FOREWORD

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

(i) Candidates preparing to write future examinations of the Institute of Chartered Accountants of Nigeria (ICAN);

(ii) Unsuccessful candidates in the identification of those areas in which they lost marks and need to improve their knowledge and presentation;

(iii) Lecturers and students interested in acquisition of knowledge in the relevant subjects contained herein; and

(iv) The profession; 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 altered slightly so that some principles or application of them may be more clearly demonstrated.

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

NOTES

Although these suggested solutions have been published under the Institute’s name, they do not represent the views of the Council of the Institute. The suggested solutions are entirely the responsibility of their authors and the Institute will not enter into any correspondence on them.
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PART 1 MULTIPLE CHOICE QUESTIONS (20 MARKS)

1. Which of the following is NOT true of the principle of Deontology?
   A. It is concerned with the application of absolute universal ethical principles.
   B. It lays down a standard by which actions may be judged in advance.
   C. It proposes that decision makers should freely pursue their own short-term desires or their long-term interests.
   D. It is found in the work of Immanuel Kant.
   E. The approach is based on the idea that facts themselves are natural. They are what is.

2. Threats to the independence of Accountants in Practice EXCLUDE
   A. self-interest.
   B. advocacy.
   C. familiarity.
   D. self-Review.
   E. advertising.

3. The Annual Financial Statements of a Quoted Company must be accompanied with
   i. External Auditors’ Report.
   iii. Internal Auditors’ Report.
   A. i only
   B. ii only
   C. iii only
   D. i and ii
   E. i, ii, and iii
According to IAS 24, Related Party Disclosures, which ONE of the following transactions need NOT be disclosed if it occurs between related parties?

A. Purchase or sale of goods
B. Purchase or sale of property and other assets,
C. Rendering of services
D. Transfer of research and development
E. Transactions which did not take place due to existence of related party relationships.

4. A Capital Reduction Scheme is allowed only on fulfillment of all BUT ONE of the following conditions:

A. It must be authorised by its Articles.
B. It must be by a special resolution passed at a General Meeting.
C. The resolution must specify the amount of reduction.
D. The resolution must be published in at least one national newspaper.
E. The capital reduction must be approved by the court.

5. A Company’s ability to meet its obligations as at when due will be shown by the

A. Income Statement.
B. Shareholders’ Fund.
C. Cashflow Statement.
D. Value Added Statement.
E. Five-Year Financial Summary.

6. Where a member of ICAN is found guilty of professional misconduct, he may face the following sanctions EXCEPT

A. terms of imprisonment awarded by the tribunal against the member.
B. Suspension from membership
C. imposition of fine.
D. reprimand.
E. Total expulsion from membership
7. Corporate governance concepts do NOT include
   A. risk management.
   B. fairness and accountability.
   C. independence of Board members.
   D. probity/honesty and transparency.
   E. independence of management.

8. In using Mendelow’s Metrix to analyse the interest and significance of stakeholders, the implications to the Company do NOT include the identification/establishment of
   A. legitimacy and urgency.
   B. key blockers and facilitators.
   C. stakeholders level of interest and power.
   D. future priorities.
   E. measure of performance and stakeholders’ expectation.

9. In line with the requirement of IAS 8 – Accounting Policies, Estimates and Errors - which of the following changes will NOT give rise to a change in accounting policy?
   A. Measurement
   B. Disclosure
   C. Presentation
   D. Recognition
   E. Depreciation

10. The Financial Director of your Company has just informed you that the Company is in the process of completing a sale or re-purchase agreement with a major customer and that the transaction amounts to ₦20 million. The customer is prepared to pay cash immediately and the Company is willing to repurchase the goods anytime within two years. The transaction should be treated as
    A. Sales/Revenue.
    B. Not certain or complex.
    C. Loan secured on the goods.
    D. Multiple Substance Transaction.
    E. Debt Factoring.
11. To comply with Nigerian and International Accounting Standards on incorporating the Financial Statements of a foreign entity into the accounts of the related Nigerian Multinational Company, which of the following methods should be used?

A. Opening Rate Method  
B. Monetary, Non-Monetary Method  
C. Fixed, Non-Fixed Rate Method  
D. Closing Rate Method  
E. Temporal Method

12. Which of the following will **NOT** lead to a significant self-review threat to independence, integrity and objectivity?

A. Lowballing  
B. Valuation services  
C. Preparation of accounting records and Financial Statements  
D. Contingent fees  
E. Shareholding in the business of an assurance client

13. In stakeholders’ theory, the best practice is that professionals must consider wider stakeholders. For an educational institution, the wider stakeholders are/is the

A. students.  
B. employees.  
C. society.  
D. lecturers and examiners.  
E. supervisory body.

14. In line with IASS 27 - Group and Separate Financial Statement (Revised) - a Parent Company should cease the consolidation of a subsidiary where the

A. activities of the parent and subsidiary are dissimilar.  
B. subsidiary is acquired or held for sale.  
C. parent Company has lost control over the Subsidiary.  
D. activities or operations of the subsidiary are immaterial.  
E. operations of the subsidiary can only be carried out at a loss.
15. The objective of IFRS 3 – Business Combinations - is to provide a framework on the concepts of the following EXCEPT

A. fair value of Purchase Consideration.
B. investment in Associates.
C. fair value of net asset acquired.
D. valuation of Non-controlling interest.
E. calculation of Goodwill.

16. Which of the following is NOT part of cash generated from investing activities?

A. Dividend paid to Non-Controlling Interest (NCI)
B. Lease rentals paid under finance lease
C. Purchase of Non-current assets
D. Disposal of property, plant and equipment
E. Investment income

17. The theory that says that an act is ethically justified if decision makers base their decisions on projected outcome is

A. Pluralism.
B. Deontologism.
C. Teleological Theory or Consequentialism.
D. Relativism.
E. Absolutism.

19. Corporate Social Responsibility in the 21st century has become prominent because of which combination of the following identifiable trends?

i. Changing social expectations
ii. Increasing affluence
iii. Globalisation
iv. Corporate scandals

A. ii and iii
B. ii and iv
C. i, ii, iii and iv
D. i and ii
E. i, iii and iv
20. A Professional Accountant who exhibits an analytic approach to social problems and fasting techniques that might help the organisation anticipate emerging social demand is said to be

A. morally responsive.
B. socially responsive.
C. ethically responsive.
D. legally responsive.
E. religiously responsive.

**PART II: SHORT - ANSWER QUESTIONS**

(20 MARKS)

1. Non-controlling interest is the proportion of the Net Assets of a Subsidiary acquired by ......................... Shareholders.

2. Within the context of Financial Reporting, what other word could be used to explain each of the following?

   i. True
   ii. Fair view

3. The benchmark standard of IAS 16 requires that Property, Plant and Equipment should be initially measured at ....................

4. Subsequent expenditure on Property, Plant and Equipment should be recognised if it will lead to improvement by way of .........................

**Use the following information to answer questions 5 and 6**

The impairment review team of your Company has provided you with the following information:

<table>
<thead>
<tr>
<th>Year</th>
<th>Impairment Loss/Gain</th>
<th>N'000</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008</td>
<td>Impairment loss on revalued asset</td>
<td>25,000</td>
</tr>
<tr>
<td>2009</td>
<td>Impairment gain on the same asset</td>
<td>5,000</td>
</tr>
<tr>
<td>2010</td>
<td>Impairment loss on the same asset</td>
<td>5,000</td>
</tr>
</tbody>
</table>

The 2010 impairment gain/loss to be recognised in the income statement and the related accounting entries are

5. Debit.......................................................... with N'
6. Credit.......................................................... with N’

7. In accordance with IAS 23 – Borrowing Cost - one of the conditions that must exist for a Borrowing Cost to be Capitalised is that the Borrowing Cost should be on direct cost in the ......................... of the asset.

8. The practice of entering a transaction before the year end and reversing the same transaction after the year-end, is known as ..........................

9. The component of Financial Statements used to measure liquidity position and financial adaptability is called ..........................

10. What is the amount of Goodwill to be disclosed in the Statement of Financial Position, based on the following information?

\[
\begin{array}{|l|c|}
\hline
\text{Fair value of Net Asset of Subsidiary} & 290 \\
\text{Fair value of cost of investment of parent} & 350 \\
\text{Fair value of Non-controlling interest} & 120 \\
\text{Impairment of Goodwill} & 35 \\
\hline
\end{array}
\]

11. The quality of being honest and having moral principles that you refuse to compromise is called ..........................

12. There is a case of conflict of interest when ...................................

13. The principle of .................................. maintains that information obtained during the course of professional work should not be disclosed without proper and specific authority unless there is a specific legal duty to do so.

14. The ethical approach that requires accountants to focus more on the objectives to be achieved than rigidly following rules is called the ..........................

15. The principle that requires accountants to base their opinions and decisions on real facts independent of personal beliefs or feelings, or those of other people is known as ..........................

16. Moving cash that is illegally acquired through financial systems so that it appears to be legally acquired is called ..........................
17. Being firm and unchanging in support of a person or organization or in your belief in certain principles is known as ……………………………..

18. Telling someone in authority about something illegal that is taking place within the organization for which you work is called ……………………..

19. A person appointed by the government to deal with complaints made against a Company or an individual that works in a specific industry is called an ………………………………..

20. The threat caused by a client exerting undue pressure on a Professional Accountant is …………………………………………..

SECTION B   ATTEMPT QUESTION ONE AND ANY OTHER THREE QUESTIONS (60 MARKS)

QUESTION 1 – CASE STUDY

Yakoyo Enterprises is a sole trading business owned by the Managing Director – Mr. Yakoyo. The Company specialised in the production and sale of a single product that was fast moving. The Company’s Rate of Return was two-thirds of the Capital Employed. Even though Mr. Yakoyo was successful in his business, he was constrained by lack of funds to meet his planned expansion. This encouraging performance stimulated the interest of Mr. Yakoyo’s friend – Mr. Maduka Benson. Mr. Maduka Benson approached his friend Yakoyo on possible formation of a partnership citing synergy for the pooling of resources together. Mr. Yakoyo quickly drew Mr. Maduka’s attention to the loss of control over his successful business as well as the profit which will now have to be shared with Mr. Maduka and therefore demanded payment for goodwill. Mr. Maduka consented but the goodwill was not brought into Yakoyo’s books.

On coming together, a partnership was formed with the name of YAKOMA LIMITED. The business was similarly successful beyond the financial capacity of Messrs Yakoyo and Maduka which made the Company go public eight years ago; under the name YAKOMACO PLC. The Articles of Association of the Company stipulated that members of the Company Management Team will spend a term of five years in the first instance and subject to satisfactory performance may be re-elected for another term of two years.
The last two years of the first term of the first Management Team witnessed poor performance due to the global economic meltdown. The Shareholders of YAKOMACO Plc. hardly allowed the first term tenure of the Management Team to expire before they were sacked and new hands were introduced.

The new Management resolved to pursue “aggressive earnings strategies”. With the prevailing global economic meltdown, the business operations of YAKOMACO continued to grapple with the economic realities in spite of the “aggressive earnings” policy of the new management, though the Company showed possible signs of recovery. Profits recorded in the first two years of operations of the new Management were not enough to fully write off the losses of the previous administration.

At the last AGM, the new Management secured the approval of the Shareholders to raise funds from the public. In order to make the prospective investors in YAKOMACO Plc. see what they ‘would like to see’ rather than what ‘they need to see’, the Finance Director of YAKOMACO Plc., Mallam Magida Steve, performed the following operations on the last reported Financial Statements of YAKOMACO Plc. (This gave a new outlook, a purportedly “rosy picture”, endearing, and a toast of all prospective investors who would want to invest in the “gold mine” seen in YAKOMACO Plc.)

OPERATIONS OF MALLAM MAGIDA STEVE ON THE FINANCIAL STATEMENTS OF YAKOMACO PLC.

1. Cash balance in the books of YAKOMACO Plc. included the sum of ₦10 million, being loans given by the Company to Directors.

2. The life span of a Non-current asset was increased thus lowering the amount of depreciation charged.

3. Receivables of more than 6 months were called in for payment at a high discount to rake in cash.

4. To increase its total net asset, intangibles were recognised and not amortised.

5. The ‘aggressive earnings’ management made credit deliveries of supplies to customers earlier than required.

6. Assets were revalued in 2009 which led to a Fixed Asset Revaluation Reserve against which the profit and loss deficit in the books were subsequently written off.

7. Based on the perceived capital reserve balance, the new management declared a dividend of 10k per share.
8. Cash proceeds from the aggressive earnings were invested in short-term securities.

The relevant extracts from the Financial Statements of YAKOMACO Plc. is shown below:

APPENDIX 1

YAKOMACO PLC.

THREE YEARS FINANCIAL SUMMARY

<table>
<thead>
<tr>
<th></th>
<th>2010</th>
<th>2009</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>N'000</td>
<td>N'000</td>
<td>N'000</td>
</tr>
<tr>
<td><strong>TURNOVER</strong></td>
<td>164,848</td>
<td>111,762</td>
<td>86,968</td>
</tr>
<tr>
<td>Operating Profit/(Loss)</td>
<td>5,091</td>
<td>4,114</td>
<td>(10,428)</td>
</tr>
<tr>
<td>Profit/(Loss) before taxation</td>
<td>5,091</td>
<td>4,114</td>
<td>(10,428)</td>
</tr>
<tr>
<td>Profit/(Loss) after tax</td>
<td>3,309</td>
<td>2,674</td>
<td>(10,428)</td>
</tr>
<tr>
<td>Declared Dividend</td>
<td>12,857</td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>

**EMPLOYMENT OF FUNDS**

<table>
<thead>
<tr>
<th></th>
<th>2010</th>
<th>2009</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fixed Assets</td>
<td>114,402</td>
<td>50,194</td>
<td>49,917</td>
</tr>
<tr>
<td>Investment</td>
<td>15,000</td>
<td>15,000</td>
<td>15,000</td>
</tr>
<tr>
<td>Long Term Debtors</td>
<td>39,516</td>
<td>122,449</td>
<td>131,000</td>
</tr>
<tr>
<td></td>
<td>108,918</td>
<td>187,643</td>
<td>195,917</td>
</tr>
</tbody>
</table>

**CURRENT ASSETS**

<table>
<thead>
<tr>
<th></th>
<th>2010</th>
<th>2009</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stock</td>
<td>10,132</td>
<td>8,141</td>
<td>6,741</td>
</tr>
<tr>
<td>Debtors (falling due within 1 year)</td>
<td>28,165</td>
<td>10,012</td>
<td>8,112</td>
</tr>
<tr>
<td>Cash and cash equivalents</td>
<td>60,111</td>
<td>12,100</td>
<td>9,010</td>
</tr>
<tr>
<td></td>
<td>98,408</td>
<td>30,253</td>
<td>23,863</td>
</tr>
</tbody>
</table>

**CURRENT LIABILITIES**

<table>
<thead>
<tr>
<th></th>
<th>2010</th>
<th>2009</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Creditors</td>
<td>(1,000)</td>
<td>(2,500)</td>
<td>(3,150)</td>
</tr>
<tr>
<td>Taxation</td>
<td>(1,782)</td>
<td>(1,440)</td>
<td>-</td>
</tr>
<tr>
<td><strong>NET CURRENT ASSETS</strong></td>
<td>26,313</td>
<td>20,713</td>
<td></td>
</tr>
<tr>
<td></td>
<td>95,626</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**SHAREHOLDERS’ FUND FINANCED BY**

<table>
<thead>
<tr>
<th></th>
<th>2010</th>
<th>2009</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share capital (128,573 ord. Shares of N2 each)</td>
<td>257,146</td>
<td>257,146</td>
<td>257,146</td>
</tr>
<tr>
<td>Fixed assets revaluation reserve</td>
<td>5,348</td>
<td>5,348</td>
<td>-</td>
</tr>
<tr>
<td>Profit &amp; Loss A/c</td>
<td>2,050</td>
<td>(48538)</td>
<td>(40,516)</td>
</tr>
<tr>
<td><strong>TOTAL SHAREHOLDERS’ FUND FINANCED BY</strong></td>
<td>N'264,544</td>
<td>N'213,956</td>
<td>N'216,630</td>
</tr>
</tbody>
</table>
Required:

(a) Discuss the accounting treatments you will give to the aggressive earnings policy issues highlighted above in order to revert YAKOMACO Plc.’s Financial Statements to show a true and fair position. (7 marks)

(b) (i) Identify and explain any TWO of the ethical issues in this case.

(ii) State TWO of the likely ethical issues that should be considered in pursuing an aggressive earnings strategy.

(iii) State at what point the aggressive earnings strategy of YAKOMACO Plc. became unethical?

(iv) Apply at least ONE basic ethical theory to the ethical issues identified in (b)(i) above. (8 marks)

(Total 15 marks)

QUESTION 2

On 1 May 2009, David Limited acquired investments as follows:
- 80% equity interest in Daniel Limited at a cost of ₦40.8 million
- 50% of Daniel Limited 8% Loan Notes at par
- 4.8 million equity shares in Rosemary Limited at a cost of ₦6.25 per share

The following information was also provided:

i. **Equity & liabilities**

<table>
<thead>
<tr>
<th></th>
<th>David Ltd.</th>
<th>Daniel Ltd.</th>
<th>Rosemary Ltd.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity share at ₦1 each</td>
<td>30,000</td>
<td>9,000</td>
<td>12,000</td>
</tr>
<tr>
<td>Retained Earnings</td>
<td>111,000</td>
<td>24,000</td>
<td>60,000</td>
</tr>
<tr>
<td>8% loan notes</td>
<td>12,000</td>
<td>6,000</td>
<td>-</td>
</tr>
</tbody>
</table>

ii. Daniel Limited Land had a fair value of ₦1.2 million in excess of its carrying value. Its plant had a fair value of ₦4.8 million in excess of its carrying value at the date of acquisition. The pre-acquisition profit amounted to ₦21 million.

Required:

(a) Discuss how the investment purchased by David Ltd. on 1 May 2009 will be treated in its Consolidated Financial Statement. (9 marks)

(b) Calculate the net Goodwill that should be recognised in the Group’s Balance Sheet, assuming that Goodwill is impaired by ₦1.2 million. (6 marks)

(Total 15 marks)
QUESTION 3

(a) Discuss TWO things which ethics is NOT in an organisation. (5 marks)
(b) How can a Board effectively reduce ethical problems in an organisation? (5 marks)
(c) State and explain TWO points that describe the role of Non-executive Directors in an organisation. (5 marks)

(Total 15 marks)

QUESTION 4

International Financial Reporting Standards (IFRS) are unnecessary impositions on developing countries with preponderance of small and medium entities (SME). Some IFRS are unnecessarily demanding and might be difficult for these SMEs to meet. Some of the information produced by adopting IFRS are not necessary for users of SME Financial Statements.

You are required to discuss the following:

a. The need to develop a set of IFRS specifically for SMEs. (5 marks)
b. The need for the modification of existing IFRS to meet the needs of SMEs. (5 marks)
c. How items not dealt with by an IFRS for SMEs should be treated. (5 marks)

(Total 15 Marks)

QUESTION 5

(a) Explain the framework of ethical decision making as presented by Markulla Center for Applied Ethics. (10 marks)
(b) What practical implications can you draw from Question 5(a) above for a Chartered Accountant? (5 marks)

(Total 15 marks)

QUESTION 6

Financial Statements of reporting entities have seen an increasing move towards the use of fair value accounting. The belief is that fair value is the most relevant measure for Financial Reporting as against the use of the Conventional Historical Cost.

Issues have been raised over the reliability and measurement of fair values and over the nature of the current level of disclosure in Financial Statements in this area.
Required:

a. Explain **THREE** problems associated with the reliability and measurement of fair values. (6 marks)

b. Discuss the view that fair value is a more relevant measure to use in Financial Reporting than Historical Cost. (6 marks)

c. Identify three strengths of the Conventional Historical Cost. (3 marks)

(Total 15 marks)

**SOLUTIONS TO SECTION A**

**PART I - MULTIPLE CHOICE QUESTIONS**

1. C

2. E

3. D

4. E

5. D

6. C

7. A

8. E

9. D

10. A

11. C

12. D

13. D
14. C
15. C
16. B
17. B
18. C
19. E
20. B

EXAMINER’S REPORT

The questions cut across virtually all the topics listed in the syllabus. All the candidates attempted the questions, and their performance was clearly above average. However, candidates are encouraged to pay more attention to the Ethics component of the course.

PART II – SHORT-ANSWER QUESTIONS

1. Minority
2. (i) Factual or Accurate
   (ii) Objective or Unbiased or Not misleading
3. Cost
4. Any of the following:
   - Faster production
   - Higher quality output
   - Better or enhanced performance
   - Upgrade
5. Dr. Revaluation Reserve with ₦5,000,000
6. Cr. Asset Account with ₦5,000,000
7. Acquisition or Construction or Manufacturing
8. Window dressing
9. Statement of Cash Flow or Cash Flow Statement
10. ₦145m
11. Integrity
12. The agent interest is in conflict with the principal’s interest; or
    Business or Personal interests intervene to prevent giving an objective opinion
13. Confidentiality
14. Conceptual framework approach or Principle based approach
15. Objectivity
16. Money Laundering
17. Loyalty or Commitment
18. Whistle blowing
19. Ombudsman
20. Intimidation.

TUTORIAL

QUESTION 10.

Calculation of Goodwill:

<table>
<thead>
<tr>
<th>Description</th>
<th>₦’m</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fair value of consideration transferred by payment</td>
<td>350</td>
</tr>
<tr>
<td>Fair value of consideration paid by NCI</td>
<td>120</td>
</tr>
<tr>
<td>Total consideration paid</td>
<td>470</td>
</tr>
<tr>
<td>Fair value of Net Assets Acquired</td>
<td>(290)</td>
</tr>
</tbody>
</table>
<pre><code>                             | 180   |
</code></pre>
<p>| Impairment                                           | (35)  |
| Goodwill attributable to parent &amp; NCI                | 145   |</p>
EXAMINER’S REPORT

The questions covered most of the topics in the syllabus. All the candidates attempted all the questions and their performance was generally good. It is observed that candidates performed better in the Financial Reporting component of the course than in the Ethics component. Therefore, there is the need for them to assign more time to the study of the Ethics aspect of the course.

SECTION B

SOLUTION TO QUESTION 1

CASE STUDY

(a)

i. The ₦10 million cash (loan to the Directors) included in the cash balance in the books of YAKOMACO should be re-classified as other debtors (short or long-term) depending on the time that the Directors are expected to pay back.

ii. Since the initial and the elongated life span of the assets were not given, the Directors can only be encouraged to continue with the application of this rate consistently for years to come until there are justifiable grounds for a review.

iii. Nothing can be done about this as the Company cannot recover any part of the discount allowed. However, if the discount has not been written off in the Profit and Loss account, this should be done. This would have the effect of reducing the profit.

iv. Intangibles should not be recognised but should be amortised to the income statement to reflect the true profit.

v. The income due on supplies deliverable in future had been earned and recognised in the Financial Statements of earlier year. It has to be noted that the customers have taken delivery therefore the title has passed. The income will be deemed to have been earned.

vi. It is a bad accounting practice to write off the profit and loss deficit in the revaluation reserve because revaluation reserves are unrealised gain/profit. Furthermore, since the revaluation done was intended to create a rosy picture of
the Financial Statements, the original entries in the book have to be reversed by:

- Debiting Capital Reserve, and
- Crediting the Asset account with the revaluation surplus;
- Debiting Profit and Loss account, and
- Crediting Revaluation Reserve Account with the Profit and Loss account deficit earlier written off;

One other entry required is to Debit Profit & Loss account and Credit Asset account with the increase in depreciation arising on revaluation.

vii. Capital Reserve balance is not a distributable profit. Dividend can only be declared from distributable profits of the entity. Every accounting entry relating to the dividend declaration should be reversed accordingly.

viii. No accounting entries required as these have been brought into the books earlier.

b(i) The ethical issues in the case include:

- **Deception, Fraud or Lying**
  - **Deception:** There is element of deception in the Financial Statement of Yakomaco Plc., in that it does not give a true and fair view of the state of affairs of the organization to the investors
  - **Fraud:** This element of deception is fraudulent because investors will be unduly lured to invest in the Company.
  - **Lying:** The false and manipulated Financial Statements were deliberate. It is not as a result of professional incompetence but a deliberate falsification of the state of affairs. This is lying.

- **Freedom, choice and autonomy:** The deceived investors at this stage will not enter into the agreement with a choice. Such a procedure erodes the deceived party of his or her freedom. The investors were deceived to believe that they have made a choice whereas there was no choice in the first case. Such an act is exploitative and manipulative and does not
indicate that what both parties have entered into is based on informed consent.

- **Violation of fundamental principles of professional ethics such as objectivity, integrity and professional behavior:**
  
  - **Objectivity:** As a Professional Accountant, there is a need to remain objective and ensure that decisions are based on real facts and should not be influenced by personal beliefs and feelings. The Financial Statements of Yakomaco Plc. are not based on real facts.

  - **Integrity:** A Professional Accountant must be honest and straightforward in performing professional duties. Lying and deception are not in line with this.

  - **Professional Behaviour:** Professionals must always ensure that they do not bring the profession into disrepute by acting in a way which is unprofessional or do not comply with relevant laws and regulations. The deception, lying or fraud violates this and Yakomaco Plc. did not follow relevant laws and regulations in pursuing its Aggressive Earnings Strategy.

(ii) The likely ethical issues to be considered in pursuing Aggressive Earnings Strategy are:

- **Stakeholders Wellbeing/well-off:** Are the current and prospective stakeholders’ interest reported clearly and accurately, or as the related economic reality warrants?

- **Fairness:** Are the interests of the stakeholders unfairly disadvantaged with benefit being transferred to another stakeholder group?

- **Right:** Are the rights of stakeholders observed and protected, including adherence to:

  - Securities, commissions guidelines for full, true and plain disclosures and specific disclosures?
Generally Acceptable Accounting Principles (GAAP)?

**Virtue expectation:** Are issues such as rights, motivation, virtuous acts, character traits which are virtuous at play? It is expected that all these character traits should be displayed.

(iii) Yakomaco Plc. became unethical in its Aggressive Earnings Strategy when it provided false Financial Statements that are misleading to investors or other users of the Financial Statements of Yakomaco Plc. in their decision making.

(iv) Basic ethical theories

- **Virtue ethics:** Unlike other ethical theories that evaluate every single action based on its outcomes, or its underlying principles, virtue ethics looks at the character of the decision maker. The primary objective is not the abstract knowledge of good but to become a good person or develop a good moral character. In other words, morally good actions are those undertaken by actors with virtuous character. Therefore the formation of virtuous character is the first step towards a morally correct behavior.

Deception, fraud or lying as displayed in our case study clearly conflicts with the nature of a virtuous person or virtuous decision marker as described by Aristotle in virtue ethics. For Professional Accountants to overcome the tendency to engage in these vices and develop a virtuous character, it is imperative that they undergo continuous moral education and training that are necessary for the development of a virtuous character.

- **Kantian Ethics/Dentologism:** Immanuel Kant in his ethics, holds that morality and the question of rightness and wrongness of actions were not dependent on a particular situation or on the consequences of the action. Rather, morality was simply a question of certain eternal, abstract and unchangeable principles that humans should apply to all ethical problems. To be morally good, one must consciously adhere to rules previously calculated by “reason” to be right or just, and the incentive for observing those rules must be for duty sake.

Kant’s categorical imperative is an example of the eternal, abstract and unchangeable principle that, according to him, humans should apply to all ethical problems. The second formulation of Kant’s categorical imperative states that you treat humanity either in your own person or the person of another
always as an end in itself and never as a means only. Going by the act of deception, fraud and lying displayed in our Case Study, the prescription or requirement of the second formulation of Kant’s categorical imperative has been negated as prospective investors and the general public will perpetually be treated as a means only.

- **Utilitarianism**: Otherwise known as the ‘greatest happiness principle’, is an ethical theory that holds that an action is right if it produces, or tends to produce the greatest amount of good for the greatest number of people affected by the action.

- **Ethical egoism**: Ethical egoism expresses the view that human conducts should be based exclusively on self-interest. An action is good if it therefore maximizes the personal good.

