THE CHARTERED INSTITUTE OF TAXATION OF NIGERIA

APRIL 2021: PATHFINDER FOR FOUNDATION LEVEL

PTE I: INCOME TAXATION

TUESDAY 13TH APRIL, 2021 **EXAM NO................................**

ATTEMPT QUESTION ONE AND ANY OTHER FOUR QUESTIONS.

SHOW ALL WORKINGS. **TIME: 3 HOURS.**

1. Western Block Communication Plc has been in business operations since year 2000. The bank provides you with the following additional information extracted from its books and records.

	₦'000
Adjusted profit for the year ended 31 December, 2020	33,000
Capital allowances for the year	23,400
Issued share capital	30,000
General reserves	7,700
Long-term loan	4,100

You are also informed that the following relate to the financial statements for the year ended 31 December, 2020.

	₦'000
Turnover	550,000
Gross profit	55,000
Net assets	36,000
Unutilised capital allowances brought forward from previous assessment year	7,800

(a) You are required to compute the company's tax liabilities for the relevant year of assessment. (23 Marks)

(b) Capital expenditure qualifying for grant of capital allowances is based on certain criteria.

(i) List four (4) categories of capital expenditure that qualify for grant of capital allowances under the Companies Income Tax Act, CAP C21 LFN 2004. (2 Marks)

(ii) Enumerate four (4) conditions for granting capital allowances. (2 Marks)

(c) The International Financial Reporting Standards (IFRS) contains some provisions that have income tax implications. State four (4) issues in IFRS that have some tax implications. (4 Marks)

(d) What are the basic conditions which must be met before a minimum tax can be levied and payable by a company for any particular year of assessment? (4 Marks)

(e) Enumerate Companies exempted from minimum tax provision. (2 Marks)

(f) List the various rates of tax under section 40 of CITA in the Finance Act, 2020 (as amended). (3 Marks)

(Total 40 Marks)

SOLUTION TO QUESTION 1

1. Based of Finance Act, 2019

(a) Western Block Communication Plc
Computation of Tax Liabilities for 2021 Assessment Year

	₦	₦
Adjusted profit		33,000,000
Less: Capital Allowances		
- Unrelief C/A B/f	7,800,000	
- Capital Allowance for the year	23,400,000	
Total Capital Allowance	31,200,000	
Relief restricted to 66 2/3% of profit	22,000,000	22,000,000
Unrelieved Capital Allowance c/f	9,200,000	
Taxable profit		11,000,000
(i) Company Income Tax @ 30% of Taxable Profit	3,300,000	
(ii) Minimum Tax (see workings 1)	2,750,000	
Tertiary Education Tax @ 2% of Adjusted Profit		660,000
Information Technology Development Levy of Adjusted Profit @ 1% of Profit before tax		330,000
Total tax		4,290,000

Workings

1. Computation of Minimum Tax

	₦	₦
Turnover (Total)	550,000,000	
Minimum tax rate	0.25%	
:. Minimum tax		1,375,000

Notes

(1) Net profit for the year is assumed to be the same as the adjusted profit for the purpose of calculating the Information Technology Development Levy.

(2) Minimum tax was computed in line with the new provision of Finance Act, 2020.
(3) Adjusted profit is assumed to be same as assessable profit.

(b) Categories of qualifying capital expenditure

(i) Plant, machinery and fixtures.
(ii) Buildings, structures or works of permanent nature.
(iii) Mines, oil wells or other sources of mineral deposits of a wasting nature.
(iv) Plantation equipment
(v) Research and development
(vi) Agricultural plants
(vii) Public transportation motor vehicles.
(viii) Public transportation (inter-city) new mass transit coach.

Conditions for granting capital allowances

(a) The taxpayer must have incurred qualifying capital expenditure in respect of an asset for the purposes or his trade or business.
(b) The taxpayer must be the owner of the asset at the end of the basis period for a year of assessment.
(c) The asset must be in use for the purposes of trade or business carried on by the taxpayer at the end of the basis period for a year of assessment.
(d) The taxpayer must make a claim for capital allowances for a year of assessment before it is granted. Nevertheless, the relevant tax authority may grant an allowance if it is of the opinion that it is reasonable and just to do so.
(e) A certificate of acceptance for all qualifying expenditure incurred by a company in a year in excess of ₦500,000 is required to be obtained from the Inspectorate Division of the Federal Ministry of Industries.

