Pathfinder.

Marking Guide		Marks	Marks
a.	Calculation of variable overhead absorption rates	3	
	Calculation of fixed overhead absorption rates	3	
	Information for pricing decision	3	
	Recommended price range	2	
	Marginal cost information for pricing decision	4	15
b.	Comments on the cost information and price recommendation		5
			20

SOLUTION 5

SKD HOLDINGS LIMITED

a. Formulation of the Linear Programming Model

Let the number of unit(s) of Doughnut be represented by x

Let the number of unit(s) of Meat-Pie be represented by y

The Objective Function is to Maximise Total Contribution: $100x + 115y$

Subject to the following Constraints:

M – 1	$8x + 10y$	$\leq$	800
M – 2	$10x + 6y$	$\leq$	600
M – 3	$4x + 12y$	$\leq$	720
Non-negativity constraints	x, y	$\geq$	0

b. Usefulness and Limitation(s) of Linear Programming in Performance Management

Usefulness of Linear Programming Model

i. It is used to solve limiting factor decision when there are at least two limiting factors;
ii. It can be used to calculate "shadow price" of a limiting factor;
iii. It can be used to determine additional unit of the limiting factor which can give extra contribution;
iv. It helps management to identify slack that might be used by management to identity the amount of constraint that is not used in the optimal solution; and
v. It is used in solving operational problems.

Limitations of Linear Programming Model

i. It cannot be used to solve limiting factor situation when there is a single limiting factor;
ii. Uncertainty is not taken care of;
iii. Parameters are assumed to be consistent;
iv. It is only useful when solving allocation problems involving more than one limiting factor;
v. For non-financial Managers, it could be complex;
vi. It assumes complete linearity.
In practice however, the liner relationship may not hold because of quantity discount of raw material, the presence of learning curve, etc.
vii. It assumes divisibility of products. In practice, fractions of products cannot be produced and sold.
viii. It assumes profit maximization. In practice, organizations may have other objectives

EXAMINER'S REPORT

The question tests candidates' knowledge of the construction of Linear Programming Model, its uses and limitations.

Between 81% and 100% of the candidates attempted the question.

Candidates showed lack of in-depth knowledge of the principles involved in model formulation as most of them attempted solving the linear programming problem against the requirement of the examiner.

Candidates commonest pitfall was their wrong application of the mathematical signs (≤,≥) and wrongful plotting of graphs.

Candidates are advised to pay attention to minute details and technicalities in the entire syllabus.

MARKING GUIDE		**MARKS**	**MARKS**
a.	Formulation of Linear Programming Model		
	Formulation of L/P table	1	
		1	
	Objective Function	1	
		3	
	The L/P Model	3	
		1	
	Non-Negativity Constrain		6
		1	
	Total		
b.	Uses of L/P		
	Any five points at 1 mark each	5	
	Limitation of L/P		
	Any four points at 1 mark each	4	9
	Total		15

SOLUTION 6

NTAMS COMMUNICATION LTD. – BALANCE SCORE CARD AND TOTAL QUALITY MANAGEMENT (TQM)

a. The Balanced Scorecard is a strategic planning and management system that is used extensively in business and industry, government, and non-profit organizations worldwide to align business activities to the vision and strategy of the organization, improve internal and external communications, and monitor organization performance against strategic goals. It was originated by Drs. Robert Kaplan (Harvard Business School) and David Norton as a performance measurement referred to as Key Performance Indicators (KPI). It is a framework that added strategic non-financial performance measures to traditional financial metrics to give managers and executives a more 'balanced' view of organizational performance. It is classified into 4 Perspectives.

The Balanced Scorecard suggests that we view the organization from four perspectives, and to develop metrics, collect data and analyze it relative to each of these perspectives. The four perspectives are:

i. **The Learning & Growth Perspective**
This perspective includes employee training and corporate cultural attitudes related to both individual and corporate self-improvement.

ii. **The Business Process Perspective**
This perspective refers to internal business processes. Metrics based on this perspective allows the managers to know how well their business is running, and whether its products and services conform to customer requirements (the mission).

iii. **The Customer Perspective**
Recent management philosophy has shown an increasing realization of the importance of customer focus and customer satisfaction in any business. These are leading indicators: if customers are not satisfied, they will eventually find other suppliers that will meet their needs. Poor performance from this perspective is thus a leading indicator of future decline, even though the current financial picture may look good.

iv. **The Financial Perspective**
Kaplan and Norton do not disregard the traditional need for financial data. Timely and accurate funding data will always be a priority, and managers will do whatever necessary to provide it. In fact, often there is more than enough handling and processing of financial data. Financial profits, Ratio analysis and information show if a company is doing well.

LEARNING AND GROWTH PERSPECTIVE	BUSINESS PROCESS PERSPECTIVE	CUSTOMER PERSPECTIVES	FINANCIAL PERSPECTIVES

The advantages of Balanced Scorecard

The Balanced Scorecard is a set of financial and non-financial measures regarding a company's success factors. It reflects the essence of the organisation's value-creating activities and helps in overcoming challenges, brings the interrelationship in measuring the scorecard of the firm and the persons in an organization and finally helps in strategic management.

b.i. **Total Quality Management (TQM)**

Total Quality management is defined as a continuous effort by the management as well as employees of a particular organization to ensure long-term customer loyalty and customer satisfaction.

Remember, one happy and satisfied customer brings ten new customers along with him whereas one disappointed individual will spread bad word of mouth and spoil several of your existing as well as potential customers.

Total quality management ensures that every single employee is working towards the improvement of work culture, processes, services, systems and so on to ensure long-term success.

Seven basic elements capture the essence of the TQM philosophy: customer focus, continuous improvement, employee empowerment, quality tools, product design, process management, and supplier quality.

ii. **Cost and Benefits of TQM**

1. **Costs** - Product disruption – implementing a Total Quality Management System requires extensive training of employees which tend to disrupt production processes during training periods.

2. **Employee Resistance** - TQM requires change in mindset, attitudes and methods of performing jobs. If management does not effectively communicate with team, workers tend to become agitated for fear of job insecurity which many lend to resistance.
3. TQM requires research and development which may require huge in resistant.

BENEFITS

- TQM offers opportunity for an organisation is benchmark with competitors with a view to quality improvement.
- Cost reduction is enhanced when QTM is consistently applied
- Consumer's satisfaction is achieved
- Staff morale is achieved

EXAMINER'S REPORT

This is a theory based question that tests the candidates understanding of the concept of Balanced Scorecard (BSC) and its uses and Total Quality Management (TQM).

Between 81% and 100% of the candidates attempted the question. Candidates exhibited a clear understanding of the Part (a) of the question, but are bereft of ideas in Part (b).

Candidates' commonest pitfall was their inability to explain in-depth, the coverage of TQM in all the four departments.

Candidates are advised to familiarise themselves with the ICAN Study Text and Pathfinder.

MARKING GUIDE		**MARKS**	**MARKS**
a.	Introduction	1	
	Perspectives:		
	Heading ½ x 4	2	
	Explanation 1 x 4	4	
			7
b.i	Introduction	1	
	Scope 3 marks each	3	
			4
ii	Costs – (Disadvantages) any points at 1 mark each	2	
	Benefits – any 2 points at 1 mark each	2	
			4
	Total		15

SOLUTION 7

DECISION MAKING AND SYSTEM IMPLEMENTATION

a.i Selling Price per unit = Contribution divided by C/S ratio = ₦8/0.4 = ₦20

ii. Weekly sales in Value and units = weekly contribution divided by C/S ratio
Weekly contribution = Weekly profit + weekly Fixed costs.

= ₦22,000 + ₦10,000 = ₦32,000

Weekly sales In value = ₦32,000/0.4 = ₦80,000

Weekly sales in units = ₦80,000 /₦20 = 4,000 units.

iii. Current year's BEP in value = Fixed cost divided by C/S ratio x 52 weeks

= ₦10,000 /0.4 = ₦25,000 x 52

= (₦25,000 x 52wks = ₦1,300,000)

BEP in units = ₦25,000/unit selling price = ₦25,000 / ₦20 = 1,250 units

= (1,250 units x 52 wks = 65,000)

iv. Statement showing the contribution under the three options

S/N	Particulars	Strategy A	Strategy B	Strategy C
1.	Budgeted selling price	₦20	₦20	₦20
2.	Budgeted Volume of sales	4,000	4,000	4,000
		₦	₦	₦
1.	New selling Price	₦20 x .98= ₦19.6	₦20 x .95= =₦ 19	₦20 x .93= ₦ 18.6
2.	New Sales Volume	4,000 x 1.1=4400	4,000 x 1.18 =4,720	4,000 x 1.25 = 5,000
		₦	₦	₦
	Sales	86,240	89,680	93,000
	Less variable costs	52,800	56,640	60,000
	Contribution	33,440	33,040	33,000
	Fixed costs	10,000	10,000	10,000
	Net Profit	23,440	23,040	23,000

Strategy A gives the highest contribution of ₦33,440 and net profit of ₦23,440 and should be adopted.

<u>Workings</u>

Selling price under current situation = ₦20

Less Unit contribution = ₦8

Unit Variable costs = ₦12

EXAMINER'S REPORT

This question tests candidates' knowledge in marginal costing and sensitivity analysis.

Between 61% and 100% of the candidates attempted the question.

Candidates displayed a good grasps of the principles involved in the question.

Their commonest pitfall was their inability to properly apply the BEP formular and compute accurately weekly sales in units and value.

Candidates are advised to make better use of the ICAN Study Texts and Pathfinder in order to improve performance in future examinations.