The situation above is indicative of the unjustifiable exploitation of state-holders which infringe upon their autonomy and their right to informed and free choice. From another perspective, deception and lying hinder investors from making objective assessment of the actual status of the organization in which they want to invest in.

**EXAMINER’S REPORT**

The question is a case study meant to test some ethical issues in financial reporting. Specifically, candidates are expected to

(a) state required reversals of the creative accounting treatments adopted in an environment of Aggressive Earnings Policy meant to deceive potential investors.

(b) identify ethical issues arising from the deliberate falsification of Financial Statements.

(c) specify an ethical theory relating to the ethical issues identified above.

Over 80% of the candidates attempted the question but performance was very poor. Candidates’ challenges include their

- inability to identify reversal accounting entries to show a true and fair position.
inadequate understanding of the financial reporting and ethical issues thrown up by the case study.

Candidates are advised to increase the scope and depth of their studies and practise appropriate tutorial questions on the various aspects of the syllabus.

QUESTION 2

(a)

(i) The eighty percent equity interest purchased in Daniel Ltd. by David Ltd on 1 May 2009 will be treated in the Consolidated Financial Statements using acquisition method. By this, Goodwill is calculated by comparing the fair value of the consideration with the proportion of the fair value of the Net Assets of Daniel’s Ltd. acquired by David Ltd.

Control is the ability to direct the operating and financial policies of an entity. This means that Daniel Ltd. is a Subsidiary of David Ltd. and David Ltd. is required to prepare Group Financial Statements and consolidate the results of Daniel Ltd. from the date of acquisition in accordance with IAS/SAS 27.

(ii) The investment of 50% in Daniel’s Loan Notes is a loan from David Ltd. Thus, the Loan Notes acquired will be treated using acquisition method and should be cancelled out to leave a net liability of N3m in the Consolidated Financial Statements.

(iii) 4.8 million equity shares of Rosemary Ltd. acquired by David Ltd represented 40% equity interest. This does not give David Ltd control over Rosemary Ltd, but is most likely to give it significant influence over Rosemary Ltd’s policy decisions. Therefore, Rosemary Ltd is an Associate of David Ltd and IAS/SAS 28 – Investment in an Associate requires that such investment should be accounted for using the equity method.

(b) Calculation of Goodwill in Daniel Ltd:

<table>
<thead>
<tr>
<th>Description</th>
<th>N’000</th>
<th>N’000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fair value of consideration transferred by David Ltd.</td>
<td>40,800</td>
<td></td>
</tr>
<tr>
<td>Fair value of Net Asset acquired:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Equity shares (9000x0.8xN1)</td>
<td>7,200</td>
<td></td>
</tr>
<tr>
<td>- Pre-acquisition profit (21,000 x 0.8)</td>
<td>16,800</td>
<td></td>
</tr>
<tr>
<td>- Fair value adjustment (4,800 + 1,200)x 0.8</td>
<td>4,800</td>
<td></td>
</tr>
<tr>
<td>(28,800)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
EXAMINER'S REPORT

The question examines the candidates on the application of the provisions of IAS/SAS 27 and 28 on Consolidated and Separate Financial Statements and Investment in Associates respectively.

Candidates were expected to apply appropriate provisions on the methods of consolidation, control of entities and computation of Goodwill.

Less than 40% of the candidates attempted the question and performance was generally poor.

Commonest pitfalls were incorrect identification of consolidation terminologies and inability to compute Goodwill.

Candidates should ensure adequate understanding of the various IAS/SAS for improved performance in future examination.

QUESTION 3

(a)

i. Ethics is NOT the same as feelings

To some people, ethics is not grounded on reason but on how we feel about an issue. This is because we always have strong feelings about ethical issues. On the other hand, it seems that we are all naturally drawn to try to convince others of our ethical standpoints through arguments. Ethics, therefore, does not thrive on feelings or emotions alone.

Feelings, however, have an important place in ethical thinking to the extent that the fact that we care about others provides an important clue to our ethical choices. This actually helps in making sense of any ethical reason. So, emotions certainly can inform our ethical judgments and can motivate us to act out of a deep concern for others, but they cannot be all there is to ethical judgment.

The main point here is that good ethical judgments are considered as judgments, rather than unexamined biases or emotional intuitions. It is important to feel strongly about our ethical convictions, but feelings alone are
not enough – we must think carefully about our ethical judgments in order to ensure that they are justified and consistent.

ii. **Ethics is not merely a religion**

Though most religions present ethical standards, not everyone is religious, yet ethics applies to everyone. Most religions do advocate high standards but sometimes do not address all the types of problems we face. Unlike religion, ethics appeals to reasons rather than authority, to justify its principles.

iii. **Ethics is not merely being legal**

A good system of law does incorporate ethical standards, but laws can deviate from what is ethical. The two domains are therefore different. Laws can be totally unethical especially in a totalitarian regime. Law can be an instrument of suppression, oppression and exploitation, designed to serve the interest of the few. For example the South African laws which until 1994 enforced a cruel racial apartheid regime in that country. On the other hand, there are things we should (ethically speaking) do, for example, give to Charities, even though they are not legally required.

iv. **Ethics is not merely adhering to culturally accepted norms**

While some cultures are quite ethical, others are corrupt or blind to certain ethical concerns. It is not a satisfactory ethical standard to say “When in Rome, do as the Romans” though it is advisable to be sensitive to cultural norms when entering another environment.

v. **Ethics is not science**

Though social and natural science can provide important information to help us make better ethical choices; Science alone does not tell us what we ought to do. It may provide information for what humans are like. But ethics provides reasons for how humans ought to act. And just because something is scientifically or technologically possible does not make it ethical.
Ethics is not the same as values

Values imply the conscious prioritizing of different behavioral alternatives or standard that are perceived possible, worthwhile or esteemed for the individual, an institution or nation. Value often time, is more personal that factual. Ethics studies and evaluate values.

Ethics is not the same as morality

Morality refers to the beliefs and practices about good and evil by means of which we guide our behavior. Morality refers to principles or standards of human conduct. For some people, ethics is a code of conduct and yet for others, it is a form of etiquette or set of rules guiding human beings in their private and public life.

Technically, ethics is not morality. Ethics is the study of morality.

Question 3b

i. Leadership modeling: this entails leading an organization by example through ethical behavior. Walking the talk, not merely talking the talk.

ii. The Board should meet regularly to evaluate the ethical climate of the organization, make, implement and continuously evaluate policies relating to the ethical behavior of employees within the organization.

iii. The Board should effectively communicate the code of ethics and code of conduct of the organization to all employees.

iv. The Board can effectively reduce ethical problems in an organization by ensuring continuous ethics training and retraining of employees.

v. The employees should be motivated to behave ethically through provision of incentives to those that have displayed high level of ethical behavior; and setting up of disciplinary committee to investigate and punish unethical behaviors.

vi. Directors should have an agreed procedure/access to independent professional advice in areas where such assistance will improve the quality of their contribution to the overall decision making process.
Question 3c

i. Non-executive Directors should bring independent judgment to bear on issues such as integrity, performance, resource management and ethical standard.

ii. Strategic role: this recognizes that Non-executive Directors have the right and responsibility to contribute to strategic success, challenging strategy and offering advice on direction.

iii. Risk-management role: Non-executive Directors should ensure that Company has adequate internal control and systems of risk management in place.

iv. Scrutinizing role: Non-executive Directors are required to hold Executive Directors to account for decisions taken and results obtained.

v. The Non-executive Directors oversee a range of responsibilities with regard to remuneration and promotion of executives.

vi. Non-executive Directors’ skills should reflect on the range of the competency needs of the Company

EXAMINER’S REPORT

The question tests candidates’ understanding of:

- the nature and role of ethics within the context of a corporate organisation as distinct from its nature and role in society at large.

- the essential ways the Board of a corporate entity can effectively reduce ethical problems and also enhance a high ethical standard within an organisation.

- how Non-executive Directors can contribute to the total well being of a corporate organisation.

In discussing the nature and role of ethics in a corporate organisation, candidates were expected to carefully delineate ethics from other notions, such as religion, morality, law and science that tend to be confused with it. With regards to the Board, candidates were required to specify and explain briefly five specific ways Board members could check ethical problems and enhance the wellbeing of an organisation and that of its stakeholders. They were also expected to briefly discuss two cogent roles of Non-executive Directors in an organisation.

With respect to the level of understanding of the question, there are justifiable reasons to conclude that while many candidates understood what the question
requires of them, only a few of them were able to provide comprehensive answers. The question is sufficiently clear, and its demands, ordinarily, should have been easy for candidates to meet.

A major pitfall of candidates’ is that those who seemed to have an insight into the correct answers merely listed the relevant points without being able to explain the points adequately. A second pitfall, which is common to virtually all candidates, is that they were not able to adequately express themselves in English. This, unfortunately, impaired their ability to convey whatever ideas or understanding they had in their efforts to respond to the question.

Given the performance of candidates, it is obvious that there is still a need for them to be well tutored in the basic concepts and principles of ethics, with emphasis on how these are relevant within the context of the accounting profession. Be that as it may, it is noted that the frequency of candidates’ attempt to the question was above 80%.

QUESTION 4

(a)

i. IFRS, were not designed specifically for a class of companies – quoted or unquoted. IFRSs gives Financial Statements enhanced reliability, relevance and credibility and result in fair presentation.

ii. SMEs’ would wish to comply with IFRSs for consistency and easy comparability with similar SMEs’ both within their own country and internationally.

iii. The objectives of general purpose Financial Statements are basically appropriate for SMEs and bigger publicly quoted companies alike. Given this, one set of IFRS that would be used nationally and internationally is desirable.

iv. The cost burden of applying the full set of IFRSs may not be justified on the basis of user needs. The purpose and usage of the Financial Statements, and the nature of the accounting expertise available to the SMEs, will not be the same as for listed companies. These may provide justification for a separate set of IFRS for SMEs.

v. Where attention is devoted to adopt local Generally Accepted Accounting Principle (GAAP) for SMEs on a national basis and IFRSs for listed companies, this practice of adopting GAAP for SMEs may differ between
countries when applied by such SMEs thus making comparability of Financial Statements difficult across national boundaries.

(b)  
   i. Most SMEs have a narrower range of users than publicly quoted companies. Users of SMEs Financial Statements are basically owners, lenders and suppliers of the merchandize and tax authorities.  
   ii. In deciding the form of modification to be made to IFRSs, the needs of these users must be taken into consideration. Also the financial burden imposed by the compliance with IFRSs by these SMEs must be identified.  
   iii. There will have to be a relaxation of some of the measurement and recognition criteria in IFRSs in order to achieve the reduction in the costs and burden of implementation.  
   iv. Some disclosures, such as Earnings Per Share, segment reporting, etc, may not be relevant to SMEs and therefore may not be needed.  
   v. A review of these disclosures requirements in IFRSs will be required to assess their appropriateness for SMEs.

(c)  
   IFRSs for SMEs would not necessarily deal with all the recognition and measurement issues facing an entity but the key issues should revolve around the nature of the recognition, measurement and disclosure of the transactions of SMEs. In the case where the item is not dealt with by the standards, there are three alternatives:
   
   i. the entity can look to the full IFRSs to resolve the issue.  
   ii. management judgement can be used with reference to the framework and consistency with other IFRSs for SMEs.  
   iii. existing practice could be used.

EXAMINER’S REPORT

The question tests candidates’ understanding of the need to develop a set of International Financial Reporting Standards (IFRSs) specifically for Small and Medium Entities (SMEs) in the context of developing economies. Parts b and c of the question request candidates to discuss the need for modification of existing IFRSs to meet the needs of SMEs and how items not dealt with by an IFRSs for SMEs should be treated respectively.
Most of the candidates demonstrated inadequate understanding of the requirements of the question. Consequently, their performance was below average. Candidates displayed inadequate knowledge of IFRSs viz-a-viz operation of SMEs.

IFRS is now the global phenomenon in Financial Reporting, hence, candidates at the final level of ICAN examinations are expected to update themselves on the principles and application of all IFRSs issued to date by IFAC, if they are to improve on their performance.

QUESTION 5

(a) **FRAMEWORK FOR ETHICAL DECISION MAKING**

(i) **Recognize an Ethical Issue**

- Is there something wrong personally, interpersonally, or socially? Could the conflict, be it a situation or a decision, be damaging to people or to the community?
- Does the issue go beyond legal or institutional concerns? What does it do to people, who have dignity, rights and hopes for a better life together?

(ii) **Get the Facts**

- What are the relevant facts of the case? What facts are unknown?
- Do individuals and groups have an important stake in the outcome? Do some individuals or groups have a greater stake because they have a special need or because we have special obligations to them?
- What are the options for acting? Have all the relevant persons and groups been consulted? If you showed your list of options to someone you respect, as better experienced, what would that person say?

(iii) **Evaluate Alternative Actions from Various Ethical perspectives**

Which option will produce the best and do the least harm?

- **Utilitarian Approach:** The ethical action is the one that will produce the greatest balance of benefits over harms.
- **Right Approach:** Even if not everyone gets all he/she wants, will everyone’s rights and dignity still be respected? The ethical action is the one that most dutifully respects the rights of all affected.

- **Fairness or Justice Approach:** Which option is fair to all stakeholders? The ethical action is the one that treats people equally, fairly and justly.

- **Common Good Approach:** Which option would help all to participate more fully in the life we share as a family, community or society? The ethical action is the one that contributes most to the achievement of a qualitative common life.

- **Virtue ethics:** Would you want to become the sort of person who acts this way (e.g., a person of courage or compassion)? The ethical action is the one that embodies the habits and values of humans at their best.

(iv) **Make a Decision and Test it:**

- Considering all the perspectives listed under (iii) above, which of the options is the right or best thing to do?

- If you were to tell someone you respect as more knowledgeable and experienced why you chose this option, what would that person say? If you had to explain your decision in public, would you be comfortable doing so?

(v) **Act, and then Reflect on the Decision Later:** Implement your decision and reflect on how it turned out for all concerned? If you had to do it over again, what would you do differently?

(b) The practical implications that can be drawn from the above for a Chartered Accountant is that when the Accountant is faced with ethical problems, the framework for ethical decision making should be applied in resolving them. However, there are difficult ethical problems that cannot be easily resolved through a rigid application of an ethical decision-making framework. Hence, in the case of novel and difficult ethical problems accountants may need to rely on discussion and dialogue with other professional colleagues about the dilemma. A careful exploration of the problem, aided by the insight and different perspectives of other more experienced professional colleagues can facilitate good ethical choices in cases of difficult ethical problems.
EXAMINER’S REPORT

The primary objective of the question is dual: First is to test candidates’ understanding of the framework for ethical decision making presented by Markulla Centre for Applied Ethics. Second is to test candidates’ capacity to apply this framework to the kind of ethical problems that could arise for a Chartered Accountant.

The A section of the question requires candidates to highlight and also explain the five major points identified in the framework in question. The B section expects candidates to apply the framework to resolve a typical ethical problem in the accounting profession in a way that would underscore the practical implications of the framework.

Most candidates understood the question, especially its part A. However, part B appears quite problematic for many candidates as they were unable to bring out the practical implications of the framework for Chartered Accountants.

The major pitfall of candidates, apart from their general inadequate mastery of the written expression of English Language, is their inability to relate the framework to practise in the accounting profession.

On the basis of the above, it is clear that there is a need for candidates to be trained in the art of applying basic concepts, theories and principles of ethics to real life situation within the context of the accounting profession.

Generally, candidates’ performance was above average.

The frequency of candidates’ attempt at this question is rated at about 50%.

QUESTION 6

(a) i. Existence of multiple markets hampers the measurement of fair value.
    ii. Different approaches exist in estimating fair value prices. e.g. valuation techniques and current replacement cost could be used.
    iii. IFRSSs do not have a single hierarchy that applies to all fair value measures.
Individual standards merely indicate preferences for certain inputs and measures of fair value over others. This guidance is not consistent among all IFRSs.

iv. Individual businesses in determining fair values for their assets, developed models that would effectively manage their individual risks. Risks differ between organisations hence fair value determination becomes more complex.

v. Management can use significant judgement in the valuation process. This approach may result in inappropriate fair value measurements.

vi. Independent verification of fair value estimates is difficult for all the above reasons.

(b)

i. The main disagreement over a shift to fair value measurement is the issue of relevance and reliability. The argument is that historical cost-based Financial Statements are not relevant because they lack current exchange value contents for the entity’s assets. Advocates of historical cost argued that fair values may be unreliable because it may not be based on ‘arm’s length’ transactions.

ii. Fair value accounting claimed its measurement is more relevant to decision makers or investors even if it is less reliable and would produce statements of financial position that are more representative of a Company’s value. On the other hand, it can be argued that relevant information that is unreliable is of no use to an investor.

iii. Fair value can be said to be more relevant than historical cost because it is based on current market values rather than a value that is, in some cases, many years out of date. Fair values for an entity’s assets, it is argued, will be given a closer approximation to the value of the entity as a whole, and are more useful to a decision maker or an investor.

iv. Historical cost accounting traditionally matches cost and revenue. The objective has been to match the cost of the asset with the revenue it earns over its useful life. This has a number of disadvantages.
v. Holding gains on inventory are included in profit. During a period of high inflation, the monetary value of inventories held may increase significantly while they are being processed. The conventions of historical cost accounting lead to the realised part of this holding gain being included in profit for the year.

vi. Under historical cost accounting, comparisons over time are unrealistic, because they do not take account of inflation.

vii. Cost incurred before an asset is recognised is not capitalised. This is particularly true of development expenditure, and it means that the historical cost does not represent the fair value of the consideration given to create the asset.

(c) The strengths of the conventional historical cost are as follows:

i. An advantage of historical cost statement of financial position figures comprises actual prices, not estimates; therefore the figures are not subject to manipulation by management.

ii. It is consistent with the fundamental accounting concepts.

iii. It is fairly objective or neutral in its measurement, because it is based on historical transactions.

iv. It enables Shareholders, perhaps through auditors to assess the success of management in their role of stewardship of the Company’s affairs.

v. It is a comparatively cheaper system to operate.

vi. It has stood the test of the time because it is practical.

vii. It is easy to identify cost data.

viii. Historical cost and revenue lend themselves easily to double entry bookkeeping.

ix. It avoids subjective revaluation of assets.

x. It is relatively easy to verify and audit recorded data.
EXAMINER’S REPORT

The question tests candidates’ understanding of the principles of fair values accounting as well as their ability to explain problems associated with the reliability and measurement of fair-values. Candidates were also required to identify the strengths of historical cost.

Most of the candidates attempted the question but majority demonstrated inadequate understanding of the question, resulting in below average performance.

Candidates are advised to familiarize themselves with the International Financial Reporting Standard No 3 (IFRS 3) that deals extensively with the principles and application of fair value accounting, since historical cost accounting will soon go into oblivion with full implementation of IFRS in Financial Reporting.
SECTION A: Attempt All Questions

PART 1: MULTIPLE CHOICE QUESTIONS (20 Marks)

1. Which of the following terms is used for the process of planning or carrying out a plan in a skilful manner?

A. Strategic Management
B. Strategic Financial Management
C. Business Policy
D. Strategy
E. Business Plan.

2. The following factors usually shape the strategies to be adopted by organizations EXCEPT

A. opportunities and threats identified in the environment.
B. organizational competence and resource capabilities.
C. social obligations.
D. organisational culture and value system.
E. protection of top management’s interests.

3. Ade saved ₦10,000 in a fixed deposit account for 5 years at a compounded interest rate of 12% p.a. What will be the worth of the deposit at the end of the fifth year?

A. ₦11,200.00
B. ₦16,000.00
C. ₦17,623.41
D. ₦17,623.42
E. ₦16,732.42.
Use the following information to answer questions 4 and 5.

Details about three possible projects for a ₦100 million budget are as follows:

<table>
<thead>
<tr>
<th>Project</th>
<th>Initial Investment (₦’million)</th>
<th>NPV (₦’million)</th>
<th>Profitability Index</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>100</td>
<td>110</td>
<td>1.1</td>
</tr>
<tr>
<td>B</td>
<td>50</td>
<td>70</td>
<td>1.4</td>
</tr>
<tr>
<td>C</td>
<td>50</td>
<td>60</td>
<td>1.2</td>
</tr>
</tbody>
</table>

4. Which project(s) should be selected?
   A. Project A only
   B. Projects A and B
   C. Projects B and C
   D. Projects A and C
   E. Project B only.

5. What is the NPV of the project(s) selected?
   A. ₦130 million
   B. ₦180 million
   C. ₦110 million
   D. ₦170 million
   E. ₦70 million.

6. Which of the following is NOT a characteristic of short-term funds?
   A. They provide liquidity for companies
   B. They enhance profitability of companies
   C. They possess little or no risk for the lenders
   D. They provide relatively cheap means of finance
   E. They may be collateralized with short-term assets
7. From a company’s point of view, which of the following is **NOT** a disadvantage of debt financing?

A. A rise in the company’s cost of equity capital due to increase in financial leverage
B. Increase in the company’s financial risk
C. A rise in the real cost of debt if rate of inflation is unexpectedly low
D. Tax deductibility on interest payments
E. Restrictive covenants hamper financial and operating flexibility

8. KayCee Plc has on issue 15% N7m preference shares of N1 each. Given that the required rate of return is 20%, determine the value of each preference share.

A. N1.33 per share
B. N1.00 per share
C. N5.25 per share
D. N0.03 per share
E. N0.75 per share.

9. The method of offering shares to the public, requiring prospective buyers to give the price they are willing to pay is known as

A. stock exchange introduction.
B. offer for sale.
C. offer by tender.
D. rights offer.
E. offer for subscription.

**Use the following information to answer questions 10 and 11.**

Grace Plc made a 1 for 4 rights issue to its existing shareholders. Given that the theoretical ex-rights price is N15 and the value of the right is N2.

10. What is the price per old share?

A. N13.00
B. N15.50
11. What is the issue price of the rights?

A. ₦13.00
B. ₦15.00
C. ₦17.00
D. ₦15.50
E. ₦14.40.

12. Efficient working capital management ensures a balance between

A. Liquidity and stability.
B. Liquidity and solvency.
C. Liquidity and continuity.
D. Liquidity and profitability.
E. Gross and net working capital.

13. The formula for computing optimum cash balance under certainty is

A. Lower limit + \( \frac{4}{3} (z) \).
B. \( \sqrt{\frac{T2C}{k}} \).
C. \( \sqrt{2 \left( \frac{CT}{k} \right)} \).
D. \( \sqrt{\frac{2CT}{k}} \).
E. \( \sqrt{\frac{2CT}{k}} \).

14. Which of the following is NOT usually a valid justification for a takeover intended to increase shareholders’ wealth?

A. Earnings growth
B. Economies of scale
C. Expertise
D. Monopoly gains
E. Efficiency gains
15. ABC Plc intends to acquire XYZ Plc which has the following data:

- Earnings per share: N3.00
- Dividend per share: N1.80
- Number of shares: 500,000
- Current market price: N36.00
- Cost of equity: 10%

**Growth rate of earnings and dividends is 7% in perpetuity. What is the expected value of the share of B Plc?**

A. N45.00  
B. N64.20  
C. N60.00  
D. N36.00  
E. N72.00

16. Which of the following is **NOT** a reason why Small and Medium Scale Enterprises are unable to access the much needed funds from banks?

A. Risk perception  
B. Short-termism  
C. Pressure on management time  
D. Risk assessment  
E. Stringent conditions.

17. Which of the following is **NOT** a possible exit route considered by Venture Capitalists to sell their shares in Small and Medium Scale Enterprises at a profit?

A. Arrangement by the company to have its shares quoted on the stock exchange  
B. Liquidation of the company  
C. Replacement with another venture capitalist  
D. Recapitalization of the company  
E. Sale of the company to its existing management.
18. The segmented foreign exchange markets in Nigeria **EXCLUDE** the

A. black market.
B. parallel market.
C. official market.
D. inter-bank market.
E. universal bank market.

19. If the expected inflation rates in the next 12 months in Nigeria and in the United States are 12% and 7% respectively, what is the expected rate of change at time T(St) given that the spot rate now is N155 to $1?

A. N161 to $1
B. N185 to $1
C. N162.75 to $1
D. N160 to $1.
E. N158.25 to $1

20. If the quotation for a three-month forward contract on a trading day is N158 to $1 while the current rate of exchange is N155 to $1; it implies that dollar is selling at a

A. future premium.
B. forward premium.
C. future rate.
D. forward discount.
E. future discount.

**PART II: SHORT ANSWER QUESTIONS**

(20 MARKS)

1. Good Corporate Governance attempts to minimise the conflict of interest between managers and ..........................................

2. A systematic exercise for determining the total resources of the organization for the achievement of quantifiable objectives within a specified time frame is referred to as ....................................

3. A series of equal amounts of money payable or receivable at the beginning of each year for a specified future time is called ........................................
4. John is considering investing in a security that will pay N15,000 in 10 years. If the competitive market interest rate is fixed at 6% per annum, what is the security worth today?

5. The scarce resources of a company can be differently allocated using the ..................................... technique.

6. The concept which states that short-term needs should be financed with short-term finance and long-term needs should be financed with long-term finance is called .....................................

7. According to Modigliani and Miller, in which type of capital market is the total value of a firm equal to the market value of the total cash flows generated by that firm's assets?

8. The capital structure of Apple Plc is made up of 100 million ordinary shares of N1.00 each, 30 million 7% preference shares of N1 each, and N10 million 6% debenture. The company requires an additional capital of N50 million to finance a project. Given that the existing capital structure is optimum, how much should be raised through preference shares?

Use the information below to answer questions 9 and 10.

Mega Plc decides to make a bonus issue on a 1 for 2 basis by capitalizing part of its revenue reserves. The company's capital structure is given below:

<table>
<thead>
<tr>
<th></th>
<th>N'000</th>
</tr>
</thead>
<tbody>
<tr>
<td>5 million ordinary shares of N1 each</td>
<td>5,000</td>
</tr>
<tr>
<td>Revenue Reserves</td>
<td>3,500</td>
</tr>
<tr>
<td>Profit and loss account</td>
<td>1,500</td>
</tr>
<tr>
<td></td>
<td><strong>10,000</strong></td>
</tr>
</tbody>
</table>

9. What will be the value of revenue reserve after the bonus issue?

10. What will be the net asset value per share after the issue?

11. The market for issuing new securities is ..........................................................
12. What is the name given to the type of short-term fund sourced internally in the course of business?

13. The length of time between when the company procures its initial inventory and the time it receives cash from the sale of the product of the inventory is .............................................

14. Savings that arise from combining the marketing and distribution of different types of related products is known as ..................................................

15. The market price per share of Moon Plc was ₦25 while that of Star Plc was ₦30, when Moon announced plans to acquire Star Plc. The pre-merger value of Star Plc was approximately ₦31 million. If the projected synergies were ₦12 million, what is the maximum exchange ratio Moon could offer in a share swap and still generate a positive NPV?

16. The current market price of large firms is likely to approximate their share’s true value, given an efficient stock market. Why is it that this situation does not hold for the share of SMEs?

17. The less sophisticated but incorrect investment appraisal techniques commonly used by SMEs have the tendency of systematically ......................... their value.

18. What does the acronym “PPP” stand for in International Financial Management?

19. In relation to foreign exchange quotation, the difference between the selling rate and the buying rate quoted by a currency dealer is called the .........................

20. An arbitrage involving more than two currencies is known as ........................................ arbitrage.
LEPA PLC
Lepa Plc is a company incorporated ten years ago under the Companies and Allied Matters Act Cap C 20 LFN 2004. It specializes in the production of “spring table water” for which it has distributors both in the Northern and Southern parts of the country. The consumers of the product in the East and West of the Country are clamouring for more branches in each of these areas to enable them have this product within their reach.

The Board of Directors of Lepa Plc had in their last meeting declared that there was no way that the company could finance any expansion programme in the interim as the company needs money to pay workers’ salaries and pay the suppliers of raw materials.

The Financial Controller reacted sharply by saying that “this company should not have had any financial problem if it had exercised a good financial planning and control. After all, a substantial amount of the company’s money is in the hands of its debtors and this is as a result of weak credit policy of the company”. As part of his submission, he suggested that steps should be taken to recover the debts of the company for the purpose of financing the programme.