(c) Some issues in IFRS that have tax implications

(i) Employees' benefits in all forms are to be recognised as part of the staff cost.
(ii) Provision for impairment on property, plant and equipment.
(iii) Goodwill that should be recognized on business combination and takeover will have capital gains tax impact.
(iv) Fair value gains and losses on investment property and financial instruments.
(v) IFRS transition adjustments.

(d) Basic Conditions for Minimum Tax

(a) A company is chargeable to a minimum tax if:
   (i) It has been in business for a minimum of more than four calendar years; and
   (ii) In any year of assessment, the ascertainment of total assessable profits from all sources of a company results in:
      - A loss; or
      - No tax payable; or
      - Tax payable which is less than the minimum tax.

(e) Companies exempted from minimum tax provisions

(i) A company carrying on agricultural trade or business.

(ii) Any company for the first four calendar years of its commencement of business.

(f) Tax rates under Section 40 of CITA (as amended) in the Finance Act, 2020.

(i) Small company – Zero Tax.

(ii) Medium – sized company – 20%

(iii) Large company – 30%

EXAMINER'S REPORT

The question tests issues on capital allowances, provisions on IFRS with income tax implications and minimum tax provisions. This is a compulsory question with over 95% attempting. Performance was relatively above average with about 60% of them scoring above 40% of marks obtainable.

Commonest pitfalls was that, some of the candidates were using old guideline for minimum tax computation of which Finance Act 2020 has amended.

Candidates are enjoined to use the Institute's Study Pack and previous examination's Pathfinders to prepare for future examinations.

2. (a) What do you understand by "statutes of limitation".

(i) In the Nigeria Tax System? and (2 Marks)

(ii) What is the statutory maximum period available to the Relevant Tax Authority? (2 Marks)

(b) An aggrieved tax payer has objection and appeal processes to follow. In line with this:

Explain the first step to be taken by a tax payer that disputes an assessment, action or decision by Relevant Tax Authority (RTA) and; the next step expected to be taken where the RTA failed to correct the "wrong" as desired by tax payer. (3 Marks)

(c) The Tax Appeal Tribunal (TAT) was established pursuant to section 59 of the Federal Inland Revenue Service (Establishment) Act as an avenue available to an aggrieved tax payer to correct the ''wrong" by RTA. Briefly discuss Tax Appeal Tribunal (TAT) with particular reference to;

(i) Who may commence appeal;

(ii) Time within which to file appeal;

(iii) Right place of instituting appeal; and

(iv) Where appeal lies against decision of TAT (8 Marks)

(Total 15 Marks)

SOLUTION TO QUESTION 2

(a) "Statutes of limitations" in the Nigerian Tax System are provisions which set the maximum time after an event within which legal proceedings may be initiated.

In the Nigeria system, the statute of limitation refers to the maximum period after which the Relevant Tax Authority (RTA) can assess a taxable person to tax in respect of a certain year of assessment (YOA). Nigerian tax legislation provides that RTAs only have six (6) years after the relevant accounting period to assess a taxable person to additional tax.

However, the above tax laws further provide that; where any form of fraud, wilful default or neglect has been committed in connection with any tax imposed by the Acts, the six years limitation would not apply and an investigation may be instituted by the RTA. This creates ambiguity implying that the RTA can go as far back as they want to review, assess and collect tax from tax payer.

Recently however, Tax Appeal Tribunal (20/08/2019) sitting in Enugu, held that a taxpayer may not be liable to taxes (including interest and penalties) based on assessments arising after the expiration of six years statutory period for tax audits. Noncompliance with this time limit could render the assessment and any accompanying interest and penalty unenforceable against the tax payer (Polaris Bank Plc Vs Abia State IRS).

(b) The first step to be taken is that the aggrieved tax person may apply to the Relevant Tax Authority) (RTA) concerned by forwarding a "letter of objection" to the RTA within thirty (30) days from the date of service of the Notice of Assessment. Objection letter must clearly and precisely state the grounds of objection.