MARKING GUIDE		MARKS	MARKS
a.	Selling Price Per Unit		
	- Formula ($\frac{c}{c/s}$ ratio)	½	
	- Contribution Per Unit	½	
	- c/s Ratio	½	
	- Solution	½	2
b.	Working Sales in Value and Units		
	- Weekly Profit	$^1/_3$	
	- Fixed Cost	$^1/_3$	
	- Total Contribution	$^1/_3$	
	- Summation of weekly units	1	
	- Summation of weekly sales (value)	1	3
c.	Current year's BEP (Units and Value)		
	- BEP formula (Value)	½	
	- Calculation of C/S ratio	½	
	- Determination of weeks in the year	½	
	- BEP in value	½	
	- BEP formula (Units)	½	
	- Calculation of C/S ratio	½	
	- Determination of Weeks	½	
	- BEP in Units	½	4
d.	Statement showing contribution Under Three (3) strategies. Any 18 ticks Out of possible, 28 ticks at $^1/_3$		6
	Total		15

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – NOVEMBER 2017

PUBLIC SECTOR ACCOUNTING & FINANCE

Time Allowed: $3^1/_4$ 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

The Federal Government of Nigeria (FGN) had twenty-seven Ministries, Departments and Agencies (MDAs). Audit carried out by the Auditor-General for the Federation revealed some financial sharp practices in the rank and file of some of these MDAs.

It was discovered that most of the Heads of these agencies, including some Permanent Secretaries were involved in the collection of salaries and wages of workers who were deceased or absconded from service by retaining their names on the government payroll. The audit further revealed that the pension entitlements of some retired workers were equally misappropriated.

Another set of top-level civil servants converted some of the funds budgeted for expenditures in their MDAs to undertake private foreign trips without recourse to the Civil Service Rules. The audit further revealed the annual haste to expend the funds allocated to the various agencies for attending workshops and seminars. These trainings sometimes served as avenues to divert public funds to private bank accounts, as most of the training might not be relevant to the human resources needs of these agencies.

The Permanent Secretary of an agency in one of the ministries was in the practice of placing government funds in fixed deposits with banks while negotiating lower interest rate for the government. The difference in the prevailing interest rate was shared among the bank officials and the top officials in the agency.

There was yet another agency of government that engaged in ignoring procurement procedures by colluding with contractors to deliver substandard goods and services to the agency, taking gratification from such contractors. Such acts gave rise to contract abandonment.

In order to reduce the various unethical activities among government officials, the government established some financial management reforms with the aim of further preventing financial leakages in the MDAs in future.

Required:

a. Discuss the role of Government Integrated Financial Information Management System (GIFMIS) as a means of reducing financial corruption in MDAs in Nigeria. (10 Marks)

b. Explain how Integrated Payroll and Personnel Information System (IPPIS) could help to curtail the fraud on personnel payroll reported in this case. (5 Marks)

c. Discuss how the Treasury Single Account (TSA) could assist to nip in the bud the frivolous use of government funds. (5 Marks)

d. Describe **FIVE** competitive tender procedures and practices in the Public Procurement Act that will prevent the procurement of shoddy contracts on goods and services for government. (10 Marks)

(Total 30 Marks)

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

QUESTION2

a. Auditing is an independent appraisal process often governed by statute, for examining, investigating and verifying the financial statements of an organisation by the person competently appointed. Auditor also makes a report to the users of financial statements and gives his opinion concerning the accuracy and integrity of the accounting records and information.

You are required to:

i. List and explain **FIVE** assessments that an external auditor should carry out before relying on the work of the Internal Auditor. (5 Marks)

ii. Explain briefly **FIVE** factors that contribute to an effective audit in the public sector. (5 Marks)

iii. Explain **THREE** features of internal control. (6 Marks)

b. Assurance engagements in public sector are enquiries commissioned by government to find out the cause or causes of an event, so that remedial actions may be taken.

Required:

Describe **FOUR** contents of an Assurance Report as it relates to the public sector. (4 Marks)

(Total 20 Marks)

QUESTION 3

The Permanent Secretary of the Federal Ministry of Women Affairs is concerned about the liquidity problem of the Family Advancement Unit of the Ministry, which deals in the sale of trinkets. The unit sells on both cash and credit terms. Customers who pay their accounts within 15 days are given a credit discount of 5% and likewise, the unit always pays cash for purchases made in order to obtain 4% discount.

The balances at the end of June 2010 are as follows:

	June	July	August
	₦'000	**₦'000**	**₦'000**
Credit Sales	80	80	90
Cash Sales	20	25	27
	100	105	117

The mark-up on sales gives a gross profit margin of 50% on cost. It is estimated that the above sales will require inventory of trinkets of ₦90,000 in sales value to be maintained. An analysis of the customers' accounts disclosed that 80% of credit customers pay on time to take advantage of cash discount: 10% pay at the end of 30 days and the remainder at the end of 60 days. There were virtually no bad debts. On average, 25% of the credit sales in any one month to customers who take the benefit of cash discount will be in debtors at the end of the month.

The estimated other expenses payable monthly are as follows:

(i)	Fixed	₦14,000 per month
(ii)	Variable	10% of gross sales

Included in the fixed expenses is a depreciation charge of ₦3,000. A capital payment of ₦20,000 is required to be made in July.

The balances at the beginning of June are as follows:

		₦
(i)	Cash	16,000
(ii)	Inventory	50,000
(iii)	Receivables	18,000

Credit sales for May, a low sales month, were ₦35,000 of which ₦14,000 was still outstanding at the end of the month. The balance of the receivables represents April sales.

Required:

Prepare a monthly cash budget for June to August 2010.
(All workings should be shown). **(Total 20 Marks)**

QUESTION 4

The following were extracted from the Statement of Financial Performance of Konko Republic for the years ended December 31, 2015 and 2016:

Statement of Financial performance (Extracts)

	2016	2015
	₦'000	**₦'000**
Revenue from Non-exchange transactions:		
Taxation Revenue:		
Income tax revenue	980,790	715,580
Taxes from goods and services	150,758	120,740
Estate taxes	250,390	212,650
Transfer Revenue:		
Transfer from other governments	75,679	80,120
Gifts, donations, Goods-in-kind	46,920	40,125
Services–in-kind	39,790	41,120

Required:

a. Calculate:

i. The revenue from Non-exchange transactions in 2016 as compared with that of 2015. (4 Marks)

ii. The ratio of transfer revenue to taxation revenue in 2016 and 2015. (4 Marks)

b. State the period in which revenue from Non-exchange transactions is recognised as contained in IPSAS 23. (6 Marks)

c. Explain **TWO** bases for measuring taxes of Non-exchange transactions and **TWO** conditions for transfer of assets in line with IPSAS 23. (6 Marks)

(Total 20 Marks)

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

QUESTION5

The table below shows the profits after tax and the book value of investment for three projects A, B, and C.

	Profits after tax (₦)			Book value of investment (₦)		
	Project A	Project B	Project C	Project A	Project B	Project C
Year 1	400,000	300,000	250,000	1,500,000	1,200,000	1,000,000
Year 2	450,000	450,000	300,000	1,350,000	1,080,000	900,000
Year 3	500,000	500,000	400,000	1,215,000	972,000	810,000
Year 4	450,000	550,000	500,000	1,093,500	874,800	729,000
Year 5		500,000	300,000		787,320	656,100
Year 6			250,000			590,490

Required:
Calculate the Accounting Rate of Return (ARR) of the three projects and recommend the best option based on your calculation. **(Total 15 Marks)**

QUESTION 6

Explain each of the following in the context of revenue generation and utilisation in Nigeria:

a. Federation Account (5 Marks)

b. Consolidated Revenue Fund (5 Marks)

c. Development Fund (5 Marks)

(Total 15 Marks)

QUESTION 7

The issue of revenue allocation is usually informed by several and diverse principles which often make the whole exercise rather contentious in a developing nation like Nigeria.

Required:
Explain the following:

a. Vertical and Horizontal Revenue Allocation. (3 Marks)

b. **THREE** principles of revenue allocation. (6 Marks)

c. **THREE** criticisms of revenue allocation in Nigeria. (6 Marks)

(Total 15 Marks)

SOLUTION 1

PUBLIC FINANCIAL MANAGEMENT REFORMS

(a) Government Integrated Financial Management System (GIFMIS) is a sub component of the Economic Reforms and Governance Projects (ERGP), which will support the public resource management and targeted anti-corruption initiatives area through modernising fiscal processes using better methods, techniques and information technology.

The financial corruption in MDAs in Nigeria has been reduced by roles of GIFMIS as it:

i. Increases the ability of Federal Government of Nigeria (FGN) to undertake central control and monitoring of expenditure and receipts in the MDAs;

ii. Enhances the ability to access information on financial and operational performance;

iii. Improves internal controls to prevent and detect potential and actual fraud;

iv. Increases the ability to access information on Government's cash position and economic performance;

v. Improves medium-term planning through a Medium Term Expenditure Framework (MTEF);

vi. Provides the ability to understand the costs of groups of activities and tasks;

vii. Increases the ability to demonstrate accountability and transparency in the public sector;

viii. Minimises interaction with government officials and contractors;

ix. Reduces incidence of money laundering;

x. Reduces incidence of theft, fraud and robbery; and

xi. Abolishes the use of cheques and cash transactions.

(b) Integrated Personnel & Payroll Information System (IPPIS) was conceived by the Federal Government of Nigeria (FGN) to improve the effectiveness and efficiency in the storage of personnel records and administration of monthly payroll in such away as to enhance confidence in staff emolument costs and budgeting.

The roles of IPPIS that will help to curtail fraud on personnel payroll reported above are as follows:

(i) Reduction in payroll bill;

(ii) Centralisation of personnel records for all MDAs that are currently on the platform;

(iii) Instant reporting capability for prompt decision making (how many staff on payroll at a particular point, their location, State/Local Government of origin, Grade Level);

(iv) Greater efficiency, transparency and accountability in the payroll and personnel cost management for all MDAs on the IPPIS platform;

(v) Prompt release of salaries to employees' accounts and payment to third parties at the end of the payroll processes;

(vi) Effective and efficient manpower planning process and quick decision making;

(vii) Easy storage and retrieval of personnel records to support monitoring of staff emolument payments against budget; and

(viii) Prevention of wastages and leakages by ensuring that staff remuneration is based on factual and correct information.