The Managing Director concluded by advising that project team should be constituted to study the feasibility of the project as well as its overall financial requirement. The team should be given three months within which to submit its report. The team, however, after serious meetings and deliberations submitted its report. The report gives the following information relating to the branch to be opened in the Eastern part of the country.

- Initial investment of ₦350,000 with nil scrap value.
- Expected life span of 10 years
- Sales volume - 20,000 units per annum
Selling price - N20 per unit
Direct variable cost of N15 per unit
Fixed cost excluding depreciation of N25,000 per annum.

The project has IRR of 17%.
The Chairman and Chief Executive is concerned about the viability of the project as the return is close to the company's hurdle rate of 15%.
He has suggested to you to evaluate the project very well so that it does not run into a loss.

You are required to:
(a) State what financial planning and financial controls are. (5 marks)

(b) Outline THREE possible strategies of enhancing a firm's debt management. (3 marks)

(c) Compute the sensitivity of the NPV to each of the underlisted variables:
   i. Sales price
   ii. Initial outlay
   iii. Sales volume
   iv. Variable cost
   v. Fixed cost (5 marks)

(d) From your calculation in (c) above, determine the TWO most sensitive variables (2 marks)
    Total (15 marks)

QUESTION 2

Dede Plc is a highly diversified company operating in a number of different industries. Its shares are widely traded on the Stock Exchange and have a current market price of N3.20.
Its dividend payments over the last five years are:

<table>
<thead>
<tr>
<th>Year</th>
<th>DPS</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>0.25</td>
</tr>
<tr>
<td>2009</td>
<td>0.23</td>
</tr>
<tr>
<td>2008</td>
<td>0.20</td>
</tr>
<tr>
<td>2007</td>
<td>0.19</td>
</tr>
<tr>
<td>2006</td>
<td>0.18</td>
</tr>
</tbody>
</table>

Dede Plc is considering two investment opportunities: one is the Hotel and Tourism (H&T) sector and the other is the Food and Beverages (F&B) sector. Both projects have relatively short lives and their cash flows are as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>H &amp; T</th>
<th>F &amp; B</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>85</td>
<td>190</td>
</tr>
<tr>
<td>2</td>
<td>170</td>
<td>180</td>
</tr>
<tr>
<td>3</td>
<td>150</td>
<td>200</td>
</tr>
</tbody>
</table>

The investment in Hotel and Tourism would cost N300 million while that in Food and Beverages would cost N400 million.

The Directors have discovered that industry beta for Hotel & Tourism and Food and Beverages sectors are 1.2 and 2.2 respectively. They believe the investments being considered are typical of projects in the relevant industries.

Dede Plc industries beta is 1.6, treasury bill rate is 9% and the average return on companies quoted on the stock exchange is 14%.

You are required to:

(a) (i) Compute the Net Present Values of both projects using the company’s weighted average cost of capital as a discount rate. (5 marks)

(ii) Compute the NPVs using a discount rate which takes account of the risk associated with the individual projects. (5 marks)

(iii) Advise the Directors regarding the project to accept. (1 mark)
(b) Enumerate the uses and limitations of the Capital Asset Pricing Model (CAPM) (4 marks) (Total 15 marks)

QUESTION 3

Adam Plc is considering acquiring Eve Plc. The summary of their most recent accounts is presented below:

<table>
<thead>
<tr>
<th>Balance sheet</th>
<th>Adam Plc</th>
<th>Eve Plc</th>
</tr>
</thead>
<tbody>
<tr>
<td>N' m</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net assets</td>
<td>3,150</td>
<td>946</td>
</tr>
<tr>
<td>Ordinary shares</td>
<td>1,000</td>
<td>500</td>
</tr>
<tr>
<td>Reserves</td>
<td>2,150</td>
<td>446</td>
</tr>
<tr>
<td></td>
<td>3,150</td>
<td>946</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Profit and Loss A/c</th>
<th>N' m</th>
<th>N' m</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit after tax</td>
<td>400</td>
<td>150</td>
</tr>
<tr>
<td>Dividend</td>
<td>(300)</td>
<td>(50)</td>
</tr>
<tr>
<td>Retained earnings</td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>

Both companies retain the same proportion of profits each year and are expected to do so in the future. Adam Plc’s return on investment is 16%, while that of Eve Plc is 21%. After the acquisition in one year’s time, Adam Plc will retain 60% of its earnings and expects to earn a return of 20% on new investment.

The dividends of both companies have been paid. The required rate of return of ordinary shareholders of Adam Plc is 12% and Eve Plc 18%. After the acquisition, this will become 16%.

Required:

(a) If the acquisition is to proceed immediately, calculate the:

i. pre-acquisition market values of the two companies. (5 marks)
ii. maximum price Adam Plc will pay for Eve Plc. (5 marks)

(b) Briefly explain the following actions a target company might take to prevent a hostile takeover bid:
i. White Knight
ii. Shark Repellants
iii. Pac-man Defence
iv. Poison Pill
v. Golden Parachute

(5 marks)

(Total 15 marks)

QUESTION 4

Unlike the old management information systems, Decision Support Systems (DSS) utilise model bases and databases in their support provision. A DSS model base is a software component comprising models used in calculations and analyses which materially display relationships among variables such as sales, expenses and net profit. A typical example of DSS models is the spreadsheet.

Required:

(a) Explain the term “Decision Support System” (DSS). (3 marks)
(b) Briefly explain FOUR applications of spreadsheet packages which are particularly relevant to the financial manager. (12 marks)

(Total 15 marks)

QUESTION 5

Victory Plc is considering making an offer for Valentine Plc. The offer is in the form of merger where the shares in both companies will be swapped for shares in Victory Plc. Extract of the latest accounts of the two companies are as follows:

Balance Sheets:

<table>
<thead>
<tr>
<th></th>
<th>Victory Plc</th>
<th>Valentine Plc</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Assets</td>
<td>₦1,419,000</td>
<td>₦4,725,000</td>
</tr>
<tr>
<td>Ordinary Shares</td>
<td>₦750,000</td>
<td>₦1,500,000</td>
</tr>
<tr>
<td>Reserves</td>
<td>₦669,000</td>
<td>₦3,225,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>₦1,419,000</td>
<td>₦4,725,000</td>
</tr>
</tbody>
</table>

Profit and Loss Accounts

<table>
<thead>
<tr>
<th></th>
<th>Victory Plc</th>
<th>Valentine Plc</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit after tax</td>
<td>₦225,000</td>
<td>₦600,000</td>
</tr>
</tbody>
</table>
Dividend Retained Profit

(75,000) 150,000
(450,000) 150,000

The two companies have the culture of retaining the same proportion of profits each year and this is expected to continue indefinitely. Victory Plc earns a return of 21% on new investments while Valentine Plc earns 16%. After the merger, Victory Plc is expected to retain 60% of its earnings and earn a return of 20% on investment.

The dividends of both companies have been paid. Ordinary shareholders of Victory Plc require 18% rate of return and those of Valentine Plc expect 12%. This will rise to 16% after the merger.

You are required to determine the:

(a) Market Value of each of the TWO companies before the merger. (8 marks)
(b) Maximum price Victory Plc should pay for Valentine Plc (7 marks)

(Total 15 Marks)

QUESTION 6

Blessed Nigeria Ltd makes annual credit sales of N4,800,000. Credit period was 30 days but due to poor credit administration, the average collection period has been 45 days with 1% sales resulting in bad debts which is normally written off.

A factor is being considered to take up the administration of the debts and trade credits at an annual fee of 2.5% of credit sales. In this respect, the company would save administrative costs of N96,000 annually and the payment period is expected to be 30 days.

The factor would provide 80% of invoiced debts in advance at an interest rate of 12% per annum (base rate). The company can obtain overdraft facility to finance its debtors at a rate of 2.5% over base rate.

Required:

(a) Advise the company’s management on whether or not to accept the services of a factor. (7 Marks)

(b) “Factoring is one of the popular ways of managing accounts receivable in corporate organizations”.
When should factoring be used for debt collection? (5 Marks)

(c) Briefly explain each of the following factoring terms:

   (i) Full service non-recourse  
   (ii) Full service recourse factoring  
   (iii) Non-notification factoring (3 marks)

(Total 15 Marks)

SOLUTIONS TO SECTION A

PART 1: MULTIPLE-CHOICE QUESTIONS

1. D  
2. E  
3. D  
4. C  
5. A  
6. B  
7. C  
8. E  
9. C  
10. B  
11. A  
12. D  
13. E  
14. D  
15. B  
16. C  
17. B  
18. E
19. C
20. B

TUTORIALS

3. Using $FV_n = P(i+r)^n$ where
   $FV$ is the worth of investment in $n$ years
   $n$ is the number of years
   $r$ is the rate of interest
   $p$ is the original amount invested/saved
   
   \[
   FV_n = N\times 10,000 \times (1.12)^5
   \]
   \[
   = N\times 17,623.42
   \]

4. Given N100m budget constraints, a combination of projects B and C should be selected because of their high ranking profitability index.

5. The NPV of projects selected is the sum of the Net Present Values of projects B and C which is N130 million.

8. $V = \frac{D_p}{K_p}$ where $V = \text{value of the preference share}$
   $D_p$ = dividend per preference share
   $K_p$ = Cost of the preference share
   
   \[
   V = \frac{0.15}{0.20} = N\times 0.75 \text{ per share}
   \]

10. If the theoretical ex-rights price is N15 per share
    Price of 5 shares (4 old ones + 1 rights share) = N15 x 5 = N75
    Price of the new issue = Theoretical ex-rights price minus
                               Value of the right
                           = N15 – 2.00
                           = N13

    Value of old share = N75 - N13 = N15.50
                          \[
                          \frac{4}{4}
                          \]
    Value of new share = N15 – 2.00 = N13.00

15. $P_o = \frac{D_o(1+g)}{r - g} = \frac{1.80 (1.07)}{0.1 - 0.07}$
    \[
    = \frac{1.926}{0.03}
    \]
    \[
    = N\times 64.20
    \]

19. Using $P_x - P_y = S_x - S_o$ where $P_x = \text{expected inflation in Nigeria}$


**EXAMINERS’ REPORT**

The questions test candidates’ knowledge of various aspects of the syllabus. Virtually all the candidates attempted the questions and performance was fair.

Some of the candidates showed good understanding of the questions while some had problems in providing appropriate solutions.

Candidates are advised to ensure adequate coverage of all sections of the syllabus for better performance.

**PART II – SHORT-ANSWER QUESTIONS**

1. Investors/Shareholders
2. Corporate Planning
3. Annuity due
4. ₦8375.92
5. Linear Programming
6. Matching Principle/Concept
7. Perfect Capital Market
8. Preference Share Capital = ₦10.715 million
9. ₦1 million
10. ₦1.33 per share
11. Primary Market
12. Spontaneous financing
13. Cash Operating Cycle
14. Economies of Scope
15. 1.66:1 or 1 for 0.6
16. SMEs shares are not quoted on the stock market i.e. they are unquoted
17. Reducing/eroding
18. Purchasing Power Parity
19. Spread
20. Triangular

**TUTORIALS**

4. Today’s worth of N15,000 in 10 years time at a rate of 6% is given by:

\[
PV = \frac{N15,000}{(1.06)^{10}}
\]

= N8,375.92

<table>
<thead>
<tr>
<th>Amount</th>
<th>Proportion</th>
</tr>
</thead>
<tbody>
<tr>
<td>N</td>
<td></td>
</tr>
</tbody>
</table>

8. Ordinary share capital 100m 71.43
7% Preference shares 30m 21.43
6% Debenture 10m 7.14
140m 100.00

Amount to be raised through share capital = 21.43% x N50m = N10.715m

9. No of bonus shares issued is \( \frac{1}{2} \times 5,000,000 \)

= 2,500,000

There will thus be a transfer of N2,500,000 from revenue reserves i.e.

N3,500,000 – 2,500,000

Revenue Reserve after the issue is N1,000,000

10. Net Asset Per share after issue = N1,000,000

54
15. Exchange Ratio \( = \frac{P_T}{P_A} = \left(1 + \frac{\text{Synergy}}{\text{MV Target}}\right) \)

\[ = \frac{\text{N}30}{\text{N}25} \left(1 + \frac{12}{31}\right) \text{ or } \frac{30}{25} + \frac{12}{31} \]

\[ = 1.66 \]

EXAMINERS’ REPORT

The questions test candidates’ knowledge of the various aspect of the syllabus.

Almost all the candidates attempted the questions and performance was average.

Candidates are advised to study extensively and adequately cover the syllabus when preparing for the Institute’s examinations.

SOLUTIONS TO SECTION B

QUESTION 1

(a) i. Financial Planning

It is a process of

- analysing the financing and investment choices open to the firm,
- projecting the future consequences of present decisions in order to avoid surprises and understand the link between present and future decisions,
- deciding which alternatives to undertake and
- measuring subsequent performance against the goals set in the financial plan.

ii. Financial Control deals with the feedback and adjustment process that is required to ensure that plans are followed. Financial statements, operating ratios and other financial tools are used to exercise financial control.
(b) **Strategies of enhancing a firm’s debt management.**

i. Debt factoring;
ii. Debt repayment restructuring;
iii. Cash discount;
iv. Engaging the services of a debt-management firm (Debt Collectors); and
v. Reducing average collection period.

(c) **Calculation of NPV**

<table>
<thead>
<tr>
<th>Year</th>
<th>Items</th>
<th>NCF (₦)</th>
<th>DF@ 15%</th>
<th>PV (₦)</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>Initial Outlay</td>
<td>(350,000)</td>
<td>1.0000</td>
<td>(350,000)</td>
</tr>
<tr>
<td>1 - 10</td>
<td>Relevant Fixed Cost</td>
<td>(25,000)</td>
<td>5.0188</td>
<td>(125,470)</td>
</tr>
<tr>
<td>1 - 10</td>
<td>Variable Cost</td>
<td>(300,000)</td>
<td>5.0188</td>
<td>(1,505,640)</td>
</tr>
<tr>
<td>1 - 10</td>
<td>Sales</td>
<td>400,000</td>
<td>5.0188</td>
<td>2,007,520</td>
</tr>
<tr>
<td></td>
<td><strong>NPV</strong></td>
<td></td>
<td></td>
<td><strong>26,410</strong></td>
</tr>
</tbody>
</table>

**NOTE:**  

\[ DF@ 15% = \frac{1-(1+r)^{-10}}{0.5} \times 5.0188 \]

Contribution  
\[ = \text{Sales} - \text{Variable Cost} \]
\[ = \₦400,000 - \₦300,000 \]
\[ = \₦100,000 \]

PV of Contribution is  
\[ = \₦100,000 \times 5.0188 \]
\[ = \₦501,880 \]

**Sensitivity Analysis:**

i. Sales Price = \[ \frac{\text{NPV}}{\text{PV of Sales}} \times 100 \]
\[ = \frac{26410}{2007520} \times 100 \]
\[ = 1.32\% \]

ii. Initial Outlay = \[ \frac{\text{NPV}}{\text{PV of Outlay}} \times 100 \]
\[ = \frac{26410}{350,000} \times 100 \]
\[ = 7.55\% \]

iii. Sales Volume = \[ \frac{\text{NPV}}{56} \times 100 \]
\[ = \frac{26410}{350,000} \times 100 \]
\[ = 5.26\% \]
The two most sensitive variables are:

i. Sales price at 1.32%

ii. Variable Cost - 1.75%

These are derived from the sensitivity analysis workings above as these are the two least NPVs in terms of sensitivity. The sales price must not fall by more than 1.32% and the variable cost must not increase by more than 1.75%.

EXAMINERS’ REPORT

Part ‘a’ of the question tests candidates’ knowledge of corporate strategy with emphasis on financial planning and financial control while the ‘b’ part tests candidates understanding of debt management. However, part ‘c’ focuses on candidates’ understanding of the treatment of uncertainty (sensitivity analysis) and its effects on capital investment decisions.

Almost all the candidates attempted the question and performance was average as most of them showed lack of adequate understanding of parts ‘a’ and ‘c’.

Candidates’ commonest pitfalls were their inability to:

i. differentiate between financial planning and financial control.

ii. differentiate between debt equity and trade debt.

iii. determine the correct discount factor to apply in computing the maximum tolerable changes in the PV of the listed variables.

iv. remember the formula for computing the maximum tolerable changes in the PV of the listed variables – the sensitivity analysis of the variables.
Candidates are advised to always cover the syllabus adequately for better result. They should also endeavour to remember key formulae.

**QUESTION 2**

(a)\(i\) Computation of NPV using WACC

**Hotel & Tourism (H & T)**

<table>
<thead>
<tr>
<th>Year</th>
<th>Cash Flow (₦'m)</th>
<th>Discount Factor @17%</th>
<th>PV (₦'m)</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>(300)</td>
<td>1</td>
<td>(300.00)</td>
</tr>
<tr>
<td>1</td>
<td>85</td>
<td>0.8547</td>
<td>72.65</td>
</tr>
<tr>
<td>2</td>
<td>170</td>
<td>0.7305</td>
<td>124.19</td>
</tr>
<tr>
<td>3</td>
<td>150</td>
<td>0.6244</td>
<td>93.66</td>
</tr>
<tr>
<td></td>
<td><strong>NPV</strong></td>
<td></td>
<td><strong>(9.50)</strong></td>
</tr>
</tbody>
</table>

**Food & Beverages (F & B)**

<table>
<thead>
<tr>
<th>Year</th>
<th>Cash Flow (₦'m)</th>
<th>Discount Factor @17%</th>
<th>PV (₦'m)</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>(400)</td>
<td>1</td>
<td>400.00</td>
</tr>
<tr>
<td>1</td>
<td>190</td>
<td>0.8547</td>
<td>162.39</td>
</tr>
<tr>
<td>2</td>
<td>180</td>
<td>0.7305</td>
<td>131.49</td>
</tr>
<tr>
<td>3</td>
<td>200</td>
<td>0.6244</td>
<td>124.88</td>
</tr>
<tr>
<td></td>
<td><strong>NPV</strong></td>
<td></td>
<td><strong>(18.76)</strong></td>
</tr>
</tbody>
</table>

(ii) Projects’ NPVs using CAPM

**Hotel & Tourism (H & T)**

<table>
<thead>
<tr>
<th>Year</th>
<th>Cash Flow (₦'m)</th>
<th>Discount Factor @15%</th>
<th>PV (₦'m)</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>(300)</td>
<td>1</td>
<td>(300.00)</td>
</tr>
<tr>
<td>1</td>
<td>85</td>
<td>0.8696</td>
<td>73.92</td>
</tr>
<tr>
<td>2</td>
<td>170</td>
<td>0.7561</td>
<td>128.54</td>
</tr>
<tr>
<td>3</td>
<td>150</td>
<td>0.6575</td>
<td>98.63</td>
</tr>
<tr>
<td></td>
<td><strong>NPV</strong></td>
<td></td>
<td><strong>(1.09)</strong></td>
</tr>
</tbody>
</table>
Food & Beverages (F & B)

<table>
<thead>
<tr>
<th>Year</th>
<th>Cash Flow</th>
<th>Discount Factor</th>
<th>PV</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>400</td>
<td>1</td>
<td>400.00</td>
</tr>
<tr>
<td>1</td>
<td>190</td>
<td>0.8333</td>
<td>158.33</td>
</tr>
<tr>
<td>2</td>
<td>180</td>
<td>0.6944</td>
<td>124.99</td>
</tr>
<tr>
<td>3</td>
<td>200</td>
<td>0.5787</td>
<td>115.74</td>
</tr>
</tbody>
</table>

NPV (0.94)

iii. In view of the high risk inherent in the Food and Beverages project, the Hotel and Tourism project should be selected. The positive NPV before the incorporation of the risk factor on the F&B project should not be taken for viability as the NPV became negative after adjusting for risk.

(b) Uses of CAPM

i. To evaluate projects taking risk into account.
ii. To determine an optimal capital structure.
iii. It is a device for understanding the risk-return relationship.

Limitations of CAPM

i. It is based on unrealistic assumptions.
ii. It is difficult to test its validity.
iii. It only considers systematic risk which does not remain stable over time.
iv. Many times, the risk of an asset is not captured by beta alone.
v. It only examines investments from the shareholders point of view.
vi. It is a theoretically one-period model and should therefore be used with caution in the appraisal of multi-period projects.

Workings

Cost of capital using CAPM:

Hotel & Tourism (HT)

\[ R_s = R_f + B(R_m - R_f) \]

\[ = 9\% + 1.2 (14\% - 9\%) \]

\[ = 9\% + 6\% \]

\[ = 15\% \]

Food and Beverages (F&B)
\[ R_s = R_f + B(R_m - R_f) \]
\[ = 9\% + 2.2(14\% - 9\%)\% \]
\[ = 9\% + 11\% \]
\[ = 20\% \]

**Cost of capital using WACC:**

\[
Ke = \frac{d(i+g)}{MV} + g
\]
\[
g = n - 1 \left( \frac{Ld}{Ed} \right) - 1
\]
\[
= 5 - 1 \left( \frac{0.25}{0.18} \right) - 1
\]
\[
= \left( \frac{0.25}{0.18} \right)^{\frac{1}{4}} - 1
\]
\[
= 0.085 \text{ or } 8.5\%
\]

\[
Ke = \frac{0.25(1.085) + 0.085}{3.20}
\]
\[
= 0.169 = 16.9\%
\]

**EXAMINERS’ REPORT**

Parts ‘a’ and ‘b’ of the question test candidates’ understanding of the use of Net Present Value (NPV) technique of investment appraisal and the calculation of discount rate (cost of capital) using the Weighted Average Cost of Capital (WACC) and Capital Asset Pricing Model (CAPM) methods. The ‘c’ part, however, tests candidates’ knowledge of valuation models with particular reference to the Capital Asset Pricing Model (CAPM) – its use and limitations.

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

The commonest pitfall of the few candidates was their inability to compute and identify the correct discount factor to apply in solving the problem. In part b, candidates were not able to advance reasonable points on the limitations and uses of Capital Asset Pricing Model (CAPM).

Candidates are advised to always cover the syllabus adequately for better result.
QUESTION 3

(a)i. **Market Value of Adam Plc**

Using the Gordon’s growth model: \( g = rb \)
where \( r = \) return on investment
\( b = \) retention ratio
\( g = rb, \ r = 0.16, \ b = 0.25 \)
\( g = 0.16 \times 0.25 = 4\% \)

Future dividend in one year
\( = \ N300m \times 1.04 = \ N312 \text{ million} \)

\[
\text{Market Value} = \frac{d}{r-g} = \frac{\ N312,000,000}{0.12 - 0.04}
\]
\( = \ N3.9 \text{ billion} \)

**Market value of Eve Plc**

\( \ r = 0.21, \ b = \frac{2}{3} \)
\( g = 0.21 \times \frac{2}{3} = 14\% \)

Future dividend in one year
\( = 50m \times 1.4 = \ N57 \text{ million} \)

\[
\text{MV} = \frac{\ N57,000,000}{0.18 - 0.14}
\]
\( = \ N1.425 \text{ billion} \)

ii. **Adam Plc earning in 1 year** \( \ N400m \times 1.04 = 416 \text{ m} \)

**Eve Plc earning in 1 year** \( \ N150m \times 1.14 = 171.587 \text{ m} \)

Dividend in 1 year
\( = \ N587m \times 0.4 \)
\( = \ N234,800,000 \)

If \( r = 0.2 \) and \( b = 0.6 \)
\( g = 0.2 \times 0.6 = 0.12 \)

\[
\text{Market Value} = \frac{\ N234,800,000}{0.16 - 0.12} = \ N5,870,000,000
\]
(b) i. **White Knight**

A situation in which the target company looks for a friendly company whose offer is more appealing for the takeover bid.

ii. **Shark Repellant**

This involves amending the company’s memorandum and articles of association in such a way that makes the takeover difficult for the acquiring company.

An example is increasing the margin of majority votes required at an Annual General Meeting called to approve such a take-over.

iii. **Pac-man Defence**

An anti-takeover strategy in which the target company tries to buy up the shares of the acquiring company.

iv. **Poison-Pill**

A strategy sometimes employed by target companies in a take-over bid to reduce the attractiveness of their securities to the prospective acquiring companies. This is often done by enlarging the outstanding shares of a target company through a new issue of shares to its shareholders at a discount to the market price, thus making the take-over quite expensive to the prospective acquiring company.

v. **Golden Parachutes**

This refers to provisions in the executives’ employment contract that call for payment of severance pay or other compensation should they lose their jobs as a result of a successful takeover.
EXAMINERS’ REPORT

Part ‘a’ of the question tests candidates’ knowledge of valuation of business units and entities (financial evaluation) under mergers and acquisitions while part ‘b’ tests candidates’ knowledge of the different types of defensive tactics usually adopted by a target company to defend itself against hostile take-over.

Many candidates attempted the question but performance was poor. Most of the candidates that attempted the question did not have clear and accurate understanding of the question hence the poor performance.

Candidates’ commonest pitfall in part ‘a’ of the question was their inability to compute the pre-acquisition values of the shares of the companies as well as the maximum amount to pay for the shares of the target company.

Candidates are advised to always cover the syllabus adequately and make use of the Institute’s pathfinders and study packs in their preparations for the Institutes examinations. They should also endeavour to improve their knowledge on mergers and acquisitions aspect of the syllabus for better result in future.

QUESTION 4

(a) Decision Support Systems are computer based information systems which give business managers the necessary interactive information support that help their decision – making. It is useful to financial managers in financial planning, financial modelling, and analysis of alternative courses of action and in financial decision making. Financial managers normally receive decision support by interacting with the computer system. Decision Support System use analytical models, specified databases, interactive computer based modelling process plus the financial managers intuitive knowledge and judgment to lend support for the making of semi-structured financial decision.
(b) Application of spreadsheet packages which are particularly relevant to the financial manager include:

i. **Financial Planning Models**

Decision Support System based financial planning models can be used in constructing projected financial statements for periods longer than one year. These models are stored in the form of spreadsheets and they can be programmed to provide support for the financial managers where there are many assumptions to be made, where there is

- need to show the effects of different assumptions;
- where there is need to evaluate different financing plans and their effects on significant variables; and
- where it is necessary to modify the initial plan based on the outcome of previous projections.

ii. **Capital Budgeting Models**

The capital budgeting models (discounted cash flows) are used to support the financial manager in the financial analysis and evaluation of different capital investment alternatives. The relevant data in the decision making process is semi-structured and the models help in making certain analysis such as ‘what if’ analysis, sensitivity analysis and so on.

Electronic spreadsheet packages such as EXCEL have in-built NPV and IRR functions in their application programmes.

iii. **Linear Programming Models**

The formulation of and the proffered solutions to linear programming problems lend itself to the utilisation of the computer-based DSS. In such problems, there may be many constraints and interacting variables which might make solutions to such problems very laborious and probably impossible under manual approach.

iv. **Decision Support Systems Analytical Models**

The use of Decision Support Systems entails a typical interactive analytical process comprising analysis such as ‘what if’ analysis, sensitivity analysis and so on. Here, alternative ‘what-if-changes’ in
input variables can be entered by the financial manager into the
computer. The Decision Support System software package, might show
series of outcomes in response to say ‘what-if-changes’. In this case,
financial managers are not asking for pre-information, instead they are
examining all possible alternatives. They need not decide in advance
what information they need. What they do is to utilise the Decision
Support Systems to get the information they require to assist them in
arriving at a decision.

EXAMINERS’ REPORT

The question tests candidates’ knowledge of Decision Support Systems (DSS); the
meaning and the usefulness of its analytical models to the Financial Manager.

Many candidates attempted the question but performance was poor particularly in
part ‘b’ which carries twelve (12) marks. Most of the candidates exhibited shallow
knowledge of part ‘b’ while part ‘a’ was fairly attempted.

Candidates’ commonest pitfall in part ‘b’ was their inability to interprete and note the
specific requirement of the question. Instead of explaining applications of
spreadsheet packages, many candidates went ahead to write on accounting and audit
software packages.

Candidates are advised to take time to read, understand and interprete questions
appropriately and note their specific requirements before attempting them.

QUESTION 5

(a) Calculation of market values of the two companies using Gordon’s growth
model (rb)

i. 