Where the RTA failed to amend assessment as desired by the tax person, an aggrieved taxable person may appeal within thirty (30) days of receipt of Notice of Refusal to Amend assessment.

(c) Tax Appeal Tribunal with reference to:

(i) Who may commence appeal

A person aggrieved by an assessment or demand notice made upon him by the service (FIRS) or aggrieved by any action of decision or the service under the provisions of tax laws administered by the service may appeal against such action, decision, assessment or demand notice within the stipulated period.

(ii) Time within which to file Appeal

An appeal shall be filed within a period of 30 days from the date on which the action, decision, assessment or demand notice which is being appealed against, was made by the service.

(iii) The right place of instituting Appeal

An appeal shall be filed in the zone from which it emanates in conformity with paragraph 1 of Tax Appeal Tribunal (Establishment) order 2009. TAT is constituted into 8 zones and each zone has states it covers. The zones are North East Zone, North West Zone, North Centra Zone, South West Zone, South East Zone, South South Zone, Abuja TAT and Lagos TAT.

(iv) Appeal against decision of TAT

Any party dissatisfied with a decision of the Tribunal may appeal against such decisions on a point of law to the Federal High Court upon giving notice in writing to the secretary within 30 days from the date on which such decision was given.

EXAMINER'S REPORT

The question tests issues on "statue of limitation" and Tax Appeal Tribunal. Over 60% of the candidates attempted this question and over 50% scored above 40% of the mark obtainable.

Commonest pitfall was the inability of some candidates to separate the Relevant Tax Authority from Tax Appeal Tribunal.

Candidates are advised to prepare well for future examinations. And they are enjoined to make use of the Institute's Study Pack and previous examination's Pathfinders.

3. Chief Lion created a trust for his three (3) children, Xion, Yion and Zion before he died in 2019. The following information were extracted from the records of the trustees:

	₦
Adjusted profit for the year ended 31/12/2019	4,850,120
Other income: - Dividend (gross)	482,315
Rental income	292,830

Additional information

(a) Trustees remuneration is 10% of computed total income.

(b) Specific legatee is entitled to 15% of income from Dividend and ₦28,910 from Rent is for the benefit of Local Government school for handicap.

(c) Fixed annuity of ₦120,000 to a beneficiary – Mr Okon, who served Chief Lion meticulously as a steward.

(d) Xion, the only amputee among the children is to receive ₦720,000 payment.

(e) The trust provides that, the beneficiaries are to share half of the distributable income in the ratio (1: 2: 1:) for Xion, Yion and Zion respectively.

Required:

(i) Determine the computed income for the relevant tax year. (5 Marks)

(ii) Compute Trustees taxable income and the amount due to each child (beneficiary). (8 Marks)

(iii) Compute tax payable by trustee. (2 Marks)

(Total 15 Marks)

SOLUTION TO QUESTION 3

(a) Chief Lion

Determination of Computed Income for 2016 Tax Year

	₦	₦
Adjusted profit		4,850,120
Add: Dividend	482,315	
Rental income	292,830	
		775,145
Total income		5,625,265
Less: Allowable payments:		
- Trustees renumeration (10% x ₦5,625,265)	562,527	
- Specific legatee (15% (₦482,315) ₦28,910)	72,347	
- Local Govt. – School for handicap	28,910	
- Fixed annuity	120,000	(783,784)
Computed income		4,841,481
Less: Dividend income		482,315
		4,359,166

(b) Trustee's Taxable Income and Amount Due to each child

	Total	Xion	Yion	Zion
	₦	₦	₦	₦
Computed income	4,359,166	--	--	--
Less: Payment to Zion	(720,000)	720,000	--	--
Remainder of computed income	3,639,166	--	--	--
Less: Distribution (50%)	1,819,583	454,896	909,791	454,896
Trustee taxable income	1,819,583	--	--	--
Due to beneficiaries		1,174,896	909,791	454,896

(c) Tax payable by Trustee

Trustee taxable income		1,819,583
First ₦300,000 @ 7%	21,000	
Next ₦300,000 @ 11%	33,000	
Next ₦500,000 @ 15%	75,000	
Next ₦500,000 @ 19%	95,000	
Next (₦1,819,583 – ₦1,600,000) @ 21% = ₦219,583.	46,112	
Tax payable	270,112	

EXAMINER'S REPORT

The question tests issues on Trustees taxable income. Less than 40% of the candidates attempted the question. None of the candidates scored 40% of the total marks obtainable.