(c) Treasury Single Account (TSA) can assist to nip in the bud the frivolous use of government funds through the following:

i. Avoiding borrowing and paying additional charges to finance the expenditures of MDAs while some MDAs keep idle funds in their respective bank accounts;

ii. Ensuring effective aggregate control of cash in monetary and budget management;

iii. Minimising transaction cost;

iv. Making rapid payments of expenses;

v. Facilitating reconciliations;

vi. Controlling and monitoring of funds allocated to MDA;

vii. Supporting monetary policy implementation;

viii. Ensuring total compliance with the relevant provision of the 1999 Constitution of the FRN (Sections 80 & 162);

ix. Collecting and remitting all revenue due to the Federation Account and Consolidated Revenue Fund (CRF);

x. Blocking all leakages in government revenue generation, collection and remittance;

xi. Enthroning a new regime of transparency and accountability in the management of government receipts;

xii. Improving the availability of funds for the development programmes and projects;

xiii. Aligning with the CBN cashless policy; and

xiv. Easing the burden of revenue payers.

(d) Competitive tender procedures and practices in the Public Procurement Act that will prevent the procurement of shoddy contracts on goods and services for government are as follows:

i. All contracts above ₦10million (Ten million Naira) should be advertised in at least two national dailies and/or Government gazette. The advertisement will be at least six weeks before the deadline for submitting bids for goods and works, and at least one month for consultancy services. Notices of all other tenders must be pasted at the notice board of procuring agencies;

ii. Opening of tenders must be done in the 'open' at a designated date and time and opening should immediately follow the closing of the bidding period, to minimize the risk of bid tampering. The following people should be invited to the opening of tenders:

- The bidders or their representatives;
- Members of the civil society; and
- Members of the press, if they wish to attend.

iii. Bid evaluation criteria should be clearly defined in the bidding documents and the award of all contracts should be based on the criteria so defined;

iv There should be a committee made up of professionals for the evaluation of the bids. The Secretary of the Tenders Board should be Secretary of the Committee. Members of the Evaluation Committee, Tenders Boards and approving authorities should be obliged to declare any conflict of interest and exclude themselves from bid evaluation and approval processes;

v. The award of any major contract of N20,000,000 (Twenty million Naira) and above, should be published in two national dailies, stating:

- Description of the contract;
- Name of the contractor; and
- Contract price.

vi. Contract awards should be properly handled so as to avoid or minimize variations. Contract variations should not be allowed except when absolutely necessary, subject to approval and/or the recommendations of the Ministerial Tenders Board (MTB). The method for determining price variation during contract execution should be incorporated into the contract. Such price variations shall be for contracts extending for more than eighteen (18) months.

EXAMINER'S REPORT

The question tests candidates' knowledge of the roles of Government Integrated Financial Management Information System (GIFMIS), Treasury Single Account (TSA) and Integrated Payroll and Personnel Information System (IPPIS) as a means of curbing financial corruption and fraud in Ministries, Departments and Agencies (MDAs). In addition, candidates are required to demonstrate their knowledge on tender procedures and practices in the Public Procurement Act that will prevent the procurement of shoddy contracts on goods and services for government.

All the candidates attempted the question and their performance was poor. Candidates' major pitfall in the question was their poor understanding of the question.

Candidates are advised to prepare very well for future examinations.

Marking Guide

	Description	Marks	Marks
a	Explanation of Government Integrated Financial Management System	2	
	Any four ways of reducing financial corruption in MDAs @ 2 marks each	8	10
b	Explanation of IPPS	1	
	Any four ways on how IPPIS can curtail the fraud on personnel payroll@ 1 mark each	4	5

c	Any five ways on how TSA can assist in curbing frivolous use of government funds @ 1 mark each	5
d	Any five competitive tender procedures and practices in the Public Procurement Act @ 2 marks each	<u>10</u>
	Total Marks	**<u>30</u>**

SOLUTION 2

Auditing in the Public Sector

a(i) Before an external auditor could rely on the work of the internal auditor, the former would have made the following assessments:

- **Degree of Independence**

  The degree of independence of the internal auditor within the organisation.

- **Scope and Objectives**

  The scope and objectives of the internal audit functions as defined by the management.

- **Due Professional Care**

  Due professional care, that is, whether or not the internal audit work is properly planned, recorded and reviewed.

- **Technical Competence**

  The technical competence of the internal auditor raises the question as to whether the internal auditor belongs to any reputable professional accounting body or has relevant practical experience in internal audit work.

- **Quality and Quantity of Audit Reports**

  The quality and quantity of the internal audit reports and to what extent they are being acted upon by the management are of interest to the external auditor.

- **Quality and Standard of Working Papers**

  The quality and standard of internal audit working papers are of significance, showing the extent of work done.

ii. **Factors contributing to an effective audit are as follows:**

- **The independence of an auditor**

He should be given free hand to do a good job. An auditor should not be under the control of management of the organisation.

- **The adequacy and scope of an auditor's power**
  The authority of an auditor should be guaranteed. An auditor must be given adequate authority to discharge his responsibilities.

- **The expertise and professionalism of an auditor and his staff**
  An auditor should be adequately trained, versatile and skilful at his job.

- **The resources at an auditor's disposal**
  There should be enough funds at the disposal of an auditor to carry out his assignment.

- **Freedom of reporting and the qualitative nature of reports**
  The reports, which an auditor transmits should be promptly looked into and timely and effective decisions taken in order to comply with the Professional Audit Standards.

- **Unrestricted access to information**
  Audits should be conducted with complete and unrestricted access to employees, property and records.

- **Stakeholder support**
  The legitimacy of an 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 involved citizens.

(iii) **Important Features of Internal Control are:**

- **Segregation of Duty**
  This is by employing division of labour so that the work in one place or department will be different from another department and carried out by different people.

- **Established Organisation Structure**
  All the duties and powers of an officer should be clearly defined so that an officer would know what is required and expected of him.

- **Perusal of Records**
  Checking the work done earlier and correcting any anomaly, error or omission detect timely.

- **Acknowledgement of Deed or Internal Check**

  This is by appending signature or initials on work done by an officer by a senior officer to confirm the task is already done.

- **Asset Protection**
  This is by keeping all records and statutory documents under lock and key and obtaining insurance policy on physical assets.

- **Formality or Underlying Documents**
  All transfers and receipt of stores have to be backed up by authorized requisition vouchers and acknowledged by signing appropriate vouchers.

- **Verification**
  All items purchased must be verified for completeness, accuracy and that they meet the required standard and specifications.

- **Internal audit**

  It is the continuous review of operation and records of an organization by specialized staff referred to as Internal Auditors.

(b) **Contents of Assurance Report**

The following must be stated in an assurance report:

(i) Confirmation and amount of loss;

(ii) The regulation, which was violated;

(iii) Recommendations to effect correction and prevent a reoccurrence;

(iv) Name and post of officer involved;

(v) Degree of negligence of individual officers; and

(vi) Recommendations and necessary sanctions.

EXAMINER'S REPORT

The question tests candidates' knowledge of the criteria an external auditor should consider before relying on the internal auditor's work, factors that can contribute to an effective audit, features of internal control and contents of Assurance Report in the public sector.

Majority of the candidates attempted the question and their performance was poor. Candidates' major pitfall in the question was lack of in-depth understanding of the section of the syllabus tested.

Candidates are advised to prepare very well for future examination and closely study the ICAN Study Text.

Marking Guide

		Description	Marks	Marks
a	i	Any five assessments of the work of Internal Auditor @ 1 mark each	5	
	ii	Any five factors that contribute to effective audit @ 1 mark each	5	
	iii	Any three features of internal control @ 2 marks each	6	16
				4
b		Any four contents of Assurance Report @ 1 mark each		
		Total		20

SOLUTION 3

CASH BUDGET

Federal Ministry of Women's Affairs (Family Advancement Unit)
Cash Budget from June -- August 2010

	June	July	August
Receipts/Inflows/Income:	₦	₦	₦
Opening balance	16,000	1,150	(10,250)
Sales/Revenue (Cash)	20,000	25,000	27,000
Collections from receivables (Wi-iv)	59,750	72,300	82,500
Total receipts (A)	**95,750**	**98,450**	**99,250**
Payments/Outflows/Expenditure:			
Fixed expenses	11,000	11,000	11,000
Capital payment	--	20,000	--
Variable expenses (10% of sales)	10,000	10,500	11,700
Payment to payables (Wv)	73,600	67,200	74,880
Total payments (B)	**94,600**	**108,700**	**97,580**
Closing balance (A - B)	**1,150**	**(10,250)**	**1,670**

Workings:

i. **Analysis of collections from receivables every month:**

80% x 95% x 75% = 57%	Current month
80% x 95% x 25% = 19%	Previous month
10% - 30 days May 10%	Previous months
10% - 60 days April 10%	2 months ago

Details	₦
ii. **June Receivables Collection:**	
57% of ₦80,000 (June)	45,600
19% of ₦35,000 (May)	6,650
10% of ₦35,000 (May)	3,500
10% of April = ₦18,000-₦14,000	4,000
Total	**59,750**

iii. **July Receivables Collection:**	
57% of ₦80,000 (July)	45,600
19% of ₦80,000 (June)	5,200
10% of ₦80,000 (June)	8,000
10% of ₦35,000 (May)	3,500
Total	**72,300**

iv. **August Receivables Collection:**

57% of ₦90,000 (Aug)	51,300

19% of ₦80,000 (July)	15,200
10% of ₦80,000 (July)	8,000
10% of ₦80,000 (June)	8,000
Total	**82,500**

v. **Calculation of Payables**

Details	**June** ₦	**July** ₦	**August** ₦
Sales	**100,000**	**105,000**	**117,000**
Cost of Sales			
Opening Inventory	50,000	60,000	60,000
Purchases	76,667	70,000	78,000
	126,667	130,000	138,000
Closing Inventory =66.67% of ₦90,000	(60,000)	(60,000)	(60,000)
Cost of Sales= 66.67% of Sales	**66,667**	**70,000**	**78,000**
Gross Profit = 50% of Cost of Sales	**33,333**	**35,000**	**39,000**
Payment to Payables = 96% of Purchases	**73,600**	**67,200**	**74,880**

EXAMINER'S REPORT

The question tests candidates' knowledge of the preparation of cash budget.