Victory Plc:

Using rb model where:

\[ r = \text{return on investment} \]
\[ b = \text{proportion of earnings retained} \]
\[ r = 21\% \text{ or } 0.21 \]
\[ b = \frac{2}{3} \]

growth = \[ rb = 21\% \times \frac{2}{3} = 14\% \]

Future dividend in one future year

65
= ₦75,000 x 1.14  
= ₦85,500

Market Value (MV) = ₦85,500  
18% - 14%  
= ₦85,500  
4%  
= ₦85,500  
0.4  
= ₦2,137,500

ii. Valentine Plc  
g = rb where: r = 16%  
b = ¼ (or 0.25)  
\[ g = 0.16 \times 0.25 = 0.04 \]  
\[ = 4\% \]  
Dividend in the next one year = ₦450,000 x 1.04  
= ₦468,000

Market Value = ₦468,000  
12% - 4%  
= ₦468,000  
0.08  
= ₦5,850,000

(b) Maximum Price Victory Plc should pay for Valentine Plc:  
Earnings in the next one year:

\[ \text{Victory Plc} \times 1.14 = 256,500 \]  
\[ \text{Valentine Plc} \times 1.04 = 624,000 \]  
\[ 880,500 \]

Dividend in the next one year (100% - 60%) = 40%  
\[ = ₦880,500 \times 0.4 = ₦352,200 \]  
 \[ r = 20\%; \ b = 60\% \]  
\[ \therefore g = rb = 20\% \times 60\% = 12\% \]  

Market Value after Merger
\[ M/V = \frac{₦352,200}{0.16 - 0.12} \]
EXAMINERS' REPORT

The question tests candidates' knowledge of valuation of business units and entities (financial evaluation) for share exchange under mergers and acquisitions.

Few candidates attempted the question and the performance of the few candidates was below average. Most of the candidates displayed lack of understanding of the requirements of the question while a selected few did well.

Candidates' commonest pitfall was their inability to apply the Gordon's Growth Model in determining the market values of the two companies and the maximum price to offer for the target company's shares. This is due to candidates' dearth of knowledge of the application of the model.

Candidates are advised to always cover the syllabus adequately, make use of the Institute's Pathfinder and Study Packs and also practise with past questions on mergers and acquisitions.

QUESTION 6

(a) Credit Sales

\[ \text{\textup{Credit Sales}} = \text{₦}4,800,000 \text{ per annum} \]

Average credit period

45 days

The annual cost is as follows:

\[ \text{₦} \]

\[ 45 \times \text{₦}4,800,000 \times 14.5\% \]

\[ = 85,808 \]

\[ \frac{365}{365} \]

Bad debts: \( 1\% \times \text{₦}4,800,000 \)

\[ = 48,000 \]

\[ \frac{133,808}{133,808} \]

The cost of the factor
80% of credit sales financed by the factor would be 80% of ₦4,800,000 = ₦3,840,000. For a consistent comparison, we must assume that 20% of credit sales would be financed by a bank overdraft.

The average credit period would be only 30 days.

The annual cost would be as follows,

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Factor’s finance</td>
<td>(30 \times \frac{₦3,840,000 \times 12%}{365})</td>
</tr>
<tr>
<td>Overdraft</td>
<td>(30 \times \frac{₦960,000 \times 14.5%}{365})</td>
</tr>
<tr>
<td>Cost of factor’s services</td>
<td>(2.5% \times \₦4,800,000)</td>
</tr>
<tr>
<td>Less savings in company’s administrative costs</td>
<td>(₦96,000)</td>
</tr>
<tr>
<td>Net cost/(benefit) of the factor</td>
<td>(73,315)</td>
</tr>
</tbody>
</table>

**Conclusion**

The factor option is cheaper by ₦60,493 (₦133,808 – ₦73,315) based on the above calculations. Management is therefore advised to accept the services of the factor.

**NOTE:**

**(stock market valuation)** ₦3,840,000 = 80% of ₦4,800,000

* ₦960,000 = 20% of ₦4,800,000

(b) Factoring can be used under the following situations

(i) When a company has a substantial amount of its working capital tied up in debtors which it cannot collect easily.

(ii) When a company is faced with liquidity problems due to failure of customers to meet the credit period allowed to them.

(iii) When the credit control system is becoming increasingly expensive to maintain.

(iv) When the company’s fixed assets are limited and it cannot obtain
additional finance without offering security.

(v) When a company wishes to raise finance without further borrowing or diluting equity.

(c) (i) Full service non-recourse factoring is where book debts are purchased by the factor assuming 100% credit risk. Full amount of invoices have to be paid to the client in the event of any debt becoming bad. Factor also advances 80 – 90% of the book debt immediately to the client.

(ii) Full service recourse factoring is where the client is not protected against the risk of bad debt. The client has no indemnity against unsettled or uncollected debts. Where the factor has advanced fund against book debts which eventually become bad, the client has to refund such advance.

(iii) Non-Notification factoring is where customers are not informed about the factoring agreement. The factor deals with customers through the client company.

EXAMINERS’ REPORT

The question tests candidates’ knowledge of debt collection techniques with particular reference to debt factoring and invoice discounting.

Most candidates attempted the question and performance was fair. Part ‘a’ of the question was not well understood by some candidates while candidates had better understanding of parts of ‘b’ and ‘c’ hence the fair performance.

Candidates’ commonest pitfall in part ‘a’ was their inability to compute the cost of hiring the services of a factor and the likely savings if a factor is hired.

Candidates are advised to read wide, and in depth for better result. They should not limit themselves to reading textbooks only but extend their readings to include the Institutes pathfinders.
THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA
PROFESSIONAL EXAMINATION II – MAY 2011
ADVANCED TAXATION
Time allowed- 3 hours

SECTION A: Attempt All Questions

PART I: MULTIPLE-CHOICE QUESTIONS (20 Marks)

1. After exercising the right of election under commencement rule, the tax payer may revoke it on his own volition within
   A. one year after the end of the third tax year.
   B. two years after the end of the third tax year.
   C. one year after the end of the second tax year.
   D. two years after the end of the second tax year.
   E. one year after the end of the first tax year.

2. What is the rate of Petroleum Investment Allowance granted on Qualifying Capital Expenditure located on-shore?
   A. 5%
   B. 0.5%
   C. 5.5%
   D. 0.05%
   E. 5.05%

3. A grace period of .................. days, is usually allowed for Stamp Duties to be paid after execution.
   A. 30
   B. 40
   C. 50
   D. 60
   E. 90
4. The tenure of members of the Tax Appeal Tribunal shall be
   A. two years renewable for another term of three years and no more
   B. two years renewable for another term of two years and no more
   C. three years renewable for another term of two years and no more
   D. three years renewable for another term of three years only and no more
   E. three years renewable for another term of one year only and no more

5. Any Company other than an indigenously controlled company applying for Pioneer Certificate can only be considered, provided the estimated cost of Qualifying Capital Expenditure to be incurred by the Company on or before the production day, shall not be less than
   A. ₦125,000
   B. ₦105,000
   C. ₦100,000
   D. ₦150,000
   E. ₦155,000

6. Which ONE of the following is an Instrument for ad-valorem assessment?
   A. Bill of Exchange
   B. Authorized Share Capital of Companies
   C. Promissory Notes
   D. Debit Note
   E. Property Valuation

7. Interest is deemed to be derived from Nigeria and therefore liable to Nigerian tax if ONE of these conditions is fulfilled. Which ONE?
   A. If there is a liability to payment of the interest to a Nigerian company or company in Nigeria regardless of where or in what form the payment is made
   B. If there is a liability to payment of the interest by a Nigerian company or company in Nigeria regardless of where or in what form the payment is made
   C. If there is a liability to payment of the interest to a foreign company or company in Nigeria regardless of where or in what form the payment is made
D. If there is a liability to payment of the interest to a Nigerian or foreign company or company in Nigeria regardless of where or in what form the payment is made
E. If there is a liability to payment of the interest by a foreign company or company abroad, regardless of where or in what form the payment is made

8. Which **ONE** of the following has responsibility for the collection of duties in respect of instruments executed between an individual or group of individuals and a company?

A. The Federal Ministry of Finance
B. The Joint Tax Board in collaboration with State Governments
C. The Central Bank of Nigeria in collaboration with the Federal Government
D. The State Government in collaboration with Federal Inland Revenue Service
E. The Federal Government

9. Education tax is payable by.
A. non-resident Companies only.
B. partnership firms registered in Nigeria.
C. companies incorporated in Nigeria.
D. non-resident firms registered in Nigeria.
E. unit trusts registered in Nigeria.

10. Under the Companies Income Tax Act CAP C21 LFN 2004, which **ONE** of these is **NOT** exempted from tax at source?

A. Dividend distributed by a pioneer company
B. Dividend distributed by a unit trust
C. Dividend received from a small company engaged in the manufacturing sector in the first three years of operation
D. Dividend received from investments in a wholly export oriented business
E. Dividend brought into Nigeria through official channels.
11. The Back Duty assignment is limited to ………………… years before the year of the assignment.
   A. five  
   B. six  
   C. ten  
   D. eight  
   E. four

12. The Pay As You Earn (PAYE) is a scheme whereby tax on employees’ incomes is deducted at source by the employer which must be remitted to the relevant tax authority within a period of ………………….. days after the end of the month.
   A. thirty  
   B. fourteen  
   C. sixty  
   D. forty-five  
   E. ninety

13. In the case of imported goods, the value on which Value Added Tax is imposed is the price of the goods including ………………… to the port of delivery.
   A. insurance  
   B. insurance and freight  
   C. insurance, freight and duties  
   D. insurance, freight, duties and commissions  
   E. insurance, freight, duties, commissions and other charges payable

14. Capital loss on disposal of any capital asset is ………………. from capital gains on disposal of any other asset.
   A. deductible  
   B. not deductible  
   C. reduced  
   D. allowance  
   E. acceptable
15. The following bodies and institutions are specifically listed in Schedule 5 of the Companies Income Tax Act CAP C21 LFN 2004 as bodies and institutions to which donations can be made and such donations will be allowed as an expense in the determination of assessable profit, EXCEPT the

A. Van Leer Nigerian Educational Trust.
B. Nigerian Conservation Foundation.
C. National Sports Commission.
D. Nigerian Museum.
E. Institute of Chartered Accountants of Nigeria.

16. The Chairman of the Technical Committee of the Federal Inland Revenue Service is the

A. Chairman of the Federal Inland Revenue Service.
B. Chairman of Local Government Revenue Committee.
C. Representative of the Minister of Finance.
D. Chairman of the Federal Internal Revenue Service.
E. Chairman of the Tax Appeal Tribunal.

17. The share of revenue accruing to the Federal Government from the proceeds of Value Added Tax (VAT) under the operation of the Value Added Tax Amendment Act 2007, shall be

A. 1.5%
B. 15.5%
C. 15%
D. 1.15%
E. 30%

18. All disputes regarding the determination of the residence of a taxpayer between the taxpayer and a tax authority or between one tax authority and another shall be referred to the

A. Minister of Finance.
B. Joint Tax Board.
C. Tax Appeal Tribunal.
D. Federal Inland Revenue Service.
E. Federal High Court.
19. Income derived by companies engaged in crude oil refining is chargeable to tax under

20. Losses used in aggregate is synonymous with the application of ..................rule in the treatment of losses under Nigeria tax laws.
   A. cessation
   B. change in accounting date
   C. commencement
   D. minimum tax
   E. merger and acquisition

PART II: SHORT ANSWER QUESTIONS (20 MARKS)

1. What is the penalty for any person who is guilty of any pioneer status offence, under the Nigerian Tax Law?

2. Any tax payable in a country which under the double taxation arrangement is to be allowed as a credit against tax payable in respect of the income being subjected to tax in Nigeria, is defined as .........................

3. Under double taxation arrangement, tax payable in a foreign country is referred to as .........................

4. Any person dissatisfied with a decision of the Tax Appeal Tribunal may appeal against such decision on a point of law to ......................... after due notice in writing to the Secretary to the Tribunal.


7. Application for deferment of loss relief under Petroleum Profits Tax should be made.

8. Define *ad-valorem* duties.


10. The residual value of the qualifying capital expenditure under Petroleum Profits Tax should be .........., which must be retained for as long as the asset has not been sold.

11. What proportion of the Education Tax Fund is devoted to the development of primary education in Nigeria?

12. Relief is available to the owners of chargeable assets lost or destroyed upon the receipt of capital sum by way of compensation under insurance policy, provided the amount is applied within .......... of receipt, in acquiring a replacement of the asset lost or destroyed.

13. The profit on which tax may be imposed on a life insurance company in Nigeria shall be .......... 

14. Notice in writing must be given to the Tax Appeal Tribunal within .......... after the Tribunal’s decision by any person dissatisfied with the decision of the Tribunal.

15. The period of tax holiday for a pioneer company shall commence from the .......... 

16. Where two basis periods overlap for the purpose of computing an annual allowance, the period common to both is deemed ..........
17. Any aggrieved person may within .................. after the date of a Stamp Duty Assessment and on the payment of the duty, appeal against the Stamp Duty Assessment.

18. At the meeting of the Joint Tax Board, a member may be represented by an official duly authorized by the member for that purpose, and ...................... members or their representatives shall constitute a quorum.

19. Small Companies are assessable to tax at lower rate for a maximum period of .................... from the commencement of business.

20. State TWO basic situations that can give rise to abnormal basis period of assessment.

SECTION B: ATTEMPT QUESTIONS ONE AND ANY OTHER THREE (60 MARKS)

QUESTION 1 - CASE STUDY

Your firm has been the Tax Consultants to Murideen Limited for the past five years. The Company makes up accounts to 31 December each year. You submitted the Company’s Tax Returns to the Federal Inland Revenue Service Lagos on 24th June 2008. On 28 July 2008, the Company forwarded to your office a BOJ Assessment Notice served on it on 27 July 2008 and dated 20 July 2008 number LC/0005/08.

The tax computations which you submitted on behalf of your client showed ₦1,150,000 as payable, but the BOJ assessment notice showed a total profit of ₦13,150,000 and tax payable of ₦3,195,000.

The accounts also contained information on a Mercedez Benz Tractor purchased during the 2006 accounting year, for the sum of ₦250,000,000 which developed some fault and a sum of ₦10,000,000 was spent in repairing it during 2007 accounting year.

You did object to the BOJ and it was discharged. However, during the course of examination of the accounts, the tax inspector disallowed the expenses on the tractor and added it back to the profit to form the basis of an additional assessment of ₦3,000,000.
You duly objected to the additional assessment but the tax inspector stood his ground and sent a final demand notice for the additional assessment.

**Required:**

(a) Prepare the specimen letter of objection to the Federal Inland Revenue Service, Lagos on the BOJ Assessment sent to the Company. (8 Marks)

(b) Identify the steps to be taken to seek redress in respect of the additional tax. (7 marks)

**(Total 15 Marks)**

**QUESTION 2**

(a) What is the status of a lost instrument under the Stamp Duties Act Administration in Nigeria? (4 Marks)

(b) State FIVE powers of the Tax Appeal Tribunal. (5 Marks)

(c) State precisely how the following items are treated under the CITA CAP C21 LFN 2004, with special reference to anti-avoidance measures.

i. Interest
ii. Undistributed profits of a closed company
iii. Artificial and fictitious transactions
iv. Application of commencement and cessation clauses and grant of initial allowances.
v. Assessment on turnover basis
vi. Dividend paid out of profits on which no tax is payable due to no total profits which are less than the amount of dividend which is paid. (6 Marks)

**(Total 15 Marks)**

**QUESTION 3**

Akintimilehin Petroleum Exploration Limited is an oil producing company in Nigeria. An extract of its results for the year ended 31 December 2008 is as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales of Kerosine</td>
<td>2,400,000</td>
</tr>
<tr>
<td>Sales of Diesel</td>
<td>2,575,000</td>
</tr>
<tr>
<td>Sales of Petrol</td>
<td>3,500,000</td>
</tr>
<tr>
<td>Refinery Costs</td>
<td>750,000</td>
</tr>
<tr>
<td>Sales of Crude Oil</td>
<td>16,950,000</td>
</tr>
</tbody>
</table>
Incidental Income 513,450
Exploration Cost 1,960,000
Management and Administration Cost 986,500
Non Productive Rent 200,000
Capital Allowances 550,392
Royalties 250,000
Custom Duties 400,000
Petroleum Investment Allowance 450,392
Transportation costs of refined products 750,000

Management and Administration expenses, capital allowances, and incidental income are apportioned between the Upstream and Downstream Operations in the ratio of 2:1 respectively.

Required:
Compute the tax liability of the company for the year, using the applicable tax rates.

(Total 15 Marks)

QUESTION 4

Janid Investment Limited had sold its two buildings. One is situated on Lagos-Badagry expressway, Amuwo, Lagos and the other in Ibadan. The Lagos building site was compulsorily acquired by the State Government in June 2008 in the course of the dualisation of the road. A compensation of N25,000,000 was paid for the building which originally cost the company N2,500,000. Fearing that the same predicament might befall the Ibadan building, the company quickly sold the building for N15,500,000 on 6 July 2008. Its original cost was N850,000. Sales expenses amounted to N3,250,000.

The company normally makes accounts to 31 December each year and the properties which were sold and purchased were reflected in the accounts to 31 December, 2008. The company decided to move to Ogun State where between September and November 2008, it acquired a new site and erected another business building at a cost of N20,500,000.

Required:
(a) Compute the Capital Gains Tax liability for the relevant year of assessment.

(6 marks)
(b) State one other alternative open to Janid Investments Limited in discharging its Capital Gains Tax liability and the time limit for exercising the option. (3 marks)

(c) In January 2001, Mr. Smith bought a property for ₦3,456,000 with the intention of building an Estate. The legal fees, stamp duty and other relevant costs amounted to ₦1,220,000.

The building of the estate was completed in year 2003 at a total cost of ₦49,550,000. Mr. Smith immediately advertised for tenants at a cost of ₦525,000. He later decided to sell the entire estate and advertised for prospective buyers after the estate was valued by a registered valuer at ₦159,350,000. Other incidental costs incurred were as follows:-

- Advertising cost for buyers ₦1,250,000
- Surveyor’s and valuers fees ₦15,650,000
- Estate agent’s commission ₦12,122,340
- Stamp duty and other official costs ₦15,335,000

**Required:**
**Calculate the Capital Gains and the Capital Gains Tax payable**

**(Total 15 Marks)**

**QUESTION 5**

(a) In relation to Taxation of Incomes from Settlements, Trusts, and Estates, you are required to define the following:

i. A Settlement
ii. A settlor
iii. An Estate
iv. Annuitant
v. Remainder Man
vi. Chargeable persons

(6 marks)

(b) The tax implications of business combinations depend on the nature of arrangement entered into by the Companies and the result of such arrangement. What are the implications of the underlisted scenarios?

i. Takeover of an existing company by a new one
ii. Acquisition or absorption of a company by an existing one
iii. Reconstituted companies

(9 marks)
QUESTION 6

Liyadi Trading Company Limited decided to change its Accounting year-end from 31 March to 31 December of each year, for administrative convenience. Its 2007 assessment was based on its accounts for the year 1 April 2005 to 31 March 2006 on preceeding year basis. Accounts prepared and submitted during the relevant period were as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>Period</th>
<th>(12 Months) assessable profit</th>
</tr>
</thead>
<tbody>
<tr>
<td>1-4-05 to 31-3-06</td>
<td></td>
<td>120,000</td>
</tr>
<tr>
<td>1-4-06 to 31-12-2006</td>
<td></td>
<td>75,000</td>
</tr>
<tr>
<td>1-1-07 to 31-12-2007</td>
<td></td>
<td>240,000</td>
</tr>
<tr>
<td>1-1-08 to 31-12-2008</td>
<td></td>
<td>28,000</td>
</tr>
</tbody>
</table>

Required:

(a) State the Total Chargeable Income of Liyadi Trading Company Limited in the relevant years of assessment. (12 marks)

(b) State THREE situations under which a company may opt to change its accounting year-end date. (3 Marks)

(Ignore Capital Allowances) (Total 15 Marks)

SOLUTIONS TO SECTION A

PART I - MULTIPLE CHOICE QUESTIONS

1. A
2. A
3. B
4. D
5. D
6. D
7. B
EXAMINERS’ REPORT

The questions test a good proportion of the syllabus. All candidates attempted the questions. Performance was good as more than half of the candidates scored 50% and above.

PART II – SHORT-ANSWER QUESTIONS

1. Liable on conviction to a fine not exceeding N1,000 or to imprisonment for five years or to both such fine and imprisonment.
2. Double Taxation Relief
3. Foreign Tax
4. Federal High Court
5. G. factor is Gas Production Cost Adjustment factor
6. Deferral Method and Liability Method
7. within 5 months after the end of the accounting period in which the Profit was earned.
8. Duties on Instruments to confer Legal Title which may vary according to values of the subject Instrument.
9. Territory refers to the States of the Federation which includes the Federal Capital Territory.
10. 1% of the Qualifying Capital Expenditure
11. 30% of the Education Tax Fund
12. 3(three) years
13. The Investment income less the management expenses (including commission)
14. 30 (thirty) days
15. Production Day
16. To be part of the first Basis Period
17. 21 (twenty one) days
18. 7 (seven)
19. 4 (four) years
20. Cessation, Commencement, Change of Accounting Date

EXAMINERS’ REPORT

The questions test a sizeable proportion of the Syllabus. All Candidates attempted the question. Performance was average as about 50% of the candidates scored 50% and above.

SECTION B

SOLUTION TO QUESTION 1

OMOBA OLADELE & CO

The Chairman, Federal Inland Revenue Service, August 10, 2008
Integrated Tax Office,
Broad Street,
Lagos.

Dear Sir,

MURIDEEN LIMITED
NOTICE OF OBJECTION TO BOJ ASSESSMENT

We write to you on behalf of our above named client and acknowledge receipt of your Notice of Assessment as detailed below:

Assessment Notice No : LC/0005/08
Date of Assessment : July 20, 2008
Date of Delivery : July 27, 2008
Period of Assessment : 1/1/2008 - 31/12/2008
Total Profit : ₦13,150,000
Tax Payable : ₦3,195,000

We write to object to the said assessment based on the following grounds:-

(i) That the Best of Judgement Assessment of ₦3,195,000 is arbitrary, excessive, punitive and without basis.

(ii) The returns for the assessment year 2008 based on the accounts for the year ended 31st December, 2007 were filed on 24th June, 2008 which was within the due date.

(iii) The tax computations, the duly filed Self Assessment Form together with the Tax Receipts were included in the Returns, all of which have been disregarded by you.

We therefore, hereby urge you to discharge the Best of Judgement Assessment raised on our client and accept the Tax Returns already sent to your office.

While looking forward to your letter of discharge, we seize this opportunity to thank you for your understanding and co-operation.

Yours faithfully,

Omoba Oladele & Co.
Tax Consultants
b. Steps to resolve the Additional Tax

(i) Write to object to the final demand notice of the additional assessment raised.

(ii) In the objection letter, refer to the relevant section of CITA (sec.20) that states that expenses on repairs and cost of spare parts for Plant, Tools etc; are to be treated as allowable expenses for income tax purposes.

(iii) Schedule a reconciliation meeting with the Tax Inspector.

(iv) Ensure that you receive a response from the Inspector in writing, communicating their position based on the reconciliation meeting you had with them.

(v) After the meeting, if they refuse to discharge the demand notice, advise your client of your intention to proceed to the Tax Appeal Tribunal (TAT).

(vi) File a notice of appeal with the Tax Appeal Tribunal and serve the tax office a copy of the notice of appeal.

(vii) Attend the Appeal Tribunal with relevant documents to prove that the expense was wholly incurred by your client.

(viii) If the decision of the TAT is not favourable, advise your client to arrange for a legal adviser in order to commence court proceedings up to Supreme Court.

(ix) The decision of the Supreme Court shall be final and conclusive.

EXAMINERS’ REPORT

The question is designed to assess candidates’ knowledge and understanding of the: The procedures adopted in handling issues relating to the filing of Corporate Tax Returns, Method of discharging, Best of Judgement (BOJ) assessments and the incidence of Additional Assessments.

About 40% of the candidates attempted the question. Performance was below average as less than 25% of the candidates who attempted the question scored above 40% of marks obtainable.

Most of the candidates exhibited a poor understanding of the question and as a consequence, performance was very poor.

Common pitfalls are as follows:

Most of the candidates could not present the correct format of a Letter of Objection.
Some candidates could not differentiate between a Best of Judgement assessment and additional assessment.

Candidates are advised to devote a good portion of their study time practising with worked examples found in relevant textbooks as well as the Institute’s Pathfinders and Study Packs.

**QUESTION 2**

(a) The status of a lost Instrument are as follows:

(i) A lost Instrument is presumed to have been duly stamped but where there is a proof that it has not been stamped, it remains unstamped.

(ii) When a duly stamped Instrument has been lost, a replica may by concession be stamped free of charge or if a replica has been stamped, it may be required that the original duty be repaid. The rate of duty at that point in time shall be the rate of duty in force at the time of the original instrument.

(iii) Claims for stamping of a replica where an original has been lost should be sent to the Stamp Duties office at which the lost document was originally stamped.

(iv) An Instrument which is not lost can be presented for Stamping on the payment of the necessary penalties if the presentation is outside the statutory time limit. A lost Instrument cannot be so presented.

(b) The Tax Appeal Tribunal has powers to;

- summon and enforce the attendance of any person and examine him/her on oath.
- require the discovery and production of documents.
- receive evidence on affidavits.
- call for the examination of witnesses or documents.
- review its decisions.
- dismiss an application for default or deciding matters exparte.
- set aside any order or dismissal of any application for default or any order passed by it exparte.
- do anything which in the opinion of the Tribunal is incidental or ancillary to its functions.

(c) (i) Interest is taxable in Nigeria if it is payable by a Nigerian resident or a person in Nigeria or if it accrues to a non-resident from a Nigerian resident or a person resident in Nigeria.

(ii) Undistributed profits of a closed company is treated as distributed and taxed at source.

(iii) Power to set aside artificial and fictitious transactions and to impose adjustments to reflect arms’ length transactions.

(iv) Discretion of FIRSB to deny the application of commencement and cessation clauses and the grant of Initial allowances where sale or transfer of businesses is between connected persons.

(v) Where the true assessable profit cannot be ascertained or the assessable profit appears less than expected, the tax authority applies a reasonable and a fair percentage on the turnover or the contract sum which is known to determine the tax liability.

(vi) Dividend on which tax is payable due to no total profits or total profits which are less than the amount of dividend which is paid, are regarded as business profits, hence the dividend paid is taxed as Total Profit.

EXAMINERS’ REPORT

The question tests candidates’ knowledge and understanding of the incidence of some key concepts and their treatment under the Nigerian Tax Laws.

About 60% of the candidates attempted the question and performance was far below average.

Candidates displayed poor knowledge and understanding of the requirements of the question. Candidates are advised in the course of their preparations for the examinations to ensure they devote proportionate time to different parts of the syllabus.
QUESTION 3

(a) AKINTIMILEHIN PETROLEUM EXPLORATION LIMITED

COMPUTATION OF PETROLEUM PROFITS TAX UPSTREAM OPERATION FOR 2008 TAX YEAR

<table>
<thead>
<tr>
<th>Description</th>
<th>N'000</th>
<th>N’000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sale of Crude Oil</td>
<td>16,950,000</td>
<td></td>
</tr>
<tr>
<td>Incidental Income (2/3 x N'513,450)</td>
<td>342,300</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>17,292,300</td>
</tr>
</tbody>
</table>

Less: Allowable Upstream Expenses:

<table>
<thead>
<tr>
<th>Description</th>
<th>N’000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exploration Cost</td>
<td>1,960,000</td>
</tr>
<tr>
<td>Non-productive Rent</td>
<td>200,000</td>
</tr>
<tr>
<td>Royalties</td>
<td>250,000</td>
</tr>
<tr>
<td>Custom duties</td>
<td>400,000</td>
</tr>
<tr>
<td>Management and admin (2/3 x N'986,500)</td>
<td>657,667 (3,738,738)</td>
</tr>
<tr>
<td>Education tax (2/102 x N'13,824,633)</td>
<td>271,071</td>
</tr>
</tbody>
</table>

Adjusted/Assessable Profit

<table>
<thead>
<tr>
<th>Description</th>
<th>N’000</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>13,553,562</td>
</tr>
</tbody>
</table>

Less:

<table>
<thead>
<tr>
<th>Description</th>
<th>N’000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital allowance (2/3 x N'550,392)</td>
<td>366,928</td>
</tr>
<tr>
<td>Petroleum Investment Allowance (PIA)</td>
<td>450,392</td>
</tr>
<tr>
<td></td>
<td>817,320</td>
</tr>
</tbody>
</table>

Restricted to:

<table>
<thead>
<tr>
<th>Description</th>
<th>N’000</th>
</tr>
</thead>
<tbody>
<tr>
<td>85% of Assessable Profit</td>
<td>11,520,528</td>
</tr>
<tr>
<td>Less: 170% of PIA</td>
<td>(765,666)</td>
</tr>
<tr>
<td></td>
<td>10,754,862</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Description</th>
<th>N’000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital allowance claimable</td>
<td>(817,320)</td>
</tr>
<tr>
<td>Chargeable Profit</td>
<td>12,736,242</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Description</th>
<th>N’000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chargeable Tax at 85%</td>
<td>10,825,806</td>
</tr>
<tr>
<td>Education Tax at 2% of Assessable Profit</td>
<td>271,071</td>
</tr>
<tr>
<td>Total tax liability</td>
<td>11,096,877</td>
</tr>
</tbody>
</table>
(b) AKINTIMILEHIN PETROLEUM EXPLORATION LIMITED

COMPUTATION OF INCOME TAX ON DOWNSTREAM OPERATION FOR 2008 TAX YEAR

<table>
<thead>
<tr>
<th></th>
<th>₦’000</th>
<th>₦’000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales of Kerosine</td>
<td>2,400,000</td>
<td></td>
</tr>
<tr>
<td>Sales of Diesel</td>
<td>2,575,000</td>
<td></td>
</tr>
<tr>
<td>Sales of Petrol</td>
<td>3,500,000</td>
<td></td>
</tr>
<tr>
<td>Add: Incidental income</td>
<td>₦(513,450 – 342,300)</td>
<td>171,150</td>
</tr>
<tr>
<td>Total Income</td>
<td>8,646,150</td>
<td></td>
</tr>
<tr>
<td>Less: Allowable Expenses:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Management and admin cost</td>
<td>₦(986,500 – 657,667)</td>
<td>328,833</td>
</tr>
<tr>
<td>Transportation cost of refined product</td>
<td>750,000</td>
<td></td>
</tr>
<tr>
<td>Refinery costs</td>
<td>750,000</td>
<td>(1,828,833)</td>
</tr>
<tr>
<td>Assessable Profit</td>
<td>6,817,317</td>
<td></td>
</tr>
<tr>
<td>Less: Capital allowance</td>
<td>₦(550,392-366,928)</td>
<td>(183,464)</td>
</tr>
<tr>
<td>Total profit</td>
<td>6,633,853</td>
<td></td>
</tr>
<tr>
<td>Company Income Tax @ 30%</td>
<td>1,990,156</td>
<td></td>
</tr>
<tr>
<td>Education Tax @ 2% of Assessable profit</td>
<td>136,346</td>
<td></td>
</tr>
<tr>
<td>Total Tax liability</td>
<td>2,126,502</td>
<td></td>
</tr>
</tbody>
</table>

EXAMINER’S REPORT

The question is on Petroleum Profits Tax Act and tests an understanding of Upstream and Downstream Petroleum operations. The distinction between the Tax Laws that govern the administration of Upstream and Downstream, was one that candidates were expected to know. Upstream operations are governed by PPTA while Downstream operations are taxed under CITA.

Some candidates did not know this distinction. Consequently they provided one computation for tax liability and inevitably lost some marks. Many candidates attempted the question. The performance was poor notwithstanding the fact that the question was from an area of the syllabus that is tested frequently. It is an area that candidates cannot avoid because of its rating in the Syllabus as well as the fact that the Industry generates over 80% of National Income.

Candidates’ common pitfall was their inability to distinguish between Upstream and Downstream operations. Performance can be improved by candidates ensuring that
they cover the entire syllabus, work through some past editions of the Institute’s Pathfinder and Study Pack, in preparing for the examination. Candidates should also read questions carefully in order to understand the requirements of questions, before attempting to provide answers.

QUESTION 4

JANID INVESTMENTS LIMITED

(a) Computation of Capital Gains Tax Liability for 2008 Year of Assessment

<table>
<thead>
<tr>
<th></th>
<th>Lagos Building</th>
<th>Ibadan Building</th>
</tr>
</thead>
<tbody>
<tr>
<td>Compensation/Sales proceeds</td>
<td>N 25,000,000</td>
<td>N 15,500,000</td>
</tr>
<tr>
<td>Deduct:- Sales expenses</td>
<td>-</td>
<td>(N 3,250,000)</td>
</tr>
<tr>
<td>Net Compensation/Sales</td>
<td>N 25,000,000</td>
<td>N 12,250,000</td>
</tr>
<tr>
<td>Deduct:- Acquisition costs</td>
<td>(N 2,500,000)</td>
<td>(N 850,000)</td>
</tr>
<tr>
<td>Capital Gains Tax (10%)</td>
<td>NIL</td>
<td>N 1,140,000</td>
</tr>
</tbody>
</table>

The Capital Gains arising on the Lagos Building is exempted from Capital Gains Tax, because it relates to a compulsory acquisition of property by an authority that has the power to do so.

(b) The company can discharge its Capital Gains Tax liability by claiming Roll-Over-Relief from the disposal of the Ibadan Building. Full Roll Over Relief will be granted if the whole of the consideration of N15,500,000 obtained from the sale of the Ibadan building is reinvested in the construction of the Ogun building.

The time limit within which the proceeds from the sale of the old asset must be reinvested in the new asset is a period beginning twelve months before and ending twelve months after the disposal of the old asset.

“Please note that the tax law did not specify the time limit for claiming Roll-Over Relief.”
(c) **MR SMITH**  
**Computation of Capital Gains Tax Liability for 2001 year of assessment**

<table>
<thead>
<tr>
<th></th>
<th>₦</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Sales Proceeds</strong></td>
<td>159,350,000</td>
</tr>
<tr>
<td><strong>Less:- Sales Costs:</strong></td>
<td></td>
</tr>
<tr>
<td>Advertising Cost for Buyers</td>
<td>1,250,000</td>
</tr>
<tr>
<td>Surveyor’s and Valuers Fees</td>
<td>15,650,000</td>
</tr>
<tr>
<td>Estate Agent’s commission</td>
<td>12,122,340</td>
</tr>
<tr>
<td>Stamp Duty and other official costs</td>
<td>15,335,000</td>
</tr>
<tr>
<td></td>
<td>(44,357,340)</td>
</tr>
<tr>
<td><strong>Net Sales Proceeds</strong></td>
<td>114,992,660</td>
</tr>
<tr>
<td><strong>Less Acquisition Costs:</strong></td>
<td></td>
</tr>
<tr>
<td>Property (Land)</td>
<td>3,456,000</td>
</tr>
<tr>
<td>Legal Fees, Stamp Duties and other costs</td>
<td>1,220,000</td>
</tr>
<tr>
<td>Construction Costs of Estate</td>
<td>49,550,000</td>
</tr>
<tr>
<td></td>
<td>(54,226,000)</td>
</tr>
<tr>
<td><strong>Chargeable Gain</strong></td>
<td>60,766,660</td>
</tr>
<tr>
<td><strong>CGT @ 10%</strong></td>
<td>₦6,076,666</td>
</tr>
</tbody>
</table>

**EXAMINERS’ REPORT**

The question tests candidates’ understanding of the computation of Capital Gains tax liability and Roll Over Relief.

Almost all the candidates attempted the three parts of the question and performance was good.

The common pitfall was that some candidates computed Roll-Over Relief, which was not a requirement. An explanation of Roll Over Relief would have been sufficient as answer for the part (b) of the question.

Candidates should familiarize themselves with the requirements of the question and make their answers as precise as possible.

They should also use recent past editions of the Institute’s Pathfinders, the current Study Pack and other relevant publications in their preparations for the examination.
QUESTION 5

(a) (i) A Settlement: is a means by which the enjoyment of an Estate or part of it, is transferred to another person, either through Disposition, Trust, Covenant, arrangement or transfer of assets.

(ii) A Settlor: Includes a person by which a Settlement was made or entered into directly or indirectly and includes a person who has provided funds directly or indirectly for the purpose of the Settlement or has made with any other person reciprocal arrangement for that other person to make or enter into the settlement.

(iii) An Estate: Is the aggregate of the properties of a person either during his lifetime or on his death.

(iv) Annuitant: A person receiving an annual payment from the Estate which may be charged on the Income or Capital of specific assets of the Estate.

(v) Remainder Man: A person who has a right to the Capital of the Settlement, when the life interest terminates.

(vi) Chargeable Persons: Are persons liable to pay tax due from Settlements, Trusts, and Estates. They include:

- The beneficiary or annuitants, who is assessed on the proportion of the share of income from the Estate.
- The Trustee or Executor, who is assessed on the remaining income after the deductions of all amounts apportioned to the beneficiaries.
- The settlor or the person who created the Trust in circumstances where he can direct the disposition of the income or the right thereto.

(b)(i) Takeover of an existing company by a new one;
Where a new Company takes over an existing company, the tax implications are as follows:

- Cessation provisions will apply to the company that has been taken over.
- The new company commences a new business and commencement rules will apply.
The assets shall be deemed to be taken over at their market values. This may result in Capital Gains Tax.
- The new company will be entitled to claim Initial allowance on the value of the assets taken over.

(b)(ii) Acquisition or Absorption of a company by an existing one:
This will usually be by the acquisition of controlling interest in another company.

- Where the companies are in similar business both before and after, the tax implications are as follows:
- The commencement and cessation rules shall not apply. The company will be assessed on preceding year basis.
- The assets of the acquired company shall be deemed to be taken over at their tax written down values.
- Initial allowance shall not be claimable on the assets taken over.
- The company will continue to claim capital allowances on its assets.

However, where the companies are not engaged in similar business the following are the tax implications:
- The acquiring company would be deemed to have commenced a new business, therefore, commencement rules shall apply.
- The company acquired would be deemed to have ceased business, therefore, cessation rules shall apply on its profits.
- The assets shall be deemed to be taken over at their market values. This may result in capital gains tax for the acquired company.
- The acquiring company will be entitled to claim Initial allowances on the assets taken over.

(iii) Where the reconstituted company is incorporated to carry on a trade or business previously carried on by a foreign company and the assets employed by the foreign company in that trade or business vest in the reconstituted company, then the following provisions shall apply:

- The commencement and cessation provisions shall not apply to the reconstituted company;
- The assets vested in the reconstituted company shall be deemed to have been sold to it, on the day of incorporation of that company, for an
amount equal to the residue of qualifying expenditure thereon, on the day following the cessation of the foreign company’s trade;

- The reconstituted company shall not be entitled to any initial allowance on those assets and shall be deemed to have received all capital allowances granted the foreign company on those assets;

- Unrelieved losses of the foreign company on the date of the reconstitution shall be deemed to have been incurred by the reconstituted company in its trade or business during the first year of assessment and shall be deductible from its assessable profits;

- Deduction of such losses is to be made from the assessable profits, if any, of the reconstituted company for the first year of assessment and so far as it cannot be so made, then from the amount of the assessable profits of the year of assessment and so on up to the fourth year after the commencement of such business.

EXAMINERS’ REPORT

The question tests candidates’ understanding of the computation of Taxable Incomes of Trusts, Settlements and Estates, as well as their knowledge of the tax implications of the various forms of business combinations. About 40% of the candidates attempted the question and their performance was poor. Common pitfall was that candidates demonstrated poor knowledge of the requirements of the question.

Candidates are advised to pay more attention to their study and better understanding of a number of basic concepts encountered as they cover the various aspects of the Syllabus.

QUESTION 6

(a) LIYADI TRADING COMPANY LIMITED
ASSESSABLE PROFITS COMPUTATION USING OLD ACCOUNTING DATE

<table>
<thead>
<tr>
<th>Year</th>
<th>Assessable Profits</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007 Assessment Year: 1/4/2005 to 31/3/2006</td>
<td>₦120,000</td>
</tr>
<tr>
<td>2008 Assessment Year: 9 Months 1/4/2006 to 31/12/2006</td>
<td>₦75,000</td>
</tr>
<tr>
<td>3 Months 1/1/2007 to 31/3/2007</td>
<td>₦60,000</td>
</tr>
<tr>
<td>(25% of = ₦240,000)</td>
<td></td>
</tr>
</tbody>
</table>


**ASSESSABLE PROFIT USING THE NEW ACCOUNTING DATE**

2007 year of Assessment: Jan-Mar 2006 (3 Months) 25% of 
\[
\text{N}120,000
\]
April – December 2006 (9 Months) 
\[
75,000
\]

2008 year of Assessment: January-December 2007 
\[
(12 	ext{ Months}) \text{ assessable Profit}
\]
\[
240,000
\]

2009 year of Assessment: January- December 2008 
\[
(12 	ext{ Months}) \text{ assessable Profit}
\]
\[
28,000
\]

**COMPARATIVE FIGURES**

<table>
<thead>
<tr>
<th></th>
<th>Old Date</th>
<th>New Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>120,000</td>
<td>105,000</td>
</tr>
<tr>
<td>2008</td>
<td>255,000</td>
<td>345,000</td>
</tr>
<tr>
<td>2009</td>
<td>187,000</td>
<td>28,000</td>
</tr>
<tr>
<td>Total Chargeable Income</td>
<td>442,000</td>
<td>373,000</td>
</tr>
</tbody>
</table>

**Comment**

Based on the above computation, it is obvious that the tax authority will assess LIYADI TRADING COMPANY LTD to tax for its 2007, 2008, and 2009 assessment years using the old accounting date with total Chargeable Income of \text{N}442,000 because it will result in a higher Tax Revenue to the Authority.

(b) The following are the conditions under which a company may opt to change its Accounting year end:

(i) To align its accounting date with that of the Holding Company in the case of a Subsidiary.

(ii) To absorb accumulated losses.
(iii) To align with seasonal variation in the company’s cash flow.
(iv) To conform with the accounting date or budget date of the government.

EXAMINERS’ REPORT

The question assesses candidates’ knowledge of and their ability to compute the chargeable income of a trading company as well as their understanding of the possible reasons why a company might desire to change its accounting year-end date.

Almost all the candidates displayed good knowledge of the question, as the performance was well above average.

The few candidates that performed poorly displayed scant knowledge of possible reasons why companies may opt to change their accounting year-end date. Candidates are advised not to limit their studies to computations, but the reasons for the peculiarity of certain computations.
SECTION A: Attempt All Questions

PART I: MULTIPLE-CHOICE QUESTIONS (20 Marks)

1. The Auditor-General for the Federation is expected to state in his report, whether in his opinion,

   i. Proper books of accounts have been kept.
   ii. The accounts show a true and fair view of the financial state of government.
   iii. There are adequate controls over the safety of public funds.

   A. i and ii
   B. ii and iii
   C. i, ii and iii
   D. ii only
   E. i and iii

2. Which of the following is a source of government revenue?

   A. Federation Account Revenue Heads
   B. Federal Accounts Allocation Committee
   C. Consolidated Revenue Fund
   D. Value Added Tax
   E. Federal Government Account Revenue Heads.

3. Who among the following, is NOT a member of the Economic and Financial Crimes Commission?

   A. Minister of Finance.
   B. Chairman, National Drug Law Enforcement Agency (NDLEA).
   C. Commissioner for Insurance.
   D. Comptroller General, Nigerian Customs Service.
   E. Director-General, Securities and Exchange Commission.
4. Which of the following particulars is **NOT** required on an Adjustment Voucher?

A. Reason for the transfer or adjustment.
B. Voucher number.
C. Month of account.
D. Particulars of treasury or audit query that originates the adjustment.
E. Name of beneficiary.

5. Which of the following is **NOT** a method of preparing a public sector organization's annual budget?

A. Planning, programming and budgeting system.
B. Rolling plan method.
C. Line item method.
D. Traditional method.
E. Incremental method.

6. In accordance with Section 16 of Finance (Control and Management) Act LFN 2004 into which of the following accounts shall monies appropriated and not expended lapse and accrue to, at the expiration of the year, in respect of which such monies are appropriated?

A. Consolidated Revenue Fund.
B. Capital Development Fund.
C. Lapsed Capital Development Fund.
D. Contingency Fund.
E. Special Fund.

7. The Federal Executive Council has power to award contracts in excess of

A. ₦20 million.
B. ₦30 million.
C. ₦40 million.
D. ₦50 million.
E. ₦100 million.
8. In accordance with Financial Regulations (FR) No 3205 – Revised to January 2009, which office is empowered to authorize parastatals to obtain loans or any other form of advance from Commercial Banks?

A. Office of the Auditor-General for the Federation.
B. Office of the Accountant General of the Federation.
C. Debt Management Office.
D. Bureau of Public Procurement.
E. Budget office, Federal Ministry of Finance.

9. Which of these uses monetary and fiscal policies as a means of control over Government expenditure?

A. Ministry of Finance.
B. The Treasury.
C. The Legislature.
D. The Executive.
E. Ministries and Extra-Ministerial Departments.

10. A technique of project appraisal which enables management to determine the cheapest means to meet a well defined objective is

A. cost-effectiveness analysis.
B. cost benefit analysis.
C. sensitivity analysis.
D. cost of service appraisal.
E. cost of benefit appraisal.

11. Which of the following is NOT an in-flow into a state government’s Consolidated Revenue Fund?

A. Statutory Allocation from Federation Account
B. Licences
C. Income tax of Armed Forces personnel
D. Court fees and medical fees
E. Dividends from state business-like activities.
12. **Pension** is 
   A. gross salary, including allowances, paid to a retiring officer. 
   B. a monthly payment to an officer who is sick. 
   C. a lump sum paid to an officer on forced retirement. 
   D. a monthly, quarterly or yearly payment to a retired officer who has served for a statutory period. 
   E. a lump sum paid to a retired officer who has served for the statutory period. 

13. Which of the following Expenditure Warrants is expected to be in operation for a maximum period of six months or until the budget has been approved? 
   A. Supplementary (statutory) expenditure warrant 
   B. Reserve expenditure warrant 
   C. Annual general warrant 
   D. Provisional general warrant 
   E. Supplementary (contingencies) warrant 

14. The following ratios highlight the short-term liquidity and soundness of a parastatal **EXCEPT** 
   A. current Ratio. 
   B. debtors’ payment period. 
   C. gearing Ratio. 
   D. quick Assets Ratio. 
   E. creditors’ payment period. 

15. Funds which are held and managed by the government as custodians and trustees are known as ..................... funds. 
   A. proprietary 
   B. general 
   C. fiduciary 
   D. custody 
   E. revolving 

16. All the following are classified as domestic debts of government, **EXCEPT** 
   A. debt instrument publicly issued through the Central Bank. 
   B. outstanding contractual obligations to its citizens.
C. direct borrowings from multilateral financial institutions.
D. direct borrowings from deposit money banks.
E. overdraft from the Central Bank.

17. The relevant factors in the success of fiscal federalism do **NOT** include

A. technical and administration building in every locality.
B. centralisation of revenue collection.
C. revenue mobilisation to support government activities.
D. institution of liberal democracy.
E. local autonomy.

18. Which of the following debt management strategies involves changing the maturity structure of a loan?

A. Debt re-scheduling.
B. Debt conversion.
C. Debt forgiveness.
D. Debt restructuring.
E. Debt-equity swap.

19. The criterion for revenue sharing which requires that economic growth and improvement in living standards should be spread to reduce inequality in the Federation is referred to as the principle of

A. equality of states.
B. even development.
C. fiscal efficiency.
D. derivation.
E. need.

20. Which of the following is **NOT** one of the headings into which the capital and recurrent expenditures of the Federal Government are specifically classified?

A. Social and Community Services
B. Economic Services
C. Administration
D. Defence
E. Transfers
PART II: SHORT ANSWER QUESTIONS (20 MARKS)

1. Not later than ninety days following the end of each year, the distribution from the Federation Account shall be rendered to the National Assembly by the .........

2. When a taxpayer seeks to reduce his tax liability through an illegal method, he is said to be engaged in ..............

3. The automatic adjustment of the income and expenditure of government in relation to ‘boom’ and ‘burst’ in the economy is called ..............

4. A development plan spanning a period of not less than 15 years is called ..............

5. A Ministry or Exra-Ministerial Department which has no control whatsoever over any of its accounting records is referred to as ..............

6. A ............... is operated from the commencement to the end of a financial year; and on the last working day of the year, an account is rendered and all unspent balances lapse.

7. A commodity that is non-rivaled and non-excludable in consumption is referred to as ..............

8. The collection and disbursement of government revenue aimed at achieving certain economic objectives is referred to as ..............

9. The total money owed by the Federal Government to its citizens is known as ..............

10. A financial statement prepared in order to explain how the wealth generated by a parastatal is distributed among interested parties is known as ..............

11. Documents issued by the Accountant-General to introduce new policies and guidelines or amend existing ones are known as ..............

12. The items of revenue and expenditure not provided for in the budget, but which form part of government accounts are called ..............
13. What documents should support Stores Receipt Vouchers and Invoices before payments are effected?

14. What accounting basis records revenue when received and not earned but recognises liability once it is incurred?

15. According to the International Public Sector Accounting Standard (IPSAS) No 27 – Agriculture, what is the harvest product of an entity’s biological assets called?

16. Give the formula used to calculate the Proportional Area Size (PAS) for each State when allocating revenue.

17. According to Financial Regulations, stocks of material and equipment purchased with Government funds is known as ......................

18. The fund set aside to meet unforeseen circumstances is known as ................

19. Who gives approval to invest idle funds available to missions abroad in short term deposit accounts?

20. The estimate of government’s tax and non-tax revenue for a new fiscal year is called ....................

SECTION B: ATTEMPT QUESTION 1 AND ANY OTHER THREE (60 MARKS)

QUESTION 1

CASE STUDY

Landia is a developing country with a population of about 65 million people as per 2007 census. The North-Western region of the country which accounts for about one-third of the country’s population is inhabited by education loving people. In that region, much attention has been paid to plans to improve public school quality by increasing the scope of choice through a “School Voucher” system. The basic approach is to provide financial support to students rather than directly to schools. Each student would be given a tuition voucher that could be redeemed at whatever qualified private school that suited the students’ family.
Proponents of School Vouchers believe that it will have a good effect in the educational market of that area. Poorly run public schools that do not reform would lose enrollees and be forced to close down. Also, parents’ and students’ perception of teachers’ quality, which are more or less ignored by the public school system, would become the basis for punishing bad teachers and poorly run public schools. Furthermore, the availability of tuition monies would prompt entrepreneurs to establish new private schools in areas where the existing schools are poor.

**Required:**

(a) In this context, is education a public good? Give reasons for your answer. (4 Marks)

(b) Explain the term “School Voucher” (3 marks)

(c) What would be the effect of moving children from public schools to private schools? (4 marks)

(d) State the effects of competition on public schools? (4 marks)

(Total 15 marks)

**QUESTION 2**

(a) List **TWO** powers of the Fiscal Responsibility Commission as contained in the Fiscal Responsibility Act, 2007. (4 marks)

(b) Section 8(1) of the Act stipulates the conditions for cessation of membership of the Commission. State any six of the conditions. (6 marks)

(c) According to Section 56 of the Act, define:

   i. Appropriation Act
   ii. Arms of Government, and
   iii. Fiscal Risk Appendix (5 marks)

(Total 15 marks)

**QUESTION 3**

You have been provided with the following figures by the office of the Accountant-General of the Federation.

<table>
<thead>
<tr>
<th></th>
<th>2010</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Opening balance – 1st January</td>
<td>(1,901,863,760,453.00)</td>
<td>(947,979,460,214.00)</td>
</tr>
<tr>
<td>Issues from Contingencies Fund</td>
<td>-</td>
<td>1,500,000,000.00</td>
</tr>
</tbody>
</table>
You were also informed that necessary approval, to write off the various Dormant Accounts, has been sought and obtained from the Honourable Minister of Finance.

Required:

(a) Prepare a Statement of Consolidated Revenue Fund for the year ended 31 December 2010. (13 marks)
(b) State any TWO types of Adjustment Vouchers in use, as contained in the Financial Regulations (FR) No. 902 (Revised to January 2009) (2 marks)

(Total 15 Marks)

QUESTION 4

(a) What factors contribute to an effective audit in the public sector? (5 marks)
(b) Discuss the following types of audit:
   i. Fund Audit
   ii. Management Audit
   iii. Operational or System Audit
   iv. Vouching Audit
   v. Audit Verification (10 marks)

(Total 15 marks)

QUESTION 5

(a) Explain the terms “domestic debt” and “external debt”. (6 marks)
(b) Write brief notes on any THREE external debt management strategies based on your country’s experience. (9 marks)

(Total 15 marks)
QUESTION 6

Arikawe Local Government is planning to construct a road using either of two methods of construction. The following data were given:

Method 1

<table>
<thead>
<tr>
<th>Cost per kilometer</th>
<th>(₦)’000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Initial Capital Cost</td>
<td>50,000</td>
</tr>
<tr>
<td>Cost of Maintenance every 3 years</td>
<td>10,000</td>
</tr>
</tbody>
</table>

Method 2

<table>
<thead>
<tr>
<th>Cost per kilometer</th>
<th>(₦)’000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Initial capital cost</td>
<td>39,200</td>
</tr>
<tr>
<td>Cost of Maintenance every 3 years</td>
<td>12,000</td>
</tr>
</tbody>
</table>

Additional Information

It is expected that the road will have a maximum life of 18 years, if properly maintained. It is required to determine the cost effectiveness of each method at 10% rate of interest.

Required:
(a) As an expert in project appraisal, advise the local government on which of the methods to use. (13 Marks)
(b) Explain the term “Project Appraisal” (2 marks)

(Total 15 Marks)

SOLUTIONS TO SECTION A

PART I - MULTIPLE CHOICE QUESTIONS

1. C
2. D
3. A
4. E
5. B
6. A
7. E
8. C
9. D
10. A
11. C
12. D
13. D
14. C
15. C
16. C
17. A
18. A
19. B
20. D

EXAMINER’S REPORT

The questions cover the entire syllabus.

The questions were well attempted and the pass rate was above average. The candidates who did not earn pass marks appeared not to have prepared well for the examination. Candidates are advised to work harder towards future examinations.

PART II – SHORT-ANSWER QUESTIONS

1. Accountant - General
2. tax evasion.
3. built-in-stabiliser or built-in-flexibility or automatic stabilisation
4. perspective plan or long-term plan
5. Non-Self Accounting Unit.
6. standing imprest
7. public good
8. fiscal policy
11. Treasury Circulars
12. “Below – the – Line” Items
13. Local Purchase Orders or Letters of Award or Contract documents.
14. Modified Accrual Basis or Modified Cash Basis.
15. Agricultural produce
16. \( \text{PAS} = \frac{\text{Areal size of State}}{\text{Total Areal size of Nigeria}} \times 100/\text{Total Revenue}. \)
17. Stores.
18. Contingency Fund.
20. Revenue Budget.

SECTION B

SOLUTION TO QUESTION 1

(a) Education is a public good since in this context, government has made effort to ensure non-excludability through the system of “School Voucher”. This is due to the fact that public goods are those whose consumption is not in rival relationship in the sense that consumption by one individual will not reduce the benefit available to others and that excludability is not applicable.

NOTE: Strictly speaking, education is, in most cases, a quasi-public good as its benefits accrue not only to individual beneficiaries but also to the larger society, i.e externalities associated with investment in education.
(b) This is a voucher given to help a family to pay the tuition of its children at any qualified school. It is redeemed by the school and converted into cash.

(c) Moving children from public schools to private schools may result in closure of the former in areas where the existing schools are poor. The implication of this is a reduction in enrolment in public schools and an increase in enrolment in private schools. In addition, entrepreneurs will be encouraged to establish new private schools in areas where existing ones are poor.

d. The effect of competition on public schools will lead to reforms if they are to remain in existence.