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

Candidates' major pitfall in this question was their poor understanding of the requirements of the question.

Candidates are advised to prepare very well for the future examinations and make use of ICAN study text and pathfinders.

Marking Guide

Details	**Marks**	**Marks**
Preparation of Cash Budget		
Calculation of opening balance for June to August @ 1/3 mark each per month	1	
Calculation of Sales/Revenue for June to August @ 1/3 mark each per month	1	

Calculation of collections from receivables from June to August @ 1/3 mark each per month	1	
Calculation of total receipts for June to August @ ½ mark each per month	1½	
Calculation of fixed expenses for June to August @ 1/3 mark each per month	1	
Calculation of capital payment for July @ ½ mark each per month	½	
Calculation of variable expenses for June to August @ 1/3 mark each per month	1	
Calculation of payments to payables for June to August @ 1/3 mark each per month	1	
Calculation of total payments for June to August @ ½ mark each per month	1½	
Calculation of closing balance for June to August @ ½ mark each per month	1½	11
Workings		
Calculation of June, to August Receivables collections @ 1 mark each per month	3	
Calculation payment to payables from June to August @ 2 marks each per month	6	9
Total		20

SOLUTION 4

(a)i. **IPSAS 23 - Revenue From Non-Exchange Transactions (Taxes and Transfers)**

Revenue from Non-Exchange Transactions	**2016**	**2015**
	₦'000	**₦'000**
Taxation Revenue		
Income Tax Revenue	980,790	715,580
Taxes from Goods and Services	150,758	120,740
Estate Taxes	250,390	212,650
Sub- Total	**1,381,938**	**1,048,970**
Transfer Revenue		
Transfer from other governments	75,679	80,120
Gifts, Donations, Goods - in – kind	46,920	40,125

Service –in – kind	39,790	41,120
Sub Total	**162,389**	**161,365**
Total	**1,544,327**	**1,210,335**

(ii) **The ratio of Transfer revenue to Taxation revenue in 2016 and 2015**

The ratio =		**2016**	**2015**
Transfer revenue	=	162,389	161,365
Taxation revenue		1,381,938	1,048,970
=		**0.12: 1**	**0.15: 1**

b. The timing or period of revenue recognition is determined by the nature of the conditions and their settlements.

For example;

i. If a condition specifies that the entity is to provide goods or services to third parties, or return unused funds to the transferor, revenue is recognized as soon as goods or services are provided.

ii. Assets and revenue arising from taxation transactions are recognised in the period in which the taxable event occurs.

iii. Assets and revenue arising from transfer transactions are recognised in the period in which the transfer arrangement becomes binding, except for some service in-kind.

iv. Where a transfer is subject to condition that, if unfulfilled, requires the return of the transferred resources, the government recognises a liability until the condition is fulfilled.

(c) i. **Bases for measuring taxes of Non-exchange transactions**

- Revenue from Non-exchange transactions shall be measured at the amount of the increase in net assets recognized by the entity.
- When an entity recognises an asset as a result of a Non-exchange transaction, it also recognises revenue equivalent to the amount of the asset measured at its fair value as at the date of acquisition, unless it is also required to recognise a liability.
- Where a liability is required to be recognized, it will be measured at its fair value as at the date of acquisition. The amount recognised as a liability should be the best estimate of the amount required to settle the present obligation at the reporting date and the amount of the increase in net assets, if any, recognised as revenue.
- When a liability is subsequently reduced because the taxable event occurs, or a condition is satisfied, the amount of the reduction in

the liability will be recognised as revenue.

- Income tax revenue is measured at the nominal value of cash equivalents received during the reporting period.
- Assets and revenue accruing from goods and services tax are initially measured at the fair value of assets accruing to government during the reporting period, principally cash, cash equivalents and goods and services tax receivable.

ii. Conditions for transfer of assets in line with IPSAS 23

The conditions of transfers of assets in line with IPSAS 23 are:

- Stipulations that specify that the future economic benefits or service potential embodied in the asset is required to be consumed by the recipient as specified or future economic benefits or service potential that must be returned to the transferor;
- An entity cannot impose a stipulation on itself, whether directly or through an entity that it controls;
- Stipulations are enforceable through legal or administrative processes. If a term in laws or regulations or other binding arrangements is unenforceable, it is not a stipulation as defined by this Standard; and
- A reliable estimate can be made of the amount of the obligation.

EXAMINER'S REPORT

The question tests candidates' knowledge of financial data analysis, provision on the period in which revenue from Non-exchange transaction is recognised in accordance with IPSAS 23 and bases for measuring taxes of Non-exchange transactions with conditions for transfer of assets as contained in the standard.

Majority of the candidates attempted the question and their performance was poor. Candidates' major pitfall in this question was poor understanding of the requirements of the question.

Candidates are advised to prepare well for the future examinations and be conversant with the provisions of International Public Sector Accounting Standards and the ICAN study text.

Marking Guide

	Details	Marks	Marks
ai.	Calculation of revenue from Non-exchange transactions in 2016	2	
	Calculation of revenue from Non-exchange transactions in 2015	2	4
aii.	Calculation of transfer revenue in 2016	1 ½	
	Calculation of transfer revenue in 2015	1 ½	
	Calculation of Ratio	1	4
B	Explanation	2	
	Any two examples @ 2 marks each	4	6
C	Any two bases of measurement @ 1½ marks each	3	
	Any two conditions @ 1½ each	3	6
	Total		**20**

SOLUTION 5

Total profit over the life of the projects

Life of the project	Profit After Tax Project A (₦)	Project B (₦)	Project C (₦)
Year 1	400,000	300,000	250,000
Year 2	450,000	450,000	300,000
Year 3	500,000	500,000	400,000
Year 4	450,000	550,000	500,000
Year 5	-	500,000	300,000
Year 6	-	-	250,000

Average Annual profit		**Project A**	**Project B**	**Project C**
$\frac{Total\ profit}{No\ of years}$	=	$\frac{1,800,000}{4}$	$\frac{2,300,000}{5}$	$\frac{2,000,000}{6}$
	=	**₦450,000**	**₦460,000**	**₦333,333.33**

Total Book Value of Investment over the life of the projects

Life of the project	**Book value of Investment**		
	Project A (₦)	**Project B (₦)**	**Project C (₦)**
Year 1	1,500,000	1,200,000	1,000,000
Year 2	1,350,000	1,080,000	900,000
Year 3	1,215,000	972,000	810,000
Year 4	1,093,500	874,800	729,000
Year 5	-	787,320	656,100
Year 6	-	-	590,490
Total	**5,158,500**	**4,914,120**	**4,685,590**

Average Investment	**Project A**	**Project B**	**Project C**
$\frac{\text{Total Book value of investment}}{\text{No of years}} =$	$\frac{5,158,500}{4}$	$\frac{4,914,120}{5}$	$\frac{4,685,590}{6}$
=	**₦1,289.625**	**₦982,824**	**₦780,931.66**

Accounting Rate of Return (ARR) $= \frac{\text{Average annual profit}}{\text{Average Investment}}$ X 100%

Project A $= \frac{450,000}{1,289,625} X\ 100 = 34.89\%$

Project B $= \frac{460,000}{982,824} X\ 100 = 46.80\%$

Project C $= \frac{333,333.33}{780,931.66} X\ 100 =$ 42.68%

It is therefore recommended that Project B should be chosen because it gives a higher return on investment than Projects A and C.

EXAMINER'S REPORT

The question tests candidates' knowledge of Accounting Rate of Return (ARR) as it relates to project appraisal and selection. The requirements of the question are the calculation of ARR and making appropriate recommendation on the best option/project for selection.

Majority of the candidates attempted the question and the performance was above average. The candidates who scored poor marks include those who failed to show explicitly all the necessary steps that led to the answers they arrived at in their calculations.

Candidates are advised to be detailed in the questions that involve calculation so as not to lose marks.

Marking Guide

Details	Marks
Calculation of total profit over the life span of each project @ 1 mark each for 3 projects	3
Calculation of average annual profit for each project @ 1 mark each for 3 projects	3
Calculation of total book value of Investment over the life span of each project@ 1 mark each for 3 projects	3
Calculation of average Investment foreach project@ 1 mark each for 3 projects	3
Calculation of Accounting Rate of Return for Projects A, B, and C @ ½ mark each	1½
Recommendation of Project B as the best option	1 ½
Total	**15**

SOLUTION 6

(a) **Federation Account**

Section 162 of the 1999 Constitution of the Federal Republic of Nigeria established the Federation Account. This account is one in which all revenue collected by the Government of the Federation, except the proceeds from the PAYE of the personnel of the Armed Forces of the Federation, the Nigeria Police Force, Foreign Service Officers and Residents of the Federal Capital Territory, Abuja shall be paid.

The sources of revenue accruing to the Federation Account could be divided into three

(i) **Direct Taxes:** These are payable by the individuals and firms such as company income tax, petroleum profit tax, capital gain tax, back duty assessment, and personal income tax of foreigners residing in Nigeria.