In addition, teachers’ quality would become the basis for punishing errant teachers and poorly run schools.

EXAMINERS’ REPORT

The question tests candidates’ ability to assess a State Government’s role in the education of its citizens. It was attempted by a good number of the candidates. Performance was average.

Candidates’ observed pitfall is their inability to appreciate the fact that case study situations are replete with challenges to which chartered accountants have to proffer solutions. Solutions proffered to case studies should necessarily derive from details available in the write-ups.

It is recommended that candidates should benefit from the academic hints furnished in the ICAN study packs on case study issues.

QUESTION 2

(a) The powers of the Fiscal Responsibility Commission are to

i) formulate and provide general policy guidelines for the discharge of the functions of the Commission;

ii) superintend the implementation of the policies of the Commission;
iii) appoint for the Commission, such number of employees as may, in the opinion of the Commission, be expedient and necessary for the proper and efficient performance of the functions of the Commission;

iv) determine the terms and conditions of service in the Commission, including disciplinary measures for the employees of the Commission;

v) fix the remuneration, allowances and benefits of the employees of the Commission as approved by the Salaries and Wages Commission;

vi) do other things, which in its opinion are necessary to ensure the efficient performance of the functions of the Commission; and

vii) regulate its proceedings and make standing orders with respect to the holding of its meetings, notices to be given, the keeping of minutes of its proceedings and such other matters as the Commission may from time to time determine.

(b) The conditions for cessation of membership of the Fiscal Responsibility Commission as stated in the Act, are as follows:

(i) If a member becomes bankrupt or makes a compromise with his creditors.

(ii) If he/she is convicted of a felony or any offence involving dishonesty, corruption or fraud.

(iii) If he/she becomes incapable of carrying out the functions of his office, either by reason of infirmity of mind or body.

(iv) If the President is satisfied that it is not in the interest of the Commission or the interest of the public that the member should continue in office and the President removes him from office.

(v) If he/she has been found guilty of violation of the code of conduct or serious misconduct in relation to his duties.

(vi) If he/she resigns his/her appointment by notice under his/she hand addressed to the President.
(vii) If in the case of a person who becomes a member by virtue of his/her office and he/she ceases to hold such office, for whatever reason.

(c)

(i) ‘Appropriation Act’ means an Act or law passed by the National or State Assembly or Local Government, authorizing spending from the Consolidated Revenue Fund, and includes a Supplementary Appropriation Act or Law, and assented to by the appropriate authority.

(ii) Arms of Government refer to the Executive, Legislature and Judiciary.

(iii) Fiscal Risk Appendix is an explanatory attachment that provides a set of indicators that can be used to measure local fiscal risk.

EXAMINER’S REPORT

The question examines candidates’ knowledge of the powers of the Fiscal Responsibility Commission, the conditions for cessation of membership of the agency and definition of terminologies stipulated under section 56 of its establishing law.

However, only few candidates attempted it and performance was on the average. Their commonest pitfall was their lack of grasp of the provisions of the Act.

Candidates are advised to take seriously to every aspect of the syllabus by working hard for future examinations.
QUESTION 3

(a) Consolidated Revenue Fund for the year ended 31st December, 2010

<table>
<thead>
<tr>
<th></th>
<th>2010</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Opening Bal. -1st Jan.</td>
<td>(1,901,863,760,453.00)</td>
<td>(947,979,460,214.00)</td>
</tr>
<tr>
<td>Contingencies Fund:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Issues from</td>
<td>-</td>
<td>1,500,000,000.00</td>
</tr>
<tr>
<td>Transfers from</td>
<td>-</td>
<td>(1,500,000,000.00)</td>
</tr>
<tr>
<td>Add: Treasury Bills -</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Issued in the year</td>
<td>2,929,202,798,470.00</td>
<td>5,128,796,601,395.00</td>
</tr>
<tr>
<td>Repaid in the year</td>
<td>(2,853,842,970,098.20)</td>
<td>(6,044,795,728,913.00)</td>
</tr>
<tr>
<td>Add: Surplus of Rev. over Exp. -</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Revenue</td>
<td>743,264,226,648.00</td>
<td>737,890,885,411.00</td>
</tr>
<tr>
<td>Total Expenditure</td>
<td>(529,763,075,155.00)</td>
<td>(523,233,913,333.00)</td>
</tr>
<tr>
<td>Transfers to Development: Fund during the year</td>
<td>(141,702,320,617.41)</td>
<td>(252,542,144,799.00)</td>
</tr>
<tr>
<td>Net Dormant Account written off</td>
<td>(1,774,682,293,782.27)</td>
<td>-</td>
</tr>
<tr>
<td>Balances c/f</td>
<td>(3,529,387,394,987.88)</td>
<td>(1,901,863,760,453.00)</td>
</tr>
</tbody>
</table>
(b) The types of Adjustment Vouchers in use, based on FR 902, are:

(i) Principal Journal Voucher
(ii) Supplementary Journal Voucher
(iii) Adjustment Voucher
EXAMINER’S REPORT

The question tests candidates’ knowledge of the preparation of a Statement of Consolidated Revenue Fund and types of Adjustment Vouchers under the Financial Regulations No 902 of year 2009.

Many candidates attempted the question and performance was average.

The commonest pitfall was their inability to adopt the conventional reporting format in that they intermingled the accounting items. A few candidates also committed errors of transposition, and were unable to cope with addition of figures in trillions.

Candidates are advised to keep abreast of Financial Regulations, ICAN Pathfinder publications and Study Packs.

QUESTION 4

A. The following factors make for effective audit in the public sector

i) Independence of the Auditor
The Auditor should be given a free hand to do his job. The auditor should not be under the control of management of the organisation.

ii) Adequacy and scope of the Auditor’s Power
The authority of the auditor should be guaranteed, and should be given adequate freedom to discharge his responsibilities.

iii) Expertise and professionalism of the auditor and his staff
The auditor should be adequately trained, versatile and skillful at his job.

iv) Resources at the Auditor’s disposal
There should be enough funds at the disposal of the auditor to carry out his assignment.

v) Freedom of reporting and the qualitative nature of reports
The reports which an auditor transmits should be promptly looked into; and timely and effective decisions taken.

B.i) Fund Audit – It is the audit of funds appropriated by the Legislature to ensure that

i) the funds are used for the authorised purposes.
ii) The total disbursement and commitment do not exceed the amount authorized.

iii) The funds are economically and efficiently utilized.

iv) Appropriations are not reserved without the approval of the National Assembly.

ii) Management Audit

This is a review of the performance of management during a period. It is synonymous with the performance review of the management, otherwise called “operational audit.”

iii) Operational or Systems Audit

The review concentrates on the operational aspect of management performance. It evaluates the efficiency and effectiveness of management practices in rendering services to the members of the public.

iv) Vouching Audit

This checks the relevance and adequacy of the supporting documents of a transaction. Receipts are checked to third parties while evidence and other financial papers are traced to the ledgers.

v) Verification Audit

It entails the confirmation of the existence of assets, liabilities and other balances in the books of accounts. This is achieved through the ascertainment of costs/value of assets/liabilities, authority for transactions, beneficial ownership and presentation of assets and liabilities.

EXAMINER’S REPORT

The question is on the factors which contribute to an effective audit in the public sector and types of audit.
Many candidates attempted the question and performance was above average. Only a few candidates did not understand the requirements of the question.

Candidates are advised to pay more attention to this area of the syllabus.

**QUESTION 5**

(a) Domestic debt refers to total debt obligations or accumulated borrowings of the Federal Government from her citizens. In general, domestic debt is procured through instruments such as treasury bills, treasury certificates, treasury bonds and government development stocks.

External or foreign debt refers to total money owed by the government to overseas governments and residents. For example, in Nigeria, external debt takes the following forms:

(i) trade arrears when the country trades with other countries and is unable to pay;
(ii) balance of payments support loan provided by multilateral institutions;
(iii) project-tied loans, and loans for socio-economic needs.

(b) External debt management strategies based on the Nigerian experience include:

(i) **Debt Refinancing:** A refinancing arrangement involves the procurement of a new loan by a debtor to pay off an existing debt, particularly short-term trade debt. The new loan may be contracted from the same creditors or a new set of creditors, as the case may be.

(ii) **Debt Rescheduling:** This is the re-arrangement of payment terms of debt with respect to new maturities, grace period and readjustment of the interest rate. The essence is to facilitate convenience in debt repayment. Series of rescheduling arrangements were negotiated with the Paris Club of creditors to which more than 50% of Nigeria’s external debt is owed.

(iii) **Debt-Equity Swap:** This involves the sale of external debts at favourable discount for equity participation in domestic enterprise

(iv) **Debt Buy-Back:** The buy-back arrangement implies the offer of a substantial discount to pay off an existing debt.
(v) **Debt Conversion:** This is the exchange of monetary instruments, e.g., promissory notes or par bonds, for tangible assets or other financial instruments. It is a mechanism for reducing a country's external debt by changing the character of its debt. Debt conversion may or may not bring in additional money but it is aimed at enhancing debt management and facilitating a country's access into international financial market area. Under the debt conversion program the Central Bank of a debtor nation would agree to repay a foreign currency denominated debt guaranteed by the public in local currency, on the condition that the local currency proceeds would be used for specific domestic activities.

(vi) **Debt Forgiveness:** This may take the form of reduction or total cancellation of financial obligation owed the creditor country. This is a form of debt relief. An example is the over US $18 billion debt forgiveness by the Paris club of creditors in 2005 during the Obasanjo Administration.

**EXAMINER’S REPORT**

The question tests, candidates' understanding of the concepts of “domestic debt,” “external debt” as external debt management strategies.

Many candidates attempted the question and performance was well above average.

The commonest pitfall was that some candidates mistook ‘debt restructuring’ for ‘debt re-scheduling’ and failed to enhance their response with contemporary examples.

Candidates are enjoined to study this area of the syllabus with more seriousness.
**QUESTION 6**

**ARIKAVE LOCAL GOVERNMENT**

**PROJECT APPRAISAL**

(a) **Method 1**

<table>
<thead>
<tr>
<th>Year</th>
<th>Cash Flow</th>
<th>DF @ 10%</th>
<th>Present Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>Initial Capital (50,000)</td>
<td>1.0000</td>
<td>(50,000.00)</td>
</tr>
<tr>
<td>3</td>
<td>Maintenance (10,000)</td>
<td>0.7513</td>
<td>(7,513.00)</td>
</tr>
<tr>
<td>6</td>
<td>Maintenance (10,000)</td>
<td>0.5645</td>
<td>(5,645.00)</td>
</tr>
<tr>
<td>9</td>
<td>Maintenance (10,000)</td>
<td>0.4241</td>
<td>(4,241.00)</td>
</tr>
<tr>
<td>12</td>
<td>Maintenance (10,000)</td>
<td>0.3186</td>
<td>(3,186.00)</td>
</tr>
<tr>
<td>15</td>
<td>Maintenance (10,000)</td>
<td>0.2394</td>
<td>(2,394.00)</td>
</tr>
<tr>
<td></td>
<td><strong>Net Present Value</strong></td>
<td></td>
<td><strong>(72,979.00)</strong></td>
</tr>
</tbody>
</table>

(b) **Method 2**

<table>
<thead>
<tr>
<th>Year</th>
<th>Cash Flow</th>
<th>DF @ 10%</th>
<th>Present Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>Initial Capital (39,200)</td>
<td>1.0000</td>
<td>(39,200.00)</td>
</tr>
<tr>
<td>3</td>
<td>Maintenance (12,000)</td>
<td>0.7513</td>
<td>(9,015.60)</td>
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<tr>
<td>6</td>
<td>Maintenance (12,000)</td>
<td>0.5645</td>
<td>(6,774.00)</td>
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<tr>
<td>9</td>
<td>Maintenance (12,000)</td>
<td>0.4241</td>
<td>(5,089.20)</td>
</tr>
<tr>
<td>12</td>
<td>Maintenance (12,000)</td>
<td>0.3186</td>
<td>(3,823.20)</td>
</tr>
<tr>
<td>15</td>
<td>Maintenance (12,000)</td>
<td>0.2394</td>
<td>(2,872.80)</td>
</tr>
<tr>
<td></td>
<td><strong>Net Present Value</strong></td>
<td></td>
<td><strong>(66,774.80)</strong></td>
</tr>
</tbody>
</table>

**Decision:**

Based on the above computations, Method 2 maintenance pattern is more cost effective because the net present value in Method 2 is lower than that of Method 1, hence Arikawe Local Government should adopt it.
i. **Method 1**

<table>
<thead>
<tr>
<th>Year</th>
<th>Outlays</th>
<th>Cash Flow</th>
<th>DF (10%)</th>
<th>Present Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>Initial Capital</td>
<td>50,000</td>
<td>1.0000</td>
<td>(50,000.00)</td>
</tr>
<tr>
<td>1-15</td>
<td>Maintenance</td>
<td>10,000</td>
<td>2.2979</td>
<td>(22,979.00)</td>
</tr>
</tbody>
</table>

Net Present Value = (72,979.00)

**Method II**

<table>
<thead>
<tr>
<th>Year</th>
<th>Outlays</th>
<th>Cash Flow</th>
<th>DF @(10%)</th>
<th>Present Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>Initial Capital</td>
<td>(39,200)</td>
<td>1.0000</td>
<td>(39,200.00)</td>
</tr>
<tr>
<td>1-15</td>
<td>Maintenance</td>
<td>(12,000)</td>
<td>2.2979</td>
<td>(27,575.00)</td>
</tr>
</tbody>
</table>

Net Present Value = 66,775.00

(b) Project Appraisal involves the evaluation of investments in order to determine the value of such projects and make a categorical decision about the relative worth of the projects. It is the assessment of a project as to the operational, technical, economic, financial and managerial efficiency of that project in the future.

**EXAMINER’S REPORT**

The question tests candidates’ knowledge of investment appraisal and cost effectiveness consideration of two alternative courses of action.

Many candidates attempted it and performance was above average. The commonest pitfall is their inability to derive the discount factors to appraise the worthwhileness of the two alternative courses of action and appreciate the fact that costs of maintenance were cash outflows. Consequently, they could not carry out their investigations and advise the local government appropriately.

Candidates erroneously discounted the maintenance cost in the eighteenth year, outside the project’s useful life.

Candidates are enjoined to read up this topic in the ICAN Study Pack and other recommended books and journals.
SECTION B – READ & DIGEST

CASE STUDY

INTRODUCTION

Augustina Plc is a company incorporated to manufacture and distribute food products that are widely accepted in many homes in Nigeria. It has operated for over 15 years since taking over the business of Just Here Nigeria Limited. The main business of Just Here Nigeria Limited was distribution of food items and other agricultural produce in the South-West geographical zone of Nigeria.

The Chief Executive Officer (CEO) of Augustina Plc, Mr. Babalola was formerly working with Jojolawo Plc for several years and thus brought into Augustina Plc a wealth of experience. Earlier in his working career, Mr. Babalola had worked with Kong Manufacturing Limited, a Chinese company where he imbibed the culture of collaboration with staff in the decision making process. Mr. Babalola, the Chief Executive Officer, is assisted by a formidable team of managers recruited from major Food and Beverage companies in the country.

The Management team tried to collectively direct individual wisdom at serving the customers. No one owned an idea. Ideas were to be shared in order to enhance their value and achieve enlightenment to aid right decisions. The prevailing principle was that a manager presents his ideas to others at 80% completion for others’ contributions and criticisms before a final proposal.

The objectives of the Management of Augustina Plc had at the onset were to:

(i) attract and retain qualified employees
(ii) remove inequalities in workers’ compensation
(iii) recognise, motivate and reward competent workers with extra efforts and achievements
(iv) ensure that compensation compares favourably with competitive organisation within the same industry
(v) help the organisations to maximize its profit.

The management of Augustina Plc was able to achieve all these objectives to a very large extent in the early years of the existence of the company.

PERFORMANCE OF THE COMPANY

Augustina Plc, by virtue of its size, expanded the coverage of the market beyond that of Just Here Nigeria Limited to other parts of the country soon after taking over.

The company had the financial support of Thrift Microfinance Bank Limited and had access to loans and overdraft facilities to finance its working capital needs and necessary expansion. This was made easy because of the relationship among the Directors of the two organisations. As a matter of fact, the CEO of the two organisations are family friends.

As a out fall of the familiarity of the officers concerned, loans and overdraft facilities were granted without necessarily following protocols and other due processes. Some of the loans obtained were diverted by Mr. Babalola to private concerns and other areas not directly beneficial to Augustina Plc. The Finance Department, to worsen matters, paid little or no attention to the management of cash, because Mr. Babalola was in charge.

The last five years witnessed a rapid growth in sales over the relatively short time period. Thanks to the influence of Mr. Babalola and his friends in the industry who are ever willing to assist the marketing drives he made. The growth in sales was accompanied by equally rapid growth in stocks and debtors, including fixed assets.

Despite the fact that Augustina Plc. was operating at a profit, of recent, it could no longer meet its debts as they fall due. This is because cash has been absorbed by growth in fixed assets, stocks and debtors.

The Profit and Loss of Augustina Plc and the Balance Sheets of the last three years are as stated in Exhibit 1 and 2 respectively.
The Directors of Augustina Plc, all along, were of the opinion that sufficient capital could be generated from trading profits that would be ploughed back into the business. Unknown to them, there had been steady erosion of the company’s capital base due to non-replacement of the long-term loans after their repayment. To worsen the situation, the CEO of Thrift Microfinance Bank Limited retired and it was no more business as usual in obtaining fresh loans and overdraft facilities.

MANAGING THE CRISIS

The liquidity crisis became a cause for concern to the CEO of Augustina Plc and he formed a review committee headed by Mr. Ettim, the Commercial Director, to look into the issues and come up with ideas for deliberation and approval of management.

The review committee could not arrive at any concrete decision as opinions were divided between them.

The CEO rose to address the Board Members and other members of staff.

“The votes of the members of the review committee have produced such an inconclusive situation that a definite recommendation to the Board of Directors is not possible. I will make a motion on the following basis”:

Meanwhile, Ms Mary King, the group marketing manager walked in. Mr. Babalola then pushed the pile of reports, regulations and newspaper clippings across the desk to her, and started explaining the events under deliberation to her and everybody present, in greater detail.

“Mary, “he said”, I want you to review all these pieces of information, but pay particular attention to the financial sections. I need to know exactly what the costs are for each alternative, and what the bottom line looks like. I want to know which of these projects presented by the committee looks more desirable.

Let’s face it, this is a highly political situation. I didn’t want to get involved, and now I am stuck in the middle. In addition to the financial analysis, I need three questions answered. Given the lack of expertise displayed by the committee we set up;

- What action should we recommend?
- How should we present our analysis?
- How can we avoid this kind of confrontation in the future?
The problem is complicated by the fact that virtually none of the committee members has had experience with economic analysis, so you’ll need to explain everything very clearly. You’ll need some background in financial analysis yourself. There are a few tricks to it. I have attached a one-page note on it for your information. Be certain to read it before you begin.

Run these numbers and send me a two-page analysis of (1) your results and (2) your suggestions on the questions I have raised.”

In his own reaction, Mr. Obalogbon, the Finance Director, having listened with concern, felt that emotions were distorting the issues being considered. He asked for permission to address the meeting and it was granted by the CEO.

He has the following to say: “I have been busy with Bank business and I must admit that I have never looked closely at the financial position of the company but I have been glancing at them now, and I think that my team could take a closer look at them.

Frankly, I can’t see my way through these committee’s reports and I am not satisfied with the financial analysis so far. I’d like to move that we suspend the motion until I contact my colleagues at the Bank to get their opinions. It also seems to me that it wouldn’t hurt to cool down a bit before we make a final decision.”

Everyone present looked a little bit relieved by Mr. Obalogbon’s suggestion and he noticed that he had inadvertently taken on the role of a mediator.

**MANAGING WORKING CAPITAL**

The Finance Director was convinced that the starting point would be a better control and management of working capital, most especially the collection of overdue accounts. He made a proposal to the Board of Augustina Plc that the company should offer a discount for payment within 10 days to its customers, who currently pay after 45 days. He is pretty sure that 40% of the credit customers would take the discount. The administrative cost savings to be gained would be \( \text{₦}4,450 \) per year. The sales, which is currently at \( \text{₦}200 \) million per year, would not be affected by the discount. The cost of short-term finance would remain at 11%.

Another proposal on the same issue submitted by the Finance Director is aimed at increasing Sales and Liquidity. In his analysis, he submitted that at the current level of sales, the Bad Debts have been 1% of sales. He noted that Cost of Sales comprises 80% Variable Costs and 20% Fixed Costs. The company’s required Rate of Return is 12%.
The Finance Director believes that if days of Credit allowed to customers should be increased to 60 days instead of the current 45 days, Sales would improve and consequently, Liquidity.

The Chief Executive Officer is sceptical and is not sure whether Augustina Plc. should consider introducing either of the proposals made by the Finance Director. The CEO of Augustina Plc did not let the matter go to rest at the level of the Finance Director only, he gave specific tasks and responsibilities to the other Directors.

Mr. Ettim, the Commercial Director, was saddled with the responsibility of considering the feasibility of expansion to a foreign location, preferably in the West African sub-region. He was to, as a matter of urgency, submit a report on this for discussion at the next Board Meeting.

DISTRIBUTION PROBLEM

In the interim, the CEO would like the management team to have a critical study of the transportation costs for distributing the existing product as one of the cost cutting measures to alleviate the present liquidity crisis.

At present, there are three production plants in Augustina Plc. These plants supply finished goods to the two distribution plants located in Kaduna (to cover the Northern part) and Owerri (to cover the Eastern part). The new option to be considered is adding another distribution plant in Lokoja (to cover the middle belt of the country). However, this must be done at the minimum cost possible for the cost cutting exercise to be meaningful. The costs likely to be incurred in Naira are as shown in Exhibit 3.

The production capabilities at the three production plants A, B, C, are 400 units, 600 units and 800 units loads per week respectively. The Management felt that the Lokoja distribution plant could absorb 400 units per week and Kaduna and Port Harcourt claiming 800 and 600 units per week respectively.

RAISING MORE MONEY

Continuing in the same vein, the CEO invited discussions on financial options to be explored with a view to improving liquidity position of Augustina Plc. He believed that it is possible to tap several other sources of funds to finance the increasing capital requirements for the ailing company.
It is to their advantage that, hitherto, the Fixed Assets have not been mortgaged for the loans outstanding. There is thus the possibility that Augustina Plc can raise money through the issuing of convertible or straight debentures pledging their assets as collateral. Other possibility might be the issuing of Ordinary Shares by way of Rights to existing Shareholders, since all hope is not lost in the survival of the Company using the right survival strategies.

He opined further that the option to be studied carefully could also include Sale and Leaseback Transactions to finance most of the company’s new production facilities. The CEO is convinced that Augustina Plc would be able to finance roughly N20million of its budgeted Capital Expenditure through sale and leaseback. The expected balance of necessary capital expenditure as well as working Capital needs would be financed through internally generated funds and/or Bank borrowings, if need be.

Members of the Management are challenged to come up with their views on the problems that may crop up on all or some of the options and strategies proposed above and also make suggestions on solving whatever problems they envisaged.

The imperative is to fulfil the objective of consolidating the Production Plants to become more profitable and to restore the company’s financial strength, allowing for expansion into areas of new profit opportunities would most probably trigger off the consideration that Augustina Plc should consider making a vertical integration with another company. Mr. Ettim, the Commercial Director, was mandated to conclude the spade work on this merger at the earliest opportunity.

**MERGER WITH GLOBAL FOODS LIMITED**

Global Foods Limited, though at a different stage of production, is within the same industry as Augustina Plc. The Commercial Director is convinced that the move to merge with Little Foods Limited will secure more outlet for the company’s products.

In his submission, he specifically mentioned that the shareholders’ wealth of Augustina Plc will be enhanced by the merger deal through economies of scale in distribution and production. Instead of investing efforts, time and money in research and development for new Patents, Trade Marks and Brands, Augustina Plc will benefit immensely by buying over Global Foods Limited. Apart from the growth potential, Market Share of the enlarged company will be further enhanced. The financial benefits that would likely be gained by Augustina Plc. would include acquisition of an undervalued target is Global Foods Limited was not quoted.
There is also likely benefit from tax shield and improvement in earnings per Share.

The agreement with the Shareholders of Global Foods Limited is to give three shares in Augustina Plc for each share held in Global Foods Limited. Other details are as follows:

<table>
<thead>
<tr>
<th></th>
<th>Augustina Plc</th>
<th>Global Foods Limited</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of shares</td>
<td>40 million</td>
<td>10 million</td>
</tr>
<tr>
<td>Annual earnings</td>
<td>N10 million</td>
<td>N5.8 million</td>
</tr>
<tr>
<td>P/E ratio</td>
<td>8</td>
<td>10</td>
</tr>
</tbody>
</table>

Post merger annual earnings of the enlarged company are expected to be 8% higher than the sum of the earnings of each of the Companies before the merger due to economies of scale and other benefits. The market is expected to apply a P/E ratio of 9% to the enlarged Company.

AFTER THE MERGER

Corporate planning at Augustina Plc became a paramount function for the executives who were enjoined to imbibe the culture of change. The CEO got the other Directors to recognise that nothing is good forever. Good planning, if done on a regular and timely basis, was assumed to result in improved performance. The CEO contended “planning as we used to stress, is making decisions now to improve performance tomorrow.”

The CEO of Augustina Plc urged his team to inculcate the culture that was accustomed to challenges.

They must constantly evaluate what is happening in the market place, what competition is doing and what opportunities are available.

To this end, a Group was formed, tagged “In House Consulting Group” and this Group was given some independence. The Group was made up of (i) Financial Planning (ii) Economic and Consumer Analysis and (iii) Operations Research units. The CEO was identified as the primary planner of the organisation.
EXPANSION BY WAY OF FOREIGN INVESTMENT

The Financial Planning Group presented a paper to the Management on “Pushes and Pulls to Internationalise.”

The basic question addressed was what motivates companies to expand their operations internationally. In some cases, the motive may be idiosyncratic, such as the desire of the Company’s chief executive to spend time in Mexico or in Europe but an extensive body of research suggests some more systematic patterns. This was to form the basis of the decision by the financial planning group to defend their paper. The traditional motivations to internationalise as identified by this Group are

- need to secure key supplies such as minerals, energy and scarce raw materials resources.
- market seeking behaviour: this is strong in companies that had some intrinsic advantage, typically related to their technology or their brand recognition.
- access low cost factor: Companies may find out that their products were at a competitive disadvantage compared to imports.

The Planning Group were able to quickly identify that while marketing and operating strategies can improve sales and profitability in existing outlets, an important part of success in the Food Industry is investment growth.

The top competitors of Augustina Plc. have been aggressively seeking access to low-cost factor in Foreign Market. Much of the success for these companies within the industry during the past years can be found in aggressive building up strategies.

In particular, a company is often able to discourage competition by being the first to build in a low population area that can only support a single food processing company. It is equally important to beat a competitor into more largely populated area where location is of prime importance.

The proposal of the Finance Planning Group was ultimately considered and a decision was taken that Augustina Plc. can expand beyond the Nigerian territory, most likely, to establish a branch in Ghana.
This is an aggressive strategy which was necessitated by the search for more profitable uses of the under-employed resources in Nigeria. It is also believed that the decision will lead to lower factor costs just as it will also enable the Company to have access to foreign business knowledge.

To this end, Augustina Plc made an application to the Ghanaian government and was lucky to be invited to start up this business. Incentives were offered for this inward investment.

This project, if successful will enable Augustina Plc to match competition from the Home Market and also favourably match the activities of other competitors who have already been successful in other Foreign Markets.

The CEO is of the opinion that there is no conceptual difference in the process of evaluating foreign investment decision as compared to domestic investment. He however wants to be doubly sure, hence he mandated the Commercial Director to give an insight into other distinctive features of international investment decisions.

Some essential features the Commercial Director highlighted in his report include the following:

- Project cashflows may need to be evaluated in foreign currency.
- Exchange rate movements create currency risk which may need hedging
- Foreign taxation system may differ from the domestic taxation system
- The investment may be subject to political risk
- Remittance of project cashflows may be restricted.

Exhibit 4 shows the Trial Balance of the operations of the Ghanaian outfit for the year ended December 31, 2009.

OTHER COMPETITIVE STRATEGIES

The Social Responsibility of Business

The “In House Planning Group” was unanimous in concluding that technical feasibility and economic profitability are not the only factors to influence business decision making. Businesses receive inputs from society therefore there is the need for companies to openly disclose their operations to the public. In the course of doing business, the environment is polluted and some indigenous economic activities are
impaired. It is imperative that society must be compensated.

What Augustina Plc. Planning Group decided to do was to offer employment to natives of the environment where their plants are located as a matter of priority.

The Company sells mostly national brands of food items and they provide refund and exchange policies that give their customers confidence. Their employees wear blue vests to more easily identify them and have friendly ushers at the doors of their shops.

The Exchange Policy and Job Promotion give their customers a good feeling that they are purchasing their own local products at Augustina Plc. For the Company, it is not all for free, they were able to pass on to the consumers through variation in their prices the cost of goods and services that are related to socially desirable activities.

**NEW INVESTMENT PROPOSALS**

The Planning Group of Augustina Plc. agreed that the sales and distribution methods should be expanded. As a result, it was decided that an addition be made to the fleet of distribution truck.

The Company had not yet decided which particular lorry to purchase, since the three lorries they need to choose from had broadly similar technical specifications and each was expected to have a working life of five years. The information available on the lorries being considered are shown in Exhibit 5.

**OTHER COST-CUTTING MEASURES**

Augustina Plc. and the other two leading food manufacturing companies have many similarities among their competitive strategies. They each attempt to provide a wide variety of high turnover goods at everyday low prices. To make economics the strategy work, they use economics of scale associated with centralised purchasing, warehousing and store planning. These companies were able to purchase in equally large quantities, which keep their product costs fairly similar to one another.

The Directors of Augustina Plc. were able to negotiate with the suppliers of their raw materials and an agreement was reached to cut their costs in order to retain the business of Augustina Plc. By accepting low margin on their business with Augustina Plc, the suppliers increased their volume and thus were able to battle competitors. Augustina Plc on the other hand, was able to increase its production at a lower cost and thus boost its selling capacity. The chain continues to the mutual benefit of all parties.
THE NEW AUDIT DEPARTMENT

The Directors of Augustina Plc wanted to be sure that the strategies they have just adopted are suitable and working in all departments. External auditors were invited to conduct an independent check on accounts receivables, notes receivables, interest earned and sales.

During the first audit, the auditors made an independent computation of the interest earned shown by the accounting records during the year. The amount of interest earned shown by the records was somewhat larger than the amount computed by the auditors. Careful analysis of entries in the interest earned account revealed one credit entry not related to any of the notes shown in the notes receivable account. Further investigation of this entry disclosed that a note had been obtained from a customer who was delinquent in paying his or her account receivable. The note receivable had not been recorded as an asset, but the account receivable that was replaced by the note had been written off as uncollectible.

Because of this situation, the auditors made a thorough investigation of all accounts written off in recent years, several of the former customers when contacted stated that they had been asked to sign demand notes for the balances owed and had been assured there would be no pressure for collecting as long as interest was paid regularly. The existence of notes receivable totalling two million naira was brought to light, these notes were not recorded as assets and were not known to officers of the client’s company.

The note transactions had been arranged by a trusted employee of Augustina Plc who admitted having extracted the interest payments received with the exception of one payment which, through oversight, he had permitted to be deposited as interest earned.

The External Auditors went further in sending confirmation requests to all customers whose accounts showed balances in excess of ₦10,000. Satisfactory replies were received from all but one account, which had a balance of approximately ₦100,000. A second confirmation request sent to this customer produced no response, but before the auditors could investigate further, they were informed by the Accountant that the account had been paid in full.
The Accountants, later after series of interrogation, confessed that the account in question was a fictitious one created to conceal a shortage and that to satisfy the auditors, he had “collected” the account receivable by diverting current collections from other customers whose accounts had already been confirmed.

Other cases that the Auditors discovered subsequently include that of the Purchasing Officer who have introduced fictitious purchase bills to the tune of ₦800,000 within the last three months.

Similarly, the Company’s Sales Supervisor sold goods worth ₦1,500,000 without bringing the same into the books of account.

One of the Executive Directors was discovered to engage in teaming and laden. The amount involved was subsequently deposited by this Director and the Management appealed to the Auditor to discountenance this act and not report it.

The need to pin down responsibilities is what immediately came to the mind of the Board. The Board brought it to the notice of the CEO in his discussion that the Company needs further investigation whereby the Accountant in charge utilizes his or her understanding of the business information and report system, accounting and auditing standards and procedures, evidence gathering and investigative technique as well as litigation processes and procedure to perform his work. There may be as a matter of urgency, the need to recruit a suitable personnel to perform the duties.

In the interim, the Head of the Internal Audit and the Credit Control Manager should be assigned the following tasks, based on the perceived experience and competence of the individuals concerned from the Management’s point of view:

- Periodic investigation and analysis of financial evidence, vouchers, invoices etc.
- Review of factual situation and processing of suggestions regarding possible causes of action.
- Assistance with protection and recovery of Assets. The Credit Control Manager in particular to ensure that the credit policy of the Company is not violated.
- Communicating their findings in the form of reports. A circulation list of the internal audit report to be determined. Follow-up action to be strictly adhered to.
- The Internal Auditor to obtain documentation necessary to support or refute a claim.

- He is to perform fraud examination functions.

- The Legal Department would also contribute in performing both investigative and litigation support functions.

**INTERNAL CONTROL**

The discoveries by the External Auditor made the Management of Augustina Plc to ask for the advice of the Auditors on the Internal Audit Department especially its overview of the internal control measures in operation.

The External Auditor in his or her enlightenment process revealed to the Management that the Internal Audit function constitutes a separate component of Internal Control with the objective of determining whether the internal controls are well designed and properly operated.

He explained further that the internal control extends beyond those matters which relate directly to the function of the accounting system and comprises the following:

(a) The control environment i.e. overall attitude, awareness and actions of the directors and management regarding the internal control system and its importance to the entity.

(b) Control procedure i.e. those specific policies and procedures in addition to the overall control environment which management has established to achieve the entity’s specific objective.

**CONTRAVENTION OF TAX LAWS**

One of the Executive Directors of Augustina Plc applied for a piece of land at Lekki. He was asked to produce his three years tax clearance certificate obtained from his employers. On approaching his colleague, the Finance Director, for assistance, he discovered that this is not available because the Company has not been remitting tax deducted from the pay of its employees to the relevant tax authority.
The CEO approached Mr. Bankole, his colleague in the Board of Internal Revenue for advice and help, because he was afraid of the consequence of his company being caught at the wrong side of the law.

In his own reaction, Mr. Bankole distinguished between tax evasion and tax avoidance. The former, he explained, is wilfully and deliberately attempting to escape tax liability totally or to reduce same without taking into consideration the provision of the Tax Acts and other legal provisions.

Tax avoidance on the other hand, is a situation where the taxpayer arranges his affairs through a properly designed planning policy to reduce his tax liability. Thus, tax avoidance is legal while tax evasion is illegal.

Mr. Bankole explained that Augustina Plc had committed an offence by not making returns on the PAYE tax deductions from its employees. He was commissioned by the Company to rectify this situation with an assurance that the company will bear all costs incurred. Apart from PAYE liabilities as above, the Company equally defaulted in rendering the necessary returns on the Income Tax payable for the past three years. Mr. Bankole, the Tax Expert, was mandated to compute the company’s tax liability based on the profit for the last financial year ended 31 December, 2010.

The CEO had read in one of the corporate finance textbooks that companies are entitled to some allowances for tax purposes with the sole objective of reducing tax liabilities. These allowances include, but are not limited to (a) Capital Allowances (b) General Investment Allowances and (c) Rural Investment Allowances.

SOCIAL RESPONSIBILITY ACCOUNTING

The fact that Augustina Plc violated one of the widely accepted social responsibility issues as reflected in the taxation liabilities issue above, called for further examination of how well the company performed in all other spheres.

The investigations and analysis were conducted into such areas as

(a) Community development particularly the assessment of how the company interacts with the local and wider community.

(b) Examination of policies of the Company as they relates to customers, suppliers and the employees. How does this relate and incorporate issues such as diverse
(c) How has the Company complied with regulations on environment pollution, beautification and assistance in terms of maintenance of roads and provision of infrastructures like borehole?

(d) What is the relationship with customers and workers overseas especially the Ghana plant? Is there any likelihood of the Company dealing with ‘dubious’ enterprise(s) abroad?

(e) Marketplace practices including how the organisation operates in the market. Does the Company employ fair business practice in its marketing efforts?

(f) How is the organisation behaving in terms of monitoring and reporting its accounting and auditing activities?

DIVISIONAL MANAGERS FOR HOME MARKET

Augustina Plc. Board of Directors agreed that the three most promising managers in the existing plants should made Divisional Managers. Each individual manager would be given responsibility for profit and not just costs or revenue. Decentralisation, as agreed by the Board, will normally be based on geographical location, or on production and sale of a particular product or group of related products.

The three divisions established are North, Central and Eastern Divisions. The names of the Divisional Managers are Kenneth, Chukwu and Hassan respectively. A group executive committee is formed consisting of the three Divisional Managers under the Chairmanship of the Chief Executive Officer of Augustina Plc. This committee is charged with the responsibility of regulating and resolving all issues and problems that may arise from the Divisions.

At the end of the first month’s general meeting of this committee, the CEO called the Finance Director to his office and the following conversation followed:

CEO: “For sometime now, I have been concerned about what is the best measure for us to use to compare the performance of the Divisions. You know what I mean – what is the right sort of target to set for them? It is no good if I impose something without agreement, and we simply did not manage to get it today. I’m going to re-open the discussion tomorrow, and I want a decision, but first I want some advice from you”
F.D: “What has really happened?”

CEO: “We’ve been working out a divisional Return On Investment (ROI). We find pre-tax profits for each division, after charging out Group Head Office costs in proportion to divisional turnover. We set that against a base of written down net assets excluding cash. Kenneth is satisfied with that, but Chukwu came up with something he called Residual Income (RI) – he argued that we have to make absolute profits, not just a return on investment.

And then, Hassan said that what we really want is growth, and that the only way to get that in the long-run is to set the target as percentage of sales’s growth.

They were obviously split, so I let it run on. Kenneth said he could certainly accept that residual income was a better measure than looking just at growth. Hassan wouldn’t accept that and still wanted the growth measure, but he agreed with Kenneth’s view that it was better to stick with our present ROI than to change to this new RI idea.

Chukwu stuck to his guns over Residual Income. He is smart. He told Hassan that he could see some merit in the growth idea, because in the end it would probably correlate with residual income. But he still thought that the ROI figure should be dropped. I tried a compromise approach, then suggested we took the measures in pairs, starting with ROI and RI, afterall they sound pretty similar.

Kenneth and Hassan voted for ROI and only Chukwu supported RI. So I had them compare ROI with growth, thinking I was home and dry and we needn’t change anything. Hassan then joined Chukwu in supporting the growth idea, I had to admit that he’d said as much. But Kenneth is pretty smart too, you know. He whispered something to Hassan. Then, he reminded us that Chukwu wanted us to try RI and that he had already told the meeting that in his view, Residual Income was a better control measure than percentage of sale’s growth, so if we were going to make a change, the majority obviously preferred income to growth.

I now felt it was time to adjourn. You’d better keep all these under your hat. But give me a short report summarizing the pros and cons of these three possibilities, and give me your view on which one would be best in principle for us to use in future. If eventually I have to lay the law down, I want to get it right, but make sure you keep it short and simple.”
On returning to his office, the Finance Director cancelled all previous arrangements and then quickly worked out the following table, showing the average annual performance of the divisions over the last three years in historic cost terms.

<table>
<thead>
<tr>
<th>Division</th>
<th>Manager</th>
<th>ROI</th>
<th>RI</th>
<th>Sales Growth</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>%</td>
<td>N</td>
<td>%</td>
</tr>
<tr>
<td>Northern</td>
<td>Kenneth</td>
<td>10</td>
<td>180,000</td>
<td>15</td>
</tr>
<tr>
<td>Central</td>
<td>Chukwu</td>
<td>8</td>
<td>160,000</td>
<td>25</td>
</tr>
<tr>
<td>Eastern</td>
<td>Hassan</td>
<td>6</td>
<td>200,000</td>
<td>20</td>
</tr>
</tbody>
</table>

The Finance Director sent a copy of the table to the CEO with a note commenting that it may help to explain the attitudes being taken in the meeting. He then finally settled down to think about the three measures proposed as means of controlling divisional performance.

ESTABLISHING A BUDGETARY CONTROL SYSTEM

The Board of Directors of Augustina Plc. in one of its deliberations, considered some key advantages of budgeting which include the following:

(i) Planning: Budgeting process ensures that managers do plan for future operations and that they consider how conditions in the next year might change and what steps they should take now to respond to these changed conditions.

(ii) Coordination: This implies that sales, production and other activities will be geared to a common goal so that sales made can always be supplied from stock.

(iii) Cost control: Cost consciousness is increased and the attitude of mind is encouraged in which waste and inefficiency cannot thrive.

(iv) Communication: The budget is a communication because, once accepted, it becomes an executive instruction and also because it provides junior managers with detailed information on the policy of the business.

Some key members of the Management of Augustina Plc sounded a note of warning about the limitation of budgetary control. Some of such criticisms are:

(a) It is a cumbersome and time consuming process. Forecasts have to be made.
data gathered from a multitude of sources and a budget drawn up that is both achievable and appropriate to the position the manager in question perceives he has in the organisation.

(b) Short-term financial control: Budgets are an expression of an organisation’s plans and objectives in financial terms. Long term aims and objectives (like increasing market share, improving levels of customer satisfaction etc) are often forgotten in the rush to hit budgeted profit.

(c) Motivation of managers: Targets for bonuses tend to be based on the figures contained in the budget and so, the budget can be seen as a commitment and constraint. It might encourage rigidity and discourage flexibility.

(d) Formal organisation structure: The budget tend to be based on a system of responsibility centres organised on a departmental or functional basis. Such organisation structure tends to be bureaucratic. Communication is often slow and responsibilities overlap.

After series of exchanges on the pros and cons of budgeting and budgetary control, the Finance Director was instructed to prepare a cash budget with necessary comments for the next three months as follows:

**CASH BUDGET**

The following information would be relevant for the preparation of the Cash Budget.

Augustina Plc. would normally sell on both cash and credit terms. Customers who pay their accounts within 15 days are given a cash discount of 5% and likewise Augustina Plc. would always pay cash on receipt of purchases in order to obtain a 4% discount. Below is the forecast sales for the next three months.

<table>
<thead>
<tr>
<th></th>
<th>October</th>
<th>November</th>
<th>December</th>
</tr>
</thead>
<tbody>
<tr>
<td>Credit sales</td>
<td>160,000</td>
<td>160,000</td>
<td>180,000</td>
</tr>
<tr>
<td>Cash sales</td>
<td>40,000</td>
<td>50,000</td>
<td>54,000</td>
</tr>
<tr>
<td>Total sales</td>
<td>200,000</td>
<td>210,000</td>
<td>234,000</td>
</tr>
</tbody>
</table>

The profit mark-up on sales gives a gross profit margin of 50% on gross cost. It is estimated that the above sales will require a stock of goods of ₦180,000 in sales value to be maintained. An analysis of customer accounts discloses that 80% of credit
customers pay in time to take advantage of the cash discount, 10% pay at the end of 30 days and the remainder at the end of 60 days. There are virtually no bad debts in this business. On the average, 25% of the credit sales in any one month to customers who take the benefit of the cash discount will be in debt at the end of the month.

The estimated other expenses, payable monthly are as follows:

Fixed ₦28,000 per month
Variable 10% of gross sales

Included in the fixed expense is a depreciation charge of ₦6,000. A capital payment of ₦40,000 is required to be made during November. The balances at the beginning of October are as follows:

Cash ₦32,000
Stock ₦100,000
Debtors ₦36,000

Credit sales for September – a low sales month were ₦70,000, of which ₦28,000 were still outstanding at the end of the month. The remainder of the debt represent August sales.

HUMAN RESOURCES CONTROL PROBLEM

The expansion of business of Augustina Plc. to International Frontier created some Human Resources problem. Prominent among such problems is how to retain the company’s cultural value and the agreement on what incentive scheme will suit the little organisation.

With over 1000 new recruits being added annually, many newcomers have only a vague sense of the Company’s culture.

Mr. Kofi, the head of Ghana operations commented, “The only constraint to our growth is people. At the top levels, our commitment to the founders of Augustina Plc. thesis still exists. But these days, the pioneers are having to learn how to fill in forms. The Company is adding about 10% to its workforce every year in addition to normal personnel turnover which can be as high as 20% in some departments.

Inculcating the company’s culture into such a rapidly growing community is itself a tremendous challenge. Another barrier we now face is the difference in attitudes between Nigeria and Ghana. Because of low job security here, Ghanaian employees
are always looking for guidance — despite their higher education and the need to achieve.

The Company’s culture requires openness and a willingness to take responsibility. The Management wants people to stand up and disagree with the authority if they have confidence in their beliefs. Despite the intensive training programmes, it has been hard making the Company’s culture their way of life here in Ghana”. The Chief Executive Officer also agreed

One of the Executive Directors felt that similarity of background was no longer in the company’s best interest as reflected in the following comments:

“Sometimes, I think there is too much ideology bordering on religion. You sell your soul to the company when you start internationalising the culture. The CEO is obsessed with his own ideas and there is an element of fanaticism and intolerance towards people who think differently. I, for one, react negatively to the stingy mentality that sometimes shows through our cost consciousness. The idea that we can reach self-fulfilment only through our jobs is also appaullingly, - it is true we must work hard, but there is no reason that our jobs should necessarily dominate our lives.”

“Humility may be a virtue in Nigeria, for example, but should we impose it on our Ghanaian organisation? Should our business drive our culture, or should our culture drive our business?”

**Evolving the Philosophy of Incentive Management**

From inception, the founding fathers of Augustina Plc had the philosophy of unsounded faith in individual and a belief in the equality of management and workers. Everyone could develop to his or her fullest potential through a system of proper incentives designated to encourage both competition and teamwork.

The idea of James F. Lincoln about human motivation was popularised by Mr. Babalola the CEO of Augustina Plc.

“There will always be greater growth of man under continued proper incentive. The profit that will result from such efficiency will be enormous - How then should the enormous extra profit resulting from incentive management be split? ....... If the worker does not get a proper share, he does not desire to develop himself or his skill ............ If the customer does not have part of the savings in lower prices, he will not buy the increased output ............
Management and Ownership must get a part of the savings in larger savings and perhaps larger dividend …… All those involved must be satisfied that they are properly recognized or they will not cooperate ….. and cooperation is essential to any and all successful application of Incentives”

With the above philosophy in place, Augustina Plc. came up with an incentive scheme for workers that have the following four key components:

- Wages for most factory jobs based solely on piecework output
- A year-end and bonus that could equal or exceed an individual’s regular pay
- Guaranteed employment
- Limited benefits

**OPEN COMMUNICATION**

Another dimension to the incentive scheme is the adoption of open communication within the small organization.

Open Communication was regarded as essential and Management from Chief Executive Officer down, historically had spent hours of each work day on the shop floor, one of the Top Management staff had this to say “if I go down to the cafeteria, the guy in grubby clothes sitting next to me is just as proud of his job as the Chairman in suit – who is sitting next to him! I think this is the best thing that piecework, the bonus system, guaranteed employment and many employee’s participation in our stock purchase plan have created a sense of ownership of the company from top to bottom.

**SPEED CULTURE**

Another sphere of the Incentive Scheme is that employees of Augustina Plc. Should, at all times, imbibe the speed structure as well as the speed culture

In the words of the Chief Executive Officer, “we get on with things. If you have a good idea, everyday you waste talking about it is a day’s lost profit”. “Keep the products as basic as possible and do not offer extra facilities than necessary”.
**Exhibit 1**

Augustina Plc – Profit and Loss Accounts for years ending 31 December

<table>
<thead>
<tr>
<th></th>
<th>2008 N’000</th>
<th>2009 N’000</th>
<th>2010 N’000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>96,000</td>
<td>108,000</td>
<td>122,000</td>
</tr>
<tr>
<td>Cost of sales</td>
<td>(67,000)</td>
<td>(78,000)</td>
<td>(88,000)</td>
</tr>
<tr>
<td>Gross profit</td>
<td>29,000</td>
<td>30,000</td>
<td>33,500</td>
</tr>
<tr>
<td>Administrative expenses</td>
<td>(26,000)</td>
<td>(27,000)</td>
<td>(36,200)</td>
</tr>
<tr>
<td>Operating profit</td>
<td>3,000</td>
<td>3,000</td>
<td>3,300</td>
</tr>
<tr>
<td>Interest</td>
<td>(1,300)</td>
<td>(1,400)</td>
<td>(1,800)</td>
</tr>
<tr>
<td>Profit before tax</td>
<td>1,700</td>
<td>1,600</td>
<td>1,500</td>
</tr>
<tr>
<td>Taxation</td>
<td>(200)</td>
<td>(100)</td>
<td>(100)</td>
</tr>
<tr>
<td>Profit after tax</td>
<td>1,500</td>
<td>1,500</td>
<td>1,400</td>
</tr>
<tr>
<td>Dividend</td>
<td>-</td>
<td>-</td>
<td>(400)</td>
</tr>
<tr>
<td>Retained profit</td>
<td>1,500</td>
<td>1,500</td>
<td>1,000</td>
</tr>
</tbody>
</table>

**Exhibit 2**

Augustina Plc Balance Sheets for years to 31 December

<table>
<thead>
<tr>
<th></th>
<th>2008 N’000</th>
<th>2009 N’000</th>
<th>2010 N’000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fixed Assets (Net)</td>
<td>16,000</td>
<td>12,000</td>
<td>10,000</td>
</tr>
<tr>
<td>Current Assets</td>
<td>20,000</td>
<td>21,000</td>
<td>22,500</td>
</tr>
<tr>
<td>Stock</td>
<td>16,000</td>
<td>18,000</td>
<td>25,000</td>
</tr>
<tr>
<td>Debtors</td>
<td>36,000</td>
<td>39,000</td>
<td>47,500</td>
</tr>
<tr>
<td>Current Liabilities</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Trade creditors</td>
<td>7,500</td>
<td>8,000</td>
<td>14,500</td>
</tr>
<tr>
<td>Overdraft</td>
<td>7,000</td>
<td>8,000</td>
<td>11,000</td>
</tr>
<tr>
<td>Net current assets</td>
<td>14,500</td>
<td>16,000</td>
<td>25,500</td>
</tr>
<tr>
<td>Total assets</td>
<td>37,500</td>
<td>35,000</td>
<td>32,000</td>
</tr>
<tr>
<td>Less long-term liabilities</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>8% debentures</td>
<td>12,000</td>
<td>8,000</td>
<td>4,000</td>
</tr>
</tbody>
</table>
The 8% Debentures are redeemable in instalments and the final instalment is due to be paid in year 2008.

**Exhibit 3**

<table>
<thead>
<tr>
<th>Production</th>
<th>Cost to ship to distribution plant in</th>
</tr>
</thead>
<tbody>
<tr>
<td>Plants</td>
<td>Kaduna</td>
</tr>
<tr>
<td>A</td>
<td>200</td>
</tr>
<tr>
<td>B</td>
<td>240</td>
</tr>
<tr>
<td>C</td>
<td>160</td>
</tr>
</tbody>
</table>

**Exhibit 4**

Augustina Plc – Ghana
Trial Balance as at December 31, 2009

<table>
<thead>
<tr>
<th></th>
<th>DR (CEDI)</th>
<th>CR (CEDI)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>1,100,000</td>
<td></td>
</tr>
<tr>
<td>Debtors</td>
<td>1,375,000</td>
<td></td>
</tr>
<tr>
<td>Prepayment</td>
<td>125,000</td>
<td></td>
</tr>
<tr>
<td>Stock</td>
<td>1,500,000</td>
<td></td>
</tr>
<tr>
<td>Fixed Assets (Net)</td>
<td>2,000,000</td>
<td></td>
</tr>
<tr>
<td>Creditors</td>
<td></td>
<td>2,500,000</td>
</tr>
<tr>
<td>Debentures</td>
<td></td>
<td>3,000,000</td>
</tr>
<tr>
<td>Ordinary shares</td>
<td></td>
<td>2,300,000</td>
</tr>
<tr>
<td>Retained Earnings 1/1/06</td>
<td></td>
<td>150,000</td>
</tr>
<tr>
<td>Sales</td>
<td></td>
<td>15,000,000</td>
</tr>
<tr>
<td>Cost of sales</td>
<td>14,000,000</td>
<td></td>
</tr>
<tr>
<td>Depreciation</td>
<td>1,300,000</td>
<td></td>
</tr>
<tr>
<td>Other expenses</td>
<td>1,550,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>22,950,000</strong></td>
<td><strong>22,950,000</strong></td>
</tr>
</tbody>
</table>
Additional information:

1. Augustina Plc. – Ghana’s Trial Balance is adjusted to conform to Augustina Plc Nigeria’s Accounting Principles. The Cedi is the functional currency of Ghana.

2. At the time of incorporation of Augustina Plc – Ghana, exchange rate was₦1.00 = 11 Cedis.

3. Cumulative Foreign Exchange Translation Adjustment account as at 31 December 2008 is₦300,000.

4. The Naira balance of Retained Earnings as at December 31, 2008 is₦160,000.

5. Exchange Rates are as follows:

<table>
<thead>
<tr>
<th>Date</th>
<th>Exchange Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>January 1, 2009</td>
<td>₦1.00 = 12 Cedis</td>
</tr>
<tr>
<td>December 31, 2009</td>
<td>₦1.00 = 14 Cedis</td>
</tr>
<tr>
<td>Average for year 2009</td>
<td>₦1.00 = 13 Cedis</td>
</tr>
</tbody>
</table>

Exhibit 5

A. Purchase Price

<table>
<thead>
<tr>
<th></th>
<th>BN</th>
<th>FS</th>
<th>VR</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>40,000</td>
<td>45,000</td>
<td>50,000</td>
</tr>
</tbody>
</table>

  Estimated scrap value after 5 years

<table>
<thead>
<tr>
<th></th>
<th>8,000</th>
<th>9,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>14,000</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Fixed costs other than depreciation

<table>
<thead>
<tr>
<th>Year</th>
<th>BN</th>
<th>FS</th>
<th>VR</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>2,000</td>
<td>1,800</td>
<td>1,500</td>
</tr>
<tr>
<td>2</td>
<td>2,000</td>
<td>1,800</td>
<td>1,500</td>
</tr>
<tr>
<td>3</td>
<td>2,200</td>
<td>1,800</td>
<td>1,400</td>
</tr>
<tr>
<td>4</td>
<td>2,000</td>
<td>2,000</td>
<td>1,400</td>
</tr>
<tr>
<td>5</td>
<td>2,400</td>
<td>2,200</td>
<td>1,400</td>
</tr>
</tbody>
</table>

Variable cost per mile

<table>
<thead>
<tr>
<th></th>
<th>6k</th>
<th>8k</th>
<th>7k</th>
</tr>
</thead>
</table>

B. The company charges 25k per mile for all journeys irrespective of the length of the journey and the expected annual mileages over the 5 years period are:
C. The company’s cost of capital is 10% per annum.

D. All operating costs are paid and revenue received at the end of the year.
THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA
PROFESSIONAL EXAMINATION – MAY 2011
MULTIDISPLINARY CASE STUDY
Time allowed- 3 hours

SECTION A: Attempt All Questions

Part I: MULTIPLE-CHOICE QUESTIONS (10 Marks)

1. Where a total disposal of a subsidiary occurs, the Group’s gain on disposal for the year ended should be classified as

A. Discontinued operation
B. Capital resources
C. Positive goodwill
D. Investment at market value
E. Negative goodwill.

2. A processing system in which multiple users concurrently engaged in a series of interactions via a remote terminal device is called

A. Real time
B. Interactive system
C. Time sharing
D. Stand alone
E. Batch processing.

3. The current assets owned by a company are: Cash ₦1,050,000; stock ₦5,600,000, debtors ₦4,200,000. The current ratio of the company is 2.1, therefore, the acid test ratio is

A. 0.67:1
B. 0.99:1
C. 0.77:1
D. 0.97:1
E. 0.89:1.
4. Risk adjusted discount rate **CANNOT** be used for **ONE** of the following:

   A. Capital rationing
   B. Internal rate of return
   C. Accounting rate of return
   D. Capital asset pricing
   E. Net present value.