(ii) **Indirect Taxes:** These are taxes on goods and services in the form of custom and excise duties, forfeiture penalties, etc.

(iii) **Mining:** These are oil pipeline licence fees, rents of mining rights, mining fees, royalties on minerals, NNPC earnings from direct sales, penalties for gas flared, and rent of oil well.

The Federation Account is a distributable pool account from which allocations are made to the Federal, State and Local Governments on such terms and in a manner prescribed by the law. Currently, the amount in the pool is distributed, as follows:

- 13% of revenue derived from oil sources goes to the States from which it is obtained, in consonance with the principle of derivation;
- 7% and 4% of the gross revenue in the Federation Account are allocated to the Customs Service and Federal Inland Revenue Services, respectively as cost of collection;
- The rates stated above are "first line charges." That is, 13% derivation source is adjusted (deducted) in the oil sector revenue received from the total oil proceeds; 11% (7% plus 4%) of other revenue receipts are taken out of the non-oil collections;
- Whatever remains in the Federation Account distributable pool is shared between the three tiers of Government;

(b) **Consolidated Revenue Fund**

Section 80 of the Constitution of the Federal Republic of Nigeria, 1999, established the Consolidated Revenue Fund (CRF). Except those revenue items which are specifically designated to other funds, all others shall be paid into the Consolidated Revenue Fund.

The sources of revenue accruing to the Consolidated Revenue Fund are as follows:

(i) Direct allocation from the Federation Account at the prevailing rate.

(ii) **Direct Taxes:** These include PAYE of the Armed Forces and Police Personnel, Foreign Service Officers and Residents of the Federal Capital Territory, Abuja.

(iii) **Licence & Internal Revenue:** These are realized from the issues of licences, e.g. arms and ammunition licence fees, goldsmith licence fees, radio & T.V Licence fees, gold dealer's licence fees.

(iv) **Mining:** These include mining fees, rent of crown lands, royalties on gold, tin, iron ore and coal mines.

(v) **Fees:** They are fees received on services rendered by Government officials, e.g., court fees, court fines and medical fees.

(vi) **Earnings and Sales:** Earnings and sales are derived from the use and subsequent disposal of Government property, e.g. sales of stores, publications and stamps, commission on money order and poundage on postal orders.

(vii) **Rent of Government Property:** The incomes include rent on Government quarters, land and buildings.

(viii) **Interests& Repayments (General):** These are interests and repayments of loans granted to individuals by the Government, Corporations and Government companies. An example is the repayment of motor vehicle loans.

(ix) **Interests& Repayments (State):** They are interests and repayments of loans granted to the State Governments.

(x) **Armed Forces:** The sales of Armed Forces' property such as old vehicles and stores.

(xi) **Reimbursements:** These are refunds for services rendered to the States, Local Governments, Public Corporations and other Statutory Bodies by the Federal Government officers. Examples are reimbursements of audit fees and refunds of overpayments made to Government workers.

(xii) **Miscellaneous:** These are other sources of revenue, apart from those stated above. Examples are overpayments refunded, lapsed deposits.

The charges or utilization from the Consolidated Revenue Fund are grouped as follows:

- **All Recurrent Expenditure Heads in the approved estimates,** e.g. personnel cost, overhead cost and servicing of national debts.
- **Salaries and Consolidated Allowances of Statutory Officers:** These are expenditure chargeable directly to the Consolidated Revenue Fund, irrespective of budget approval. Statutory Officers include:
    - Commissioners of the following Bodies;
    - Police Service Commission;
    - Public Complaints Commission;
    - Public Service Commission;
    - Nigerian Law Reform Commission;
    - Independent National Electoral Commission;
    - Auditor - General for the Federation;
    - President and Justices of the Federal Court of Appeal;
    - Chief Judge and Judges of the Federal High Court; and
    - Chief Justice and Justices of the Supreme Court.

- **Pension and Gratuity**. These are the entitlements of both statutory and non-statutory officers, including members of the Armed Forces.

(c) **Development Fund**

The existence of the Development Fund was solidified by the 1999 Constitution of the Federal Republic of Nigeria, although created earlier by Section 25 of the Finance (Control & Management Act of 1958). The Fund was established for the purpose of capital development projects. The sources of revenue accruing to the Development Fund could be divided into four, viz:

(i) **Contribution from the Consolidated Revenue Fund:** These are yearly transfers of money from the Consolidated Revenue Fund, in the Federal Government's wisdom.

(ii) **External Grants:** These are usually received from foreign countries and non- financial institutions.

(iii) **External Loans:** These may come from such foreign bodies as the International Monetary Fund (IMF).

(iv) **Internal Loans:** These are loans raised and retired within the country. They may be long-term loans, raised through development stocks, or short-term loans through Treasury Certificates, (which have a life span of two years), and Treasury Bills.

The charges or utilization from the development fund may also be categorized into four main classes, thus:

- **Summary of Capital Expenditure Payments**: This is expenditure incurred for the provision and maintenance of infrastructural amenities such as the construction of bridges and dams.
- **General Administration**: These are expenditure items made for the provision and maintenance of Army Barracks/Police Stations, Staff Houses, Motor Vehicles and Hospitals.
- **External Financial Obligations**: They are disbursements made for expenditure incurred to provide financial assistance to countries, which are in need. The relief may be in form of donations, grants and aids to neighbouring countries.
- **Loans made to State Governments in Nigeria:** These are different types of loans which, the Federal Government grants to the States for developmental purposes.

EXAMINER'S REPORT

The question tests candidates' knowledge of basic understanding of Federation Account, Consolidated Revenue Fund and Development Fund in the context of revenue generation and utilisation.

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

Candidates' pitfall was their inability to give detailed explanation of the three tested accounts.

Candidates are advised to prepare very well in the future examinations.

Marking Guide

	Details	Marks	Marks
A	**Federation Account**		
	Description	2	
	Any three sources of Revenue @ ½ mark each	1½	
	Any three disbursements of Fund @ ½ mark each	1½	5

B	**Consolidated Revenue Fund**		
	Description	2	
	Any three sources of Revenue @ ½ mark each	1½	
	Any three disbursements of Fund @ ½ mark each	1½	5
c	**Development Fund**		
	Description	2	
	Any three sources of Revenue @ ½ mark each	1½	
	Any three disbursements of Fund @ ½ mark each	1½	5
	Total		**15**

SOLUTION 7

(a) **Vertical Revenue Allocation** involves the sharing of revenue from the top to the bottom in order to create a workable condition for the jurisdictions. That is, the revenue is shared from the Federal Government to the States and Local Governments.

Horizontal Revenue Allocation is the sharing of the revenue among the jurisdictions at the same level of Government, either State or Local Governments with the source of the revenue from the Federal Government.

(b) **Principles of Revenue Allocation are:**

(i) **Principle of Derivation.** The State from which the bulk of the revenue is obtained should have extra share over and above what the other States receive;

(ii) **Principle of Need.** This is based on the perceived need of each state. When the need of a state is put against the needs of others, it may require the transfer of financial resources from one state to another in the interest of equity;

(iii) **Principle of Even Development.** This principle requires that growth and development should be spread so that serious inequality is reduced in the federation;

(iv) **Principle of National Interest.** This requires that in the allocation of federally collected revenue; primary importance should be given to national interest;

(v) **Principle of Equality of States.** This states that the revenue sharing among the States should be on equal basis since States are created equally with different endowment of economic, financial and potential powers;

(vi) **Principle of Population**. This states that States with larger population should receive larger extra share of the revenue than others with smaller population;

(vii) **Principle of Continuity of Government**. This suggests that each level of Government has a minimum responsibility and that the level of service provided should not be allowed to fall below certain level;

(viii) **Principle of Fiscal Efficiency**. This asserts that States should minimise the cost of fiscal administration or obtain the maximum revenue from a given cost; and

(ix) **Landmass Principle**: The states that have larger landmass should receive extra share of the revenue than others with smaller landmass.

(c) **Criticisms of Revenue Allocation**

(i) **High concentration of revenue in the coffers of the Federal Government**: The actual receipts of the Federal Government are far in excess of its statutory allocations as a result of the Stabilisation Fund, Ecological Fund, Development of Natural Resources etc. that are dedicated to some specific projects.

(ii) **Reliance on population figures projected from the controversial 1963 census:** The use of population principle has adversely affected the prospects of generating accurate census figures in the future.

(iii) **The use of landmass in revenue allocation:** This has also been criticised as biased in favour of States with large landmass but thin population while States with small landmass and dense population suffer.

(iv) **Constitutional limitations:** There are constitutional limitations on the independent power of the State and Local Government to generate revenue. This results in the States inability to adequately perform their statutory functions.

EXAMINER'S REPORT

The question is on revenue allocation: the two basic forms, the principles and criticisms often levied against the exercise in Nigeria.

Majority of the candidates attempted the question and the performance was below average. Many of the candidates were able to identify and explain the principles of

revenue allocation. However, most of them had problem in differentiating between vertical and horizontal revenue allocation. They also fell short of articulating the various criticisms often advanced against the revenue allocation exercise in Nigeria.

Candidates are advised to consult the relevant textbooks on this topic, especially the study text of the Institute for better understanding.

Marking Guide

	Details	**Marks**
a	Explanation of Vertical and Horizontal Revenue Allocation @ 1 1/2 each	3
b	Any three principles @ 2 marks each	6
c	Any three criticisms of revenue allocation in Nigeria @ 2 marks each	6
	Total	**15**

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION - NOVEMBER 2017

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

Win Win Plc, a public limited liability company incorporated in the year 2000, operates in Ogun State of Nigeria. The company is in the Foods and Beverages Industry and has done well since incorporation. This is largely due to the availability of local raw materials and a huge market for its products. Win Win Plc exports both raw materials and finished goods to other countries.