5. In a period, 11,280 bags of materials were used at a total standard cost of ₦46,248. The material usage variance was ₦492 adverse. What was the standard allowed bags of materials for the period?

   A. 11,160
   B. 1,180
   C. 11,280
   D. 11,520
   E. 13,394.

6. A company engaged in agro-allied business can carry forward its trading losses for

   A. indefinitely,
   B. for 10 years,
   C. for 20 years,
   D. for 5 years,
   E. for 15 years.

7. Which of the following is **NOT** true of Revenue control?

   A. Official receipts must be issued for government money collected
   B. All cash is lodged at the bank every other day.
   C. The safe has a Treasury number
   D. Cash book postings are promptly made
   E. There is a safeguard for Government money.
8. Which of the following is NOT an example of Assurance Engagement?

A. A statutory audit
B. Reports for lenders and other investors
C. Reports on Environmental Performance
D. Reports on Corporate Social Responsibility Performance
E. Reports on Statements of Accounting Policies.

9. Threats to objectivity do NOT include ONE of the following:

A. advocacy threat,
B. self-Interest threat,
C. intimidation threat,
D. self-regulatory threat,
E. familiarity threat.

10. Which of the following is NOT true for non-executive directors according to the Code of Best Practices?

A. The range of the competency needs of the company should reflect the skills mix of non-executive directors
B. The entire Board should decide the appointment of non-executive directors
C. Non-executive directors bring independent judgement to bear on issues such as strategy, performance, standard of conducts and key appointments.
D. Non-executive directors should not participate in the company's share-option but should be pensionable.
E. Non-executive directors may not participate in the running of the business.

Part II: SHORT ANSWER QUESTIONS (30 Marks)

1. Items of Revenue and expenditure which cannot be budgeted for because they are difficult to foresee or estimate are referred to as……………………

2. Stock held by consignees but legally owned by the consignor which gives the consignee the right to sell the goods or return them unsold are called ……………………………
3. The disclosure of information of the effect that the operations of an entity has on the natural environment is known as………………………………

4. The key agency of government responsible for fighting terrorism and financial crimes is ……………………………..

5. Forensic Accounting encompasses both…………….and Investigative Accounting

6. The process by which someone is appointed and in whom is vested the legal right to receive property belonging to a company is called…………………………

7. A person who shall NOT be eligible for appointment as the approved auditor of a Bank under the Banks and other Financial Institutions Act is known as ………………………………………...

8. The acceptable factor that determines the degree of risk or misstatement through error or irregularity is known as………………………………

9. The term “independence of mind” in relation to ethical conduct of a Professional Accountant is known as……………………………………..

10. In auditing, a ………….contains records relating to the client’s organization and which do not change from time to time.

11. State ONE financial statement which has to be published in accordance with the Finance Control and Management Act Cap 144 LFN 1990.

12. The “displacement theory” was propounded in 1961 by ………….and ……………

13. The provision in the building contract agreement that permits variation in prices is known as………………………………

14. How is partly completed units measured in manufacturing process?
15. Densu Construction Company has the following data concerning one of its contracts:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Contract price</td>
<td>₦4,000,000</td>
</tr>
<tr>
<td>Value Certified</td>
<td>₦2,600,000</td>
</tr>
<tr>
<td>Cost Incurred</td>
<td>₦2,100,000</td>
</tr>
<tr>
<td>Cash Received</td>
<td>₦2,400,000</td>
</tr>
<tr>
<td>Cost of work certified</td>
<td>₦2,000,000</td>
</tr>
</tbody>
</table>

What is the Profit attributable to the contract?

16. A company’s fixed cost is ₦100,000 and has two products. The sales and contribution sales Ratio are as tabulated below:

<table>
<thead>
<tr>
<th>PRODUCT</th>
<th>SALES</th>
<th>P/V RATIO</th>
<th>VARIABLE</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>300,000</td>
<td>20</td>
<td>-</td>
</tr>
<tr>
<td>B</td>
<td>80,000</td>
<td>50</td>
<td>-</td>
</tr>
</tbody>
</table>

Determine the variable cost for each of Products A and B.

17. What is opportunity cost from accounting point of view?

18. A Management Accounting System which focuses on ways by which the maximum return per unit of bottleneck activity can be achieved is known as..........................

19. The costs on which Management has some discretions as to amount it will budget for particular activity is known as.........................

20. A term used to describe any technique where decisions are tested by their vulnerability to changes in any variable is known as..........................

21. A Cost Reduction Technique which is concerned with new products at the design stage before production commences is known as ............

22. A price which exactly covers incremental costs of making the items sold and the opportunity costs of the resources consumed in making the item is called........
23. The difference between Sales Income and Bought in Goods and Services is known as. . . . .
24. When there is a gap between the basis period on a change of accounting date, which year is the gap deemed to belong?
25. The only form of loss relief available to a company in Nigeria is. . . . .
26. **One** way by which the various governments have increased their revenue is through. . . . .
27. Under a sale agreement, risk or loss passes when. . . . .
28. Appeals from the Industrial Arbitration Panel go to. . . . .
29. Information flows among persons at different levels who have no direct reporting relationships with one another is called. . . . .
30. The loss of high-talent key personnel to competitors or start up ventures as a result of the attractive remuneration and better conditions of service in such companies is called. . . . .

**SECTION B - QUESTIONS ON THE CASE STUDY  (60 Marks)**

*Attempt all Questions*

**QUESTION 1**

(a) The Finance Director of Augustina Plc. is concerned with the poor liquidity of the company. Advise him on the company’s recent performance with relevant calculations. (6 Marks)

(b) Considering the proposal made by the Finance Director of Augustina Plc.,

(i) What is the maximum discount that the Company could offer to its credit customers? (3 Marks)

(ii) Should the Company increase the days of credit to 60 days as proposed? (3 Marks)

*(Total 12 Marks)*
QUESTION 2

(a) As the External Auditor of Augustina Plc., state three actions to be taken on the discovery of numerous cases of fraud and misappropriations you have discovered.

(3 Marks)

(b) What do you consider as the inherent limitations of an Internal Control System, citing examples from the case of Augustina Plc.

(3 Marks)

(c) From the assertion of the Board that further investigation is required to pin down responsibilities after External Audit report, advise the Board on the type of consultant to engage and what will be his or her responsibilities using acceptable professional languages.

(4 Marks)

(Total 10 Marks)

QUESTION 3

(a) Domestic investment decisions differ considerably from International Capital investment decisions. State any four critical issues involved.

(4 Marks)

(b) Using the information in the case study (Exhibit 4) which of the lorries should Augustina Plc purchase given that they all have similar technical specification?

(8 Marks)

(Total 12 Marks)

QUESTION 4

(a) Enumerate Four of the advantages and the disadvantages of mergers and acquisition respectively

(4 Marks)

(b) Determine the extent to which the shareholders of Global Foods Plc will benefit from the merger with Augustina Plc.

(4 Marks)

(Total 8 Marks)
QUESTION 5

As the Finance Director of Augustina Plc prepare a cash budget for the three months October to December for Augustina Plc. (10 Marks)

QUESTION 6

(a) Write short notes on the following:
   (i) Capital Allowances
   (ii) General Investment Allowances
   (iii) Rural Investment Allowances. (6 Marks)

(b) What are the legal implications of the default by Augustina Plc of the tax obligations to the relevant authorities? (2 Marks)

(Total 8 Marks)

SOLUTIONS TO SECTION A

PART 1 - MULTIPLE CHOICE QUESTIONS

1. A
2. C
3. D
4. C
5. A
6. A
7. C
8. E
9. D
10. D
Tutorial

Question 3

Current Ratio = \[
\frac{\text{Current Assets (C/A)}}{\text{Current Liabilities (C/L)}}
\]

\[\text{N} m = \frac{10.5 + 5.6 + 42}{\text{C/L}} = 2/1\]

\[\text{C/L} = 10.85 = 5.425\]
\[\frac{2}{2} = 5,425\]

Acid test rate = \[\frac{10.85 - 5.6}{5.425} = 0.97\]

Question 5

\[11,280 - \left(\frac{\text{₦} 482}{\text{₦} 46248}\right)\]

\[\frac{1}{11280}\]

\[11,280 - 120 = 11,160\]

PART II SHORT-ANSWER QUESTIONS

1. “Below the line” Accounts.
2. Goods on consignment.
3. Environmental Reporting.
5. Litigation.
6. Receivership.
7. A director or officer or agent of a company.
8. Materiality.
9. Objectivity

    or Statement No. 3.0 – Statement of Consolidated Revenue Fund.
    or Statement No. 3.1 – Statement of Recurrent Revenue
    or Statement No. 3.2 – Statement of Recurrent Expenditure
    or Statement No. 4.0 – Statement of Development Fund (Capital Expenditure)


13. Variation clause.

14. Equivalent Unit.

15. Profit taken \( \left( \frac{2,600,000 \times 2,400,000}{2,600,000} \right) = \$553,846 \)

16. Product A – Variable cost = \$240,000 (i.e. \$300,000 x 0.8)
    Product B – Variable cost = \$40,000 (i.e. \$80,000 x 0.5)

17. The value of the next best alternative.

18. Limiting factor or Constraint.

19. Total Discretionary costs (are costs which management has some discretion as to the amount it will budget for the particular activity, e.g advertising, research and development, etc. cost that has no optimum relationship between inputs (as measured by the cash expended) and outputs).

20. Sensitivity Analysis

21. Value Engineering

22. Marginal cost

23. Value added

24. Earlier Year

25. Carry-forward loss relief

26. Internally Generated Revenue (IGR)
27. The ownership passes, even if the goods are yet to be delivered
28. National Industrial Court
29. Diagonal flow or crosswise communication
30. “Pouching”

EXAMINER’S REPORT FOR PART 1 AND II

The questions test various areas in the syllabus. Many candidates attempted the questions but the performance was very poor.

Candidates are advised to study very well for the examination.

SECTION B

SOLUTION TO QUESTION 1

COMMENT ON PERFORMANCE

<table>
<thead>
<tr>
<th>Ratios to be calculated</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>A. Overall Profitability</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>ROCE %</td>
<td>8</td>
<td>8.6</td>
<td>10.3</td>
</tr>
<tr>
<td>Net Profit %</td>
<td>3.1</td>
<td>2.8</td>
<td>2.7</td>
</tr>
<tr>
<td>B. Asset Management</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current ratio (no of times)</td>
<td>2.5</td>
<td>2.4</td>
<td>1.9</td>
</tr>
<tr>
<td>Quick ratio (no of times)</td>
<td>1.1</td>
<td>1.1</td>
<td>1.0</td>
</tr>
<tr>
<td>Stock turnover (days)</td>
<td>109</td>
<td>98</td>
<td>93</td>
</tr>
<tr>
<td>Debt ratio (days)</td>
<td>61</td>
<td>61</td>
<td>75</td>
</tr>
<tr>
<td>C. Financial Risk</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total debts/capital employed (%)</td>
<td>51</td>
<td>46</td>
<td>47</td>
</tr>
<tr>
<td>Total debts/equity (%)</td>
<td>74</td>
<td>59</td>
<td>54</td>
</tr>
<tr>
<td>Interest cover (no of times)</td>
<td>2.3</td>
<td>2.1</td>
<td>1.8</td>
</tr>
</tbody>
</table>
GENERAL COMMENTS

1 (a) From the calculations shown above, the worry of the Finance Director is not substantiated. The liquidity ratios are 1.1, 1.1, and 1.0 for 2008, 2009 and 2010 respectively, which do not indicate serious liquidity problem. The Debtor days increased from 61 to 75 in 2010 but ROCE also moved in sympathy with increased turnover and discount introduced motivated liquidity depicting a good working capital management. The advise is to encourage such a practice in future.

(bi) Current level of debtors
\[
\text{N} \quad \frac{200,000,000 \times 45}{365} = 24,657,534
\]

Proposed level:

Those not taking discount: (in naira)
\[
\text{N} \quad \frac{60\% \times 200,000,000 \times 45}{365} = (14,794,520.4)
\]

Those taking Discount: (in naira)
\[
\text{N} \quad \frac{40\% \times 200,000,000 \times 10}{365} = (2,191,780.8)
\]

Change in level of debtors
\[
7,671,232.8
\]

Savings in financial cost
\[
7,671,232.8 \times 11\% = 843,835.6
\]

Admin. Cost savings
\[
\text{N} \quad 4,450 = 848,285.61
\]

Calculation of Maximum Discount

Maximum discount x 40% of 200 million
\[
\text{N} \quad = 848,285.61
\]

Maximum Discount
\[
\frac{848,285.61}{80,000,000} = 0.01 \text{ or } 1\%
\]

Additional Comment:

Current level of sales = 200,000,000
Bad debts = 1% of sales
Cost of sales comprises 80% variable cost  
20% fixed cost

The company’s required rate of return is 12%. Current credit period is 45 days.

b (ii) Proposed change to 60 days.

The cost of finance is and will remain at 11%.

It is believed that relaxing credit period from 45 days to 60 days will improve  
i.e it will lead to increase in sales (percentage increase not specified).

Therefore two options for arriving at percentage increase in sales are

- Use percentage change in credit period
  
  \[
  \frac{15}{45} \times 100\% = 33.34\%
  \]

- Use increase in sales trend from 2008 – 2010 = 13%

Using the 1st option – assessing sales to increase by 33.34%.

\[
\text{New sales level} = 200,000,000 \times 1.3334
\]

\[
= 266,680,000
\]

Increase in sales level = 66,680,000

Variable cost 80% of 72%  
\[
\left(\frac{70+73+73}{3}\right) = 58\%
\]

of increase in sales

\[
\text{Contribution from sales} = \text{₦}28,005,600
\]

Proposed investment in debtors = 266,680,000 \times \frac{60}{365} = 43,857,810

Current Investment in debtors = 200,000,000 \times \frac{45}{365} = 24,657,534
Increase Investment in debtors = 19,180,276

New level of bad debts = 266,680,000 x 1.34% = 3,573,512

Current level of bad debts = 200,000,000 x 1% = 2,000,000

Additional Financial cost on increased debtors
(11% of 19,180,276) = 2,109,830
Add increase in bad debts = 1,573,512
3,683,342

Increase in Contribution from sales = 28,005,600

Savings made by changing credit policy from 45 days to 60 days is 28,005,000 less 3,683,342 = 24,322,258

Therefore, the credit period should be changed from 45 days to 60 days.

EXAMINER’S REPORT

The question tests candidates’ ability to compute liquidity of the company using distance. The candidates understood the questions on ratio computation but did not understand determination of maximum discount of credit allowable to customers.

The performance of candidates was above average.

Candidates are advised to learn how to determine maximum discount of credit allowable to customers.

QUESTION 2

(a) Actions to be taken include

(i) The Auditors should conduct further investigation in view of the frauds discovered to determine the extent of the fraud, the amount involved and people culpable of the offence.
(ii) Various frauds perpetrated should be highlighted, their implications should be stated and management should be advised on the consequences of these acts.

(iii) The Auditors should be able to describe the strength of the current internal control system, identifying the reasons for the weaknesses and suggest solutions to remedy the weaknesses.

(iv) All the Auditors’ observations and findings should be properly reported to the Management and obtain Management response.

(v) The Auditors should consider how their report will affect the financial statements and their treatment therein.

(vi) If the irregularities are material, the auditors should consider issuing qualified audit opinion on the financial statements.

(b) Internal control weaknesses in the case include the following:

(i) The oversight function of the Board of Directors was very weak as corporate governance principles were not adhered to by the Managing Director, Mr. Babalola diverted some of the loans taken by the company to his private concern.

(ii) Management of the cash was weak as adequate control was not maintained because the managing Director was in charge.

(iii) Segregation of duties was not in place, as authorization, approval and custody were in the hands of only one staff - the accountant was able to manipulate receivables to his advantage and the purchasing officer was able to introduce fictitious purchases.

(iv) Supervision by superior officer was also not in place regarding all transactions.

(v) Adequate recording of movement in stocks was not in place – the sales supervisor did not report a sales of ₦1.5m in the company’s record without detection.

(vi) The control environment was poor – the overall attitude, awareness and actions of the directors and management regarding internal control was poor.
(vii) Little or no control procedure was established over the Company operational processes.

(c) Augustina Plc. will need to engage the services of a Forensic Accountant, an accountant who possesses the following qualities – curiosity, persistence, creativity, discretion, organization, confidence, sound professional judgment, instincts and intuition,

His or her Responsibilities will include the following:

- Investigating and analyzing recorded transactions.
- Pinning down responsibilities for exceptional areas.
- Assisting with the protection and recovery of assets.
- Communicating his findings in the form of reports, exhibits and collection of documents
- Co-ordination with other experts including:
  (a) Private Investigator
  (b) Forensic Document Examiner
  (c) Consulting Engineers
  (d) Legal and Litigation specialists

- Helping to obtain documentation necessary to support or refute a claim

(vii) Attendance at trials to hear the testimonies of the opposing expert and provide assistance with cross examination.

EXAMINER’S REPORT

The question tests candidates’ knowledge of actions required to be taken when auditors discovered fraud and miss-appropriations. It also tests candidates’ knowledge of limitations of internal Control System.

Many candidates did not understand the requirements of the question as such the performance was poor.

Candidates are advised to understand the basic issues auditing.
QUESTION 3

a(i) The difference between project cashflows of Domestic and International capital investment decisions include the following:

- Need for 2 stage evaluation process
- Remittable and distributable cashflow
- Difficulties in identifying relevant cashflows
- Effect of investment on other operations

(ii) Difficulties in evaluating investment by parent companies:

- Transfer of capital such as equipment and inventory
- Use of opportunity cost.

(iii) Problem of exchange rates

(iv) Taxation issues:
- Different tax policies
- Difference in allowances
- Withholding taxes etc.

(v) Foreign investment and the Cost of Capital:
- Identifying risk premium
- Systematic risk – what factor to use.

(vi) Restrictions on the repatriation of funds:

- Exchange control
- Royalties and management fees.

(vii) Risks:

- Political risk e.g. expropriation of assets in case of civil war
- Exchange rate fluctuation
- Interest rate risk.
DECISION = BN should be purchased because it gives a positive NPV of ₦6,728
EXAMINER’S REPORT

The question tests candidates’ knowledge of legal implications of the default of the tax obligations to the relevant authorities.

Majority of the candidates had clear understanding of the question. The performance was good. The common pitfall is the inability of a few to state current Investment Allowance. Candidates should understand basic terms in taxation.

QUESTION 4

(i) Advantages of mergers and acquisition are

- Economies of scale
- Enhanced market base for product outlets
- Benefit of synergy, \(2 + 2 = 5\)
- Enlarged capital base-both human and structural capital
- Diversification of risk
- Increased profitability
- Enhanced management structure/policies.

(ii) Disadvantages of mergers and acquisition are

- Loss of identity
- Functional realignment that may lead to loss of job
- Conflicts of interest
- Problems of managing an enlarged entity
- Merger forecloses easy market entry for new comers
- Creating a new going concern may involve huge expenses.

(bi) Determination of Benefits to Shareholders of Global Food Plc.

Market value appreciation before merger is \(\text{₦}5.8\) million @ 10 = \(\text{₦}58\) million.

Earnings after merger:
\((\text{₦}10\text{ million } + \text{₦}5.8\text{ million}) \times 1.08 = \text{₦}17.06\)
Apply P/E Ratio of 9
\((\text{₦}17.06 \times 9) = \text{₦}153.54\) million.
10 million shares swaps for 30 million shares of the combined company. Total share of the combined company is 30 million + 40 million shares i.e 70 million shares.

Wealth of Global Foods Limited = \( \frac{30 \times 153.54}{70} \) million

= \( \text{N}65.8 \) million

Benefit = \( \text{N}(65.8 - 58.0) \) million

= \( \text{N}7.8 \) million

(ii) • Capital appreciation
• Increased earnings in terms of dividends
• Security of their investment

EXAMINER’S REPORT

The question tests candidates’ knowledge of the advantages and disadvantages of mergers and acquisition and benefits of merger of Global Foods Plc. with Augustina Plc.

Many candidates understood advantages and disadvantages but some did not understand the computational aspect of benefits of merger.

The performance was generally good.

Candidates should learn the computational aspect of mergers and acquisition benefits to shareholders.
QUESTION 5

AUGUSTINA PLC
CASH BUDGET FOR THREE MONTHS
OCTOBER – DECEMBER

<table>
<thead>
<tr>
<th></th>
<th>October</th>
<th>November</th>
<th>December</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Receipts</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash Sales</td>
<td>40,000</td>
<td>50,000</td>
<td>54,000</td>
</tr>
<tr>
<td>Debtors</td>
<td>113,200</td>
<td>137,200</td>
<td>166,600</td>
</tr>
<tr>
<td>Total receipts</td>
<td>153,200</td>
<td>187,200</td>
<td>220,600</td>
</tr>
</tbody>
</table>

|                   |          |          |          |
| **Payment**       |          |          |          |
| Purchase          | 147,200  | 134,400  | 149,760  |
| Fixed expenses    | 22,000   | 22,000   | 22,000   |
| Variable expenses | 20,000   | 21,000   | 23,400   |
| Capital payment   | -        | 40,000   | -        |
| Total payment     | 189,200  | 277,400  | 195,160  |

|                    |          |          |          |
| **Summary**        |          |          |          |
| Balance b/f        | 32,000   | (4,000)  | (342,000) |
| Surplus            | (36,000) | (30,200) | 2,544    |
| Balance b/f        | 4,000    | (34,200) | (8,760)  |

Workings

Schedule of Receipts from Debtors

<table>
<thead>
<tr>
<th></th>
<th>August</th>
<th>November</th>
<th>December</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>N</td>
<td>N</td>
<td>N</td>
</tr>
<tr>
<td>August</td>
<td>8,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>N800</td>
<td>14,000</td>
<td>14,000</td>
<td></td>
</tr>
<tr>
<td>October</td>
<td>91,200</td>
<td>32,000</td>
<td>32,000</td>
</tr>
<tr>
<td>(N60,000)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>November</td>
<td>91,200</td>
<td>32,000</td>
<td>32,000</td>
</tr>
<tr>
<td>(N60,000)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>December</td>
<td>102,600</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(N80,000)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>113,200</td>
<td>137,200</td>
<td>166,600</td>
</tr>
</tbody>
</table>
COMPUTATION OF PURCHASE

December Credit Sale Analysis

Those who take discount = 80% x 180,000
= ₦144,000

Those who pay at the end of 30 days = 10% x 180,000
= ₦18,000

Those who pay at the end of 60 days = 10% x 180,000
= ₦18,000

Schedule of Receipts from Debtors

<table>
<thead>
<tr>
<th></th>
<th>October</th>
<th>November</th>
<th>December</th>
</tr>
</thead>
<tbody>
<tr>
<td>August</td>
<td>₦8,000</td>
<td>₦8,000</td>
<td>₦113,200</td>
</tr>
<tr>
<td>September</td>
<td>₦28,000</td>
<td>₦14,000</td>
<td>₦137,200</td>
</tr>
<tr>
<td>October</td>
<td>₦160,000</td>
<td>₦32,000</td>
<td>₦166,600</td>
</tr>
<tr>
<td>November</td>
<td>₦160,000</td>
<td>₦32,000</td>
<td>₦166,600</td>
</tr>
<tr>
<td>December</td>
<td>₦180,000</td>
<td></td>
<td></td>
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</tbody>
</table>

Note. 2

Computation of Purchases

<table>
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<tr>
<th></th>
<th>October</th>
<th>November</th>
<th>December</th>
</tr>
</thead>
<tbody>
<tr>
<td>Opening Stock</td>
<td>₦100,000</td>
<td>₦120,000</td>
<td>₦120,000</td>
</tr>
<tr>
<td>Purchases</td>
<td>₦153,333</td>
<td>₦140,000</td>
<td>₦156,000</td>
</tr>
<tr>
<td>Closing stock</td>
<td>(₦120,000)</td>
<td>(₦120,000)</td>
<td>(₦120,000)</td>
</tr>
<tr>
<td>Cost of sale</td>
<td>₦133,333</td>
<td>₦140,000</td>
<td>₦156,000</td>
</tr>
<tr>
<td>Gross profit</td>
<td>₦66,667</td>
<td>₦70,000</td>
<td>₦78,000</td>
</tr>
<tr>
<td>Sale</td>
<td>₦200,000</td>
<td>₦210,000</td>
<td>₦234,000</td>
</tr>
<tr>
<td>Payment to creditors</td>
<td>96%×₦153,333</td>
<td>96%×₦140,000</td>
<td>96%×₦156,000</td>
</tr>
<tr>
<td></td>
<td>₦147,200</td>
<td>₦134,400</td>
<td>₦149,760</td>
</tr>
</tbody>
</table>
Summary

<table>
<thead>
<tr>
<th></th>
<th>32,000</th>
<th>(4,000)</th>
<th>(34,200)</th>
</tr>
</thead>
<tbody>
<tr>
<td>(36,000)</td>
<td>(30,200)</td>
<td></td>
<td>25,440</td>
</tr>
<tr>
<td>4,000</td>
<td>(34,200)</td>
<td></td>
<td>(8,700)</td>
</tr>
</tbody>
</table>

October Credit Sale Analysis

Those who take Discount = 80% x ₦160,000
= ₦128,000

Those who pay at the end of 30 days = 10% x 160,000
= ₦16,000

Those who pay at the end of 60 days = 10% x 160,000
= ₦16,000

November Credit Sale Analysis

Those who take discount = 80% x ₦160,000
= ₦128,000

Those who pay at the end of 30 days = 10% x 160,000
= ₦16,000

Those who pay at the end of 60 days = 10% x 160,000
= ₦16,000

EXAMINER’S REPORT

The question tests candidates’ knowledge of the preparation of cash budget. Many candidates did not understand the requirements of the question as they were preparing cash flow statements instead of cash budget.

The performance was poor. Candidates are advised to know the difference between cash budget and cash flow statement.
QUESTION 6

(a)  

(i) Capital Allowances are reliefs granted to any company which incurred qualifying capital expenditure during a basis period in respect of fixed assets in use at the end of the basis period for the purpose of a trade or business. Capital allowances cover initial allowance and annual allowance.

(ii) General Investment Allowance:

This is the allowance granted to any taxpayer who incurred expenditure on plant, equipment and machinery at the rate of 10% of the cost of the asset. For example,

- Plant and equipment used for agricultural business with effect from 1995.
- Plant and equipment used for agricultural business with effect from 1990.
- Plant and equipment for any other business with effect from 1991.

(iii) Rural Investment Allowance:

From 1992 tax year, this incentive is available to any taxpayer that locates its business not less than 20 kilometres away from normal facilities: Examples are

- Where there is no electricity – 50% of expenditure
- Where there is no water – 30% of expenditure
- Where there is not tarred road – 15% of expenditure
- Where there is no telephone – 5% of expenditure

This was repealed in 2010.

(b) The legal implications of the default by Augustina Plc of the tax obligations to the relevant authorities are:

i. Income Tax:

- Penalty of ₦2,500 is payable by every company in the first month that failure to file tax return occurs and thereafter ₦500 penalty attends to each month the failure persists.
 Denial of instalmental payment privileges.
 Payment of provisional tax for the year with accrued penalties and interest.

ii. **PAYE**

Where an employer who is expected to deduct PAYE tax fails to deduct or deducts but fails to remit same to the relevant tax authority, the amount thereof together with a penalty of 10% per annum of the amount plus interest at the prevailing commercial rate shall be recoverable as a debt due to by the employer to the relevant tax authority.

**EXAMINER’S REPORT**

The question tests candidates’ knowledge of the legal implications of the default of the tax obligations to the relevant authorities.

Candidates’ had clear understanding of the question but many of them did not mention General Investment Allowance.

The performance of candidates was generally fair.

Candidates are advised to study harder.