In a recent seminar organised for board members, the board was enlightened on the importance of innovation for firms and industries to remain successful. The role of government in encouraging innovation in order to retain national comparative advantage was also emphasised.

The board of Win Win Plc has engaged your services as a consultant to present a proposal to the board on how the organisation can attain national or regional dominance in the food and beverage industry.

You are required to prepare a proposal that should:

a. Adopt Porter's Diamond Model in presenting an analysis of the factors that give a country or region competitive advantage.
(17 Marks)

b. Advise the Board on **TWO** major weaknesses of Porter's Diamond Theory.
(4 Marks)

c. Evaluate the role of government in creating national competitive advantage.
(4 Marks)

d. Provide an assessment of the impact and probability of risk by identifying and placing them on a simple risk map. (5 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 company's risks create risks for its stakeholders. Management should be aware of the impact of the company's risk on its stakeholders because the risks could affect their attitude and behaviour towards the company.

You are required, as a risk consultant, to write a presentation on:

a. The impact of a company's risks on **FIVE** categories of stakeholders. (15 Marks)

b. **FIVE** ways in which risk awareness can be embedded in the culture of the organisation by the board of directors and senior management. (5 Marks)

(Total 20 Marks)

QUESTION 3

a. As a result of increasing corporate challenges, there is a growing awareness of the importance of professional and business ethics. Hence, professionals in the corporate sector are now required to be competent in these areas.

Required:

To demonstrate your competence as a professional accountant in training, provide a brief analysis of the following:

i. Business Ethics (3 Marks)

ii. Ethical Dilemma (3 Marks)

iii. Normative Ethical Relativism (3 Marks)

iv. Descriptive Ethical Relativism (3 Marks)

v. Ethical Objectivism (3 Marks)

(15 Marks)

b. Evaluate the rules-based approach to Corporate Governance with clear illustrations of its advantages and disadvantages. (5 Marks)

(Total 20 Marks)

QUESTION 4

Gold Limited is a company which makes and sells rechargeable lamps. One of its products, "the dove", which uses a combination of solar energy and electricity has been in production for about five years and has been successful. The product has been very popular with customers because of its use of alternative energy and the range of colours available. Recently, sales figure fell to the point at which the company is losing so much money in producing the dove. Due to competitive pressures in the market, increases in the selling price of the product have not improved the profit margin.

At a management meeting called to discuss the situation, it was suggested that certain technical alterations could be made to the product that would help reduce its production cost. However, the expected useful life of dove would fall by about 30%.

It was envisaged that if the technical alterations were not made, the company would have to cease production and subsequently the sales of the product. However, if the technical alterations were made, the product would again become profitable.

Required:

a. Using the American Accounting Association (AAA) Model for ethical decision-making, advise on the course of action management should take on “the dove”. (14 Marks)

b. Provide **FOUR** reasons for the study of ethics by accountants. (6 Marks)

(Total 20 Marks)

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

QUESTION 5

Code of Corporate Governance for public companies emphasises key issues that determine how well a company is governed.

Required:

Evaluate the main areas covered by this code. **(Total 15 Marks)**

QUESTION 6

The collapse of corporate entities may be directly linked with poor corporate governance and inadequate deployment of Information Technology.

Required:

a. Advise on **FIVE** corporate governance failures that could precipitate corporate collapse. (10 Marks)

b. Discuss the duties of the Board of Directors in relation to the deployment of Information Technology. (5 Marks)

(Total 15 Marks)

QUESTION 7

a. A company is planning on switching from labour to mechanised method of production. It anticipates some resistance to the proposed change.

Required:
Using the Lewin's Force Field Analysis, suggest steps that can be adopted in the management of such transformational change. (8 Marks)

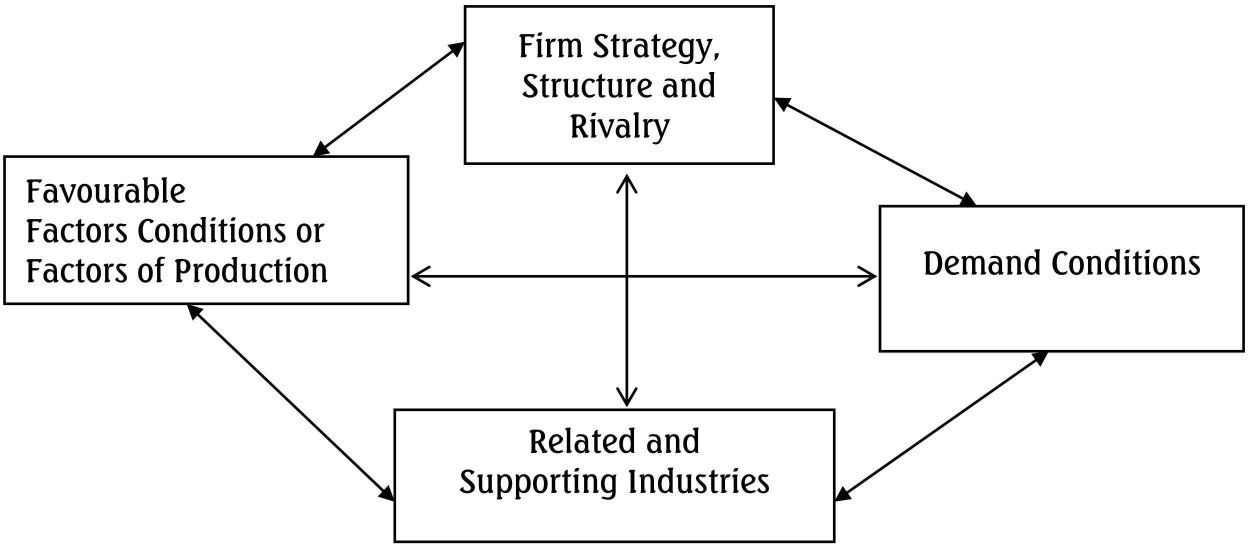
b. Sonex Plc, a multinational corporation, plans to establish a common culture across all its subsidiaries located in fifty countries. The objective of this policy is to make the company's culture supportive of its global business strategy.

Required:
Using the Hofstede's framework, advise the management of Sonex Plc on the likely effects of national culture on the success of this policy. (7 Marks)

(Total 15 Marks)

SOLUTION 1

a. Porter's Diamond model diagram



Explanation of Porter's Diamond Model

The factors that bestow competitive advantage on a nation or region are explained below:

i. Favourable Factors/Conditions/Factors of Production

- Land (raw materials and all gifts of nature)
- Labour (skilled, semi-skilled and unskilled)
- Capital (money, equipment, machine)
- Entrepreneural ability (organiser of other factors)

ii. Related and Supporting Industries

- Related Industries: Industries involved in the production of similar products/services.
- Supporting Industries: These complement the activities of the main firm; for instance suppliers of raw materials, creditors, government agencies (e.g, NAFDAC), insurance companies.

iii. Demand Conditions: Favourable factors that aid the demand for product/services. These include price of the goods/services, price of substitutes, weather, population of active consumers, nature and quality of products, etc.

iv. Firm Strategy, Structure and Rivalry

- Firm strategy can be explained using the four 'P' approach: Price, Product, Place and Production Strategies.
- Structure: The structure of an organization can be presented in an organogram. It will show lines of responsibilities and command structure.
- Rivalry – Competition/competitors will force producers/companies to be innovative and strive to improve continually.

Whether at organizational, national or regional level; the four components of Porter's/Demand Model are applicable in building competitive advantage.

(b) Weaknesses of Porter's Diamond Model

Weaknesses in the Porter's Diamond Theory include:

(i) It is more relevant to companies in advanced economies than those in developing economies.

(ii) It does not consider multinational companies which locate production operations in different countries across the world.

(c) The role of government in creating national competitive advantage include:

i. Ensuring strict adherence to high technical standards of products;
ii. Encouragement of healthy rivalry and competition amongst companies rather than protecting them from outside competition;
iii. Provision of incentives to organisations that achieve comparative competitive advantage;

iv. Creation of an education and training system that develops appropriate labour skills and knowledge;
v. Assisting companies to raise their performance levels by enforcing strict product standards;
vi. Creation of early demand for new and advanced products by purchasing the products themselves; and
vii. Creating a stable economy characterized by basic infrastructure.

(d) Risk assessment is the process of evaluating the importance of a risk by making an estimate of two variables:

i. The probability of the risk event being realized; and
ii. The impact that the risk would have.

Probability refers to the likelihood of the risk materialising and is expressed either as a percentage or as a proportion of one (e.g. a 0.5 risk is considered to be 50% likely).

The impact refers to the value of the loss if the risk event were to materialise.

The structure of a simple risk map is shown below:

Impact/size of potential loss	Low probability/ frequency	High probability/ Frequency
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*

Probability or frequency of the risk materialising

ACCEPT (LOW - LOW)
Risks assessed at low probability and low impact can be accepted or tolerated.

TRANSFER (HIGH - LOW)
Those with high impact but low probability are often transferred or shared. This may consist of risk insurance or implementing contingency plans to reduce severity of risk. This will minimize insurance premiums.

MONITOR (LOW - HIGH)

Steps are typically taken to monitor and reduce risks with low impact but high probability.

AVOID (HIGH - HIGH)
Risks with high impact and high probability are typically avoided. Take Immediate action to reduce severity and frequency of losses, including charging higher prices to customers or ultimately abandoning the activities.

Risks that are known to be more likely to occur in the near future ('proximate' risks) may be assessed as having higher probability and hence, more urgent strategies employed for managing them.

EXAMINER'S REPORT

The question tests candidates' ability to employ Porter's Diamond Model in analysing the factors that give a country or region competitive advantage. It also tests their understanding of the weaknesses of the Model, role of government in creating national competitive advantage and how a risk map can be used to assess the impact and probability of risks.

Being a compulsory question, all the candidates attempted the question but general performance was poor. Only about 30% of them performed above average. Commonest pitfalls include inadequate understanding of the demands of the question and the confusion of Porter's Diamond Model with Porter's Five Forces Model. Many of them were also unable to evaluate the role of government in creating national competitive advantage. Some also had problems with the requirement to use a risk map to assess the impact and probability of risks.

Candidates are advised to effectively cover the syllabus and use ICAN's Study Text. They should also ensure that they understand the distinctions between related theories and models.

MARKING GUIDE		**MARKS**	**MARKS**
a.	Porters' Diamond Model diagram	1	
	Identification and explanation of each of the four components of the model at 4 marks each	16	
b.	Two weaknesses with porter's diamond model (2 marks each)	4	
c.	The role of government (1 mark each for four points)	4	
	Risk Assessment		
d.	Risk map	1	
e.	Interpretation of the map	2	
f.		2	
	Total Marks		30

SOLUTION 2

(a) The impact of a company's risk on its stakeholders, which varies depending on circumstances, includes the following:

(i) **Employees**: Employees are exposed to several risks on their jobs. These include:

- Loss of Jobs: Jobs may be threatened by the strategic choices taken by a company. If a company makes a wrong strategic decision and the company loses money, many employees may lose their jobs.

- Employee benefits may be threatened: Regular payment of salaries and other remunerations may be hindered.

- Threat to health or safety in the work place. Safety risks for a company might be measured in terms of the risk of serious or minor injuries to employees over a given period of time.

(ii) **Investors:** The impact of a company's risk on its investors includes the following:

- The investors may lose their investment;
- The expected returns may not be realised;
- Shareholders may decide to sell off shares to invest in a low-risk company. However, investors with a large risk appetite may buy the shares.

(iii) **Creditors:** The impact of a company's risks on its creditors and suppliers includes the following:

- The company may not be able to pay what it owes its creditors and suppliers;
- The company may stop buying goods and services from them; and
- A high-risk company is a high credit risk, because the liquidity risk and insolvency risk facing a company has an impact on the credit risk for a supplier or lender.

(iv) **Communities and General Public**: Communities and general public are exposed to risks from the actions of companies and the failure by companies to control their risks.

Risks to the general public include:

- The economy of the country in which a business entity faces high risk of decline may go into recession especially when the company is a major employer of labour.

- Health and safety risk to the public may result from failure of a company to supply goods that comply with health and safety standards.

- Quality of life may be undermined due to environmental pollution resulting from the failure of the company to control its environmental pollution risks.
- Economic risks faced by the entire community may increase if a company is forced to close down a production plant in an area where it is a major employer of labour.

(v) **Government** - Impact of a company's risk on government includes:
- Loss of Revenue - as a result non-payment of taxes; and
- Loss of Jobs - due to business failure.

(vi) **Customers** - Some risks facing companies also have impacts on their customers.
- If a company is late in supplying a key component to a business customer, the customer will be late in supplying to its own customers. Errors and delays permeate the entire supply chain.
- Product safety risks for a company are also risks to customers who use them. For example, manufacturers of food products, drinks, medicines and drugs need to consider the potential risks to customers from weakness in their own safety controls.

(vii) **Business Partners**: Risks in joint ventures for all the partners include:
- A company in a joint venture may attempt to dominate decision making; and
- Partners' loss of investments.

b. Creating a culture of risk awareness should be a responsibility of the board of directors and senior management that should show commitment to the management of risk in every way possible.
Risk awareness may be enhanced by:
- Putting in place reporting systems for disclosing issues relating to risk;
- Sharing of risk-related information;
- Managers and other employees recognising the need to disclose information about risks and about failures in risk control;
- A general recognition that problems should not be kept hidden. 'Bad news' should be reported as soon as it is identified. The sooner problems are identified, the sooner control measures can be taken, and the less the damage and loss;
- Creating a culture in which problems are disclosed and there is openness and transparency. Employees should be willing to admit to mistakes;
- Rejecting the 'blame' culture: Individuals should not be criticized for making mistakes, provided they own up to them promptly; and
- Adopting the attitude that risks will always be present and when they manifest, the objective should be to take measures to deal with them. Mistakes should be analysed in order to find solutions to them and prevent repetition. Risk management should be a constructive process.

EXAMINER'S REPORT

The question tests candidates' knowledge of the impact of company's risks on stakeholders and how the culture of risk awareness can be embedded in organisational culture.

About 90% of the candidates attempted the question and overall performance was above average. The commonest pitfall was their inability to adequately discuss how risk awareness can be properly embedded into organisational culture.

Candidates are advised to pay adequate attention to details of each section of the syllabus and the contents of ICAN's Study Text.

MARKING GUIDE **MARKS** **MARKS**

		MARKS	MARKS
a.	Identification and explanation of company's risk on any 5 stakeholder groups at 3 marks each for any 5 points.	15	
b.	Explanation of any 5 points on creation of risk awareness at 1 mark each.	5	
	Total		20

SOLUTION 3

a.

i. **Business ethics:**

- It describes the moral principles and values that guide how people and institutions behave in the world of commerce.
- Considers how the pursuit of self-interest (e.g. profits) impacts others through the actions of individuals or firms within business.
- It is a formal corporate code of ethics that provides a reference point for employees' and other stakeholders' behaviour.
- Consists of a code of ethics that applies to all employees whether they are members of a professional body (and therefore subject to a code of professional ethics too) or not.

ii. **Ethical dilemma:**

- Ethical dilemma or moral dilemma involves a conflict between two moral principles whereby it can be argued that both perspectives are fair and reasonable.
- It is a conflicting situation that an individual faces involving a decision about appropriate behaviour.
- It occurs when you must make a choice among alternative actions and the right choice is not absolutely clear.
- It can also be described as one in which the choice of alternative action affects the well-being of other people.

iii. **Normative ethical relativism is the school of thought or principle that:**

- Holds that beliefs or moral values within each culture are right within that culture;
- Affirms that it is impossible to judge the values of a culture externally or objectively; and
- Claims that moral values of a culture can only be judged from within the culture.

iv. **Descriptive ethical relativism is the view that:**

- Different cultures and societies have different ethical systems and standards;
- 'Right' and 'wrong' are concepts that relate to particular cultures; and
- It holds that there is no universal rule about right and wrong.

v. **Ethical objectivism holds that moral values are:**

- Independent of one's perception or conception;
- Intrinsic and not dependent on anything external to them;
- Believed to be perceptible by all rational creatures; and that
- What is right or wrong does not depend on what anyone thinks is right or wrong but rather the pure facts, irrespective of scenario.

b. **Rules-based approach to corporate governance**

A rules-based approach to corporate governance is the approach that companies are required by law (or by some other form of compulsory regulation) to comply with established rules of good corporate governance. For the companies to which they apply, the rules must be obeyed and only a few (if any) exceptions to the rules are allowed.

(i) **Advantages of a rules-based approach**

- Companies do not have the choice of ignoring the rules.
- All companies are required to meet the same minimum standards of corporate governance.
- Investors' confidence in the stock market might be improved if all the stock market companies are required to comply with recognised corporate governance rules.

(ii) **Disadvantages of a rules-based approach**

- The same rules might not be suitable for every company because the circumstances of each company are different.
- A system of corporate governance is too rigid if the same rules are applied to all companies.
- There are some aspects of corporate governance that cannot be regulated easily. These include negotiating the remuneration of directors, deciding the most suitable range of skills and experience for the board of directors, and assessing the performance of the board and its directors.

EXAMINER'S REPORT

The question tests candidates' understanding of some of the theories in ethics that are relevant to the professional accountant and their knowledge of the rules-based approach to Corporate Governance.

Over 85% of the candidates attempted the question but general performance was below average. Major pitfall was the widespread inability of candidates to properly analyse ethical theories and the rules-based approach to Corporate Governance.

Candidates should ensure that they have an in-depth understanding of ethical theories relevant to the accountancy profession.

MARKING GUIDE

			MARKS	MARKS
a.	.	Analysis of:		
	i.	Business Ethics	3	
	ii.	Ethical Dilemina	3	
	iii.	Normative Ethical Relativism	3	
	iv.	Descriptive Ethical Relativism	3	
	v.	Ethical Objectivism	3	15
b.		Clarification of rules-based approach	1	
	i.	2 advantages of rules-based approach at 1mark each	2	
	ii.	disadvantages of rules-based approach at 1 mark each	2	5
		Total		20

SOLUTION 4

a. Using the American Accounting Association Model, Management should adopt the following course of action:

i. **Identify the fact:** The facts given in the question include:

- The product uses a combination of solar energy and electricity;
- It has been in production for five (5) years successfully;
- The product has been very popular with customers;
- It has a range of colours;
- There is a loss of revenue due to loss of sales;
- There are competitive pressures in the market; and
- There is an increase in selling price without a corresponding increase in the profit margin.

ii. **Identify the ethical issues:** A major ethical issue is whether the company should reduce the quality of the product without informing customers.

iii. **Identify the ethical principle and values** that are relevant to the moral dilemma: A key principle is that of honesty in relation to the fair treatment of customers. The company should be open and fair to customers,

iv. **Identify the alternative courses of action:** These include either making technical alteration to the product or to stop producing it.

v. **Identify actions that are consistent with the principle and values in (iii) above:** For example, informing customers of the reduction in quality of the product would be consistent with the principles of fair dealing with the customer.

vi. **Identify the possible consequences of each alternative action:** For example:

- If the technical alternations were made and the customers were informed, the company might be more profitable.
- If the technical alternation were not made, the company will cease production which will lead to loss of market share.

vii. **Making a decision**: management can be assisted in decision-making by the company's ethical stance, If the company has a code of ethics that insists on fair treatment and due consideration for customers, the technical alternation will not be made without informing customers.

b. **Importance of the study of ethics for accountants**

The study of ethics is important to accountants due to the following considerations:

- Accountants must abide by the professional code of ethics of their professional body;
- Members of the public will have more confidence in the accountancy profession if accountants adhere to ethical and professional standards;
- Accountants must continue to be seen as ethical and objective for their opinions to be valued in audit and advisory roles;
- The study of ethics will help promote consistency in the ethical values and principles expected of accountants; and
- Adherence to professional codes of ethics remains ever so critical in protecting the reputation of the accountancy profession in the light of corporate scandals (such as Enron and WorldCom) and the global financial crisis.

EXAMINER'S REPORT

The question tests candidates' understanding of the American Accounting Association (AAA) model for ethical decision-making and the importance of ethics for accountants.

About 70% of candidates attempted the question and general performance was slightly below average. Commonest pitfalls were the inability of many candidates to identify the ethical issues and other relevant facts in the scenario from which the question was derived.

Candidates are advised to develop the skill of analysing scenarios so as to identify the ethical issues embedded in them. They should also understand how to address ethical issues that could arise within the context of the accountancy profession.

MARKING GUIDE		**MARKS**
a.	AAA Model 7 points at 2 marks each (½ for identification, 1½ for explanation)	14
b.	Four reasons why the study of ethics is important to accountants (4 points at $1^1/_2$ mark each)	6
	Total	**20**

SOLUTION 5

- Code of Corporate Governance is the system of rules, practices and processes by which a company is directed and controlled.
- It involves balancing the interest of a company's many stakeholders such as shareholders management, customers, suppliers, financiers, governmental and the community.
- It became a pressing issue following the 2002 introduction of the Sarbanes Oxley Act in the United States of America.
- The Code of Corporate governance was ushered in to restore public confidence in companies and markets after accounting fraud bankrupted high net worth companies such as Enron and WorldCom.
- The pillars on which corporate governance rests are transparency, accountability and fairness.

The main areas covered by the Code of Corporate Governance are as follows:

- **The role and responsibility of the Board**
  The board of directors should have a clear understanding of its responsibilities and should provide suitable leadership to the company.

  Governance is therefore concerned with establishing what the responsibilities of the board should be and making sure that these are carried out properly.

- **Shareholders Right**
  The right of all shareholders including the right of minority shareholders and foreign shareholders should be protected. The voting system should enable all shareholders to exercise their votes. If a company's policy differs from the 'one share, one vote' standard of voting such that some shareholders have voting power that is disproportionate to the number of shares they hold

in compliance with any extant law, this should be explained by the company.

- **The composition and balance of the Board of Directors**
  The board should have the appropriate balance of skills, experience/independence and knowledge of the company to enable it discharge its responsibilities effectively. It specifies that board membership should not be less than five (5) nor exceed fifteen (15) persons. The board should not be dominated by a powerful Chief Executive or Chairman.

  All directors should be available for re-election at regular intervals of every three years.

  There must be diversity in the composition of the board.

- **Financial Reporting/Narrative reporting and auditing**
  The board should be accountable to its shareholders and should be open and transparent with investors generally. In order to make the board accountable, high standards of financial reporting, narrative reporting and external auditing must be upheld.

- **Directors' Remuneration**
  In order to encourage directors' commitment to the company, they should be rewarded with incentives so that they are motivated to achieve performance targets. Linking remuneration to performance is considered essential for successful corporate governance. However, linking directors' pay to performance is complex, and remuneration schemes for directors have not been particularly successful. Non-executive directors should be responsible for fixing the remuneration of executive directors.

- **Risk Management and Internal Control**
  Directors should ensure that their company operates within acceptable level of risks and should ensure, through a system of internal control, that the resources of the company are properly used and its assets well protected.

- **Corporate social responsibility and ethical behaviour by companies (business ethics):** These business ethics issues are issues related to corporate governance.

EXAMINER'S REPORT

The question tests candidates' knowledge of the Code of Corporate Governance.

Over 80% of the candidates attempted the question and performance was poor. This is largely due to their inadequate understanding of key issues in Corporate Governance.

Candidates are advised to ensure that they understand all the issues included in the syllabus.

MARKING GUIDE	**MARKS**
Explanation of Code of Corporate Governance: ½ mark	
for each of the 5 points	2½
Identification and explanation of any 5 areas covered by the Code of Corporate Governance at 2½ marks each	<u>12½</u>
Total	<u>15</u>

SOLUTION 6

a) The corporate governance failures that could result in the collapse of corporate entities include/are:

i) **False accounting/window dressing/cosmetic/creative accounting**
Executive management encourages or allows incorrect and misleading treatment of transactions in the company's account.

ii) **Audit Committee**
The Audit Committee of the company approves misleading annual financial statements.

iii) **Company's Transactions/Conflict of Interest/Self-Interest**
Executives in the company and professional advisers, profit personally (but secretly) from transactions involving the company.

iv) **Ineffective Board**
The Board is ineffective in supervising the actions of the company's senior executives.

v) **Whistle-blowers**
The Board ignores information from 'whistle-blowers' about serious problems and dubious transactions.

vi) **Failure of internal control**
Where internal controls are not efficiently followed.

vii) **Poor Risk Management**
This can be in the form of inadequate risk assessments, risk awareness or risk management mechanism.

b) Duties of the Board of Directors in relation to Information Technology include ensuring that:

i) Appropriate Information Technology and information systems are put in place to enable the organisation achieve its objectives;

ii) Adequate funding is available to support the IT infrastructure;

iii) An IT strategy that aligns with the organisation's overall goals, missions and objectives is put in place;

iv) A robust system of internal control is in place to prevent or detect, and correct errors in the Information Technology systems; and

v) There are efficient safeguards for Information Technology assets (both tangible and intangible) and data.

EXAMINER'S REPORT

The question tests candidates' knowledge of reasons for Corporate Governance failures and how these precipitate corporate collapse. It also tests their understanding of the duties of the Board of Directors in relation to the deployment of I.T.

Over 80% of the candidates attempted the question and the overall performance was below average. Commonest pitfall was the inability of most of them to provide correct answers to the questions.

Candidates are advised to study the ICAN's Study Text and endeavour to understand its contents.

MARKING GUIDE	**MARKS**	**MARKS**
Identification and explanation of any 5 Corporate Governance failure at 2 marks each	10	
Discussion of 5 duties of directors in relation to IT at 1 mark each	5	
Total		15

QUESTION 7

(a) Kurt Lewin, a social psychologist, developed a theory that explains the forces that come into conflict in respect of planned changes. According to him, two opposing forces affect changes in an organisation. These are:

i. Driving forces: Forces that support need for change; and
ii. Restraining Forces: Forces that oppose and resist change.

Dimensions of the driving and restraining forces of change include:

- The people involved in the change and what they want for themselves;
- Habit and custom of individuals;

- Attitudes of individuals;
- The relationship between people involved;
- Vested interest;
- The entity's policies;
- The resources available to make each change;
- Regulations; and
- Relevant events (happenings).

Change will only occur when driving forces are stronger than restraining forces, otherwise such planned change may not be achieved.

Thus, the management of the organisation in the given scenario has the following options:

- Strengthening the driving forces of change: This however may not effectively enhance the planned change because the restraining forces will still remain and they may grow stronger.

- Reducing retraining forces of change: The management should thus identify these restraining forces and reduce them through.

- Holding meetings to discuss issues and difficulties that people may face, for instance, in the conversion from labour to mechanised method of production.

- Taking practical steps to allay the fears and misgiving of workers so as to eliminate the restraining forces.

(b) The Hofstede framework suggests six key dimensions of the influence of national culture on organisational culture. Thus, the management of Sonex Plc is advised as follows based on these dimensions:

i. Power–distance dimension: This represents how power is distributed within an entity. When power-distance dimension is low, inequalities in the distribution of power within the organisation is minimised. When power-distance dimension is high, inequalities in power are regarded as acceptable, and those without power look to those with power to make decisions for the organisation.

ii. Individualism vs Collectivism Dimension: In some countries, the interest of the group emanates from the concern for individuals, e.g., Indonesia. In some other countries, collective interests come before individual interests e.g. Canada and Australia.

iii. Uncertainty Avoidance: This describes the extent to which a group feels threatened and endangered by unexpected and unfamiliar happenings.

When a culture of uncertainty avoidance is high, work behaviour such as precision and punctuality are highly valued.

iv. Masculinity and Femininity: Some countries, such as Sweden and Norway are known to have strong cultural acceptance of feminine qualities, such as modesty, intuition and quality of life. Some other countries, such as Japan have a culture of acceptance of masculinity such as aggressiveness and competition.

v. Long-term Orientation vs Short-term Orientation: In many developing countries, there is greater focus on short-term goals and short-term results. In contrast, most developed countries have a culture of giving greater consideration to long-term goals.

vi. Indulgence vs Restraint: While some countries (e.g USA), allow relatively free gratification of basic and natural human desires related to enjoying life and having fun, others control gratification of needs and regulate it by means of strict social norms (e.g Russia).

EXAMINER'S REPORT

The question tests candidates' understanding of transformational change using Lewin's Force Field Analysis. It also tests their understanding of Hofstede's Framework in relation to corporate culture and national culture.

About 30% of candidates attempted the question and their performance was poor. The commonest pitfall of candidates was their inadequate understanding of both Lewin's Force Field Analysis and Hofstede's Framework.

Candidates are advised to pay close attention to the details of all the theories, frameworks and concepts discussed in ICAN Study Text.

MARKING GUIDE		MARKS	MARKS
a.	Identification of the two opposing forces of change	2	
	Discussion of any 2 of the components of the forces of change	2	
	Discussion of the steps involved in the management of change	4	8
b.	Explanation of Hofstede's Framework	2	
	Discussion of the 5 dimensions of the Framework at 1 mark each	5	7
	Total		15