Candidates' commonest pitfall was lack of understanding of the requirements of the question.

Candidates are advised to prepare well for future examination and they are enjoined to make adequate use of the Institute's Study Pack and the previous examination's Pathfinders.

4. (a) Enumerate five (5) objectives of the Tertiary Education Trust Fund. (5 Marks)

   (b) What are the penalties for failure to pay Tertiary Education Tax on the due date in Nigeria? (5 Marks)

   (c) State the structure of disbursement of Tertiary Education Tax to the various levels of Education in Nigeria. (5 Marks)

(Total 15 Marks)

SOLUTION TO QUESTION 4

(a) Objectives of Tertiary Education Trust Fund:

The amount in the Tertiary Education Trust Fund is to be disbursed to Federal and State tertiary education institutions specifically for the provision and/or maintenance of:

(i) Research and publications;
(ii) Essential physical infrastructure for teaching and learning;
(iii) Instructional materials and equipment;
(iv) Academic and staff training and development; and
(v) Any other need which in the opinion of the Board of Trustees is essential for the improvement of quality and maintenance of standards in the higher education institutions.

(b) Penalties for failure to pay tertiary education tax on the due date

Failure to pay the tertiary education tax on the due date attracts 5% of the tax unpaid. A demand notice shall be served on the company for the unpaid tax plus penalty and if payment is not made within two (2) months of the demand, the company shall be guilty of an offence.

Where an offence is committed by body corporate or firm or other association of individuals:

(i) Every director, manager, secretary or other similar officer of the body corporate; or
(ii) Every partner or officer of the firm; or
(iii) Every person concerned with the management of the affairs of the association; or
(iv) Every person who was purporting to act in that capacity shall be severally guilty of that offence and liable to be prosecuted and punished for the offence, unless he proves that the act or omission constituting offence took place without his knowledge, consent or connivance.
A person who is guilty of an offence under the Act shall on conviction be liable; or
(v) For the first time be liable to a fine of N1,000,000 or imprisonment for a term of six months or both; and
(vi) For a second and subsequent offence to a fine up to ₦2,000,000 or to imprisonment for a term of twelve months or both.

(c) Disbursement of Tertiary Education Tax:

The Board of Trustees shall administer the tax, manage and disburse it on the basis of:

(i) Funding of all public tertiary education institutions;
(ii) Equality among the 6 geo-political zones of the Federation in the case of special intervention; and
(iii) Equality among the states of the Federation in the case of regular intervention.

The disbursement of the funds shall be in the ratio of 2:1:1 as between universities, polytechnic and colleges of education.

The Board of Trustees shall have power to give consideration to the peculiarities of each geo-political zone in the disbursement and management of the tax between the various levels of the tertiary education.
The Minister of Education shall, on the recommendation of the Board of Trustees and subject to the approval by the President, make guidelines for the disbursement of funds under the Act.

EXAMINER'S REPORT
The question test issues on Tertiary Education Trust Fund. About 60% of the candidate attempted the question. Less than 30% scored above 40% of marks obtainable.

Candidates are advised to prepare well for future examinations. Candidates are also advised to use the Institute's Study Pack and previous examination's Pathfinders while preparing for future examinations.

5. Chukwudumeme Ezego Ventures disposed off a building in Ojota, Lagos. The property was acquired in 2014 for ₦3.2m. The sitting tenants of the property finally vacated the property in January 2017 and a security man and a gardener were immediately employed to provide security and tide up the property until it was disposed off in July 2017.

The following details were extracted from the books and records of the Company:

	₦'000
Sales proceed of the property	9,600
Advertisement cost for disposal of the property	33
Insurance premium against risk of damage to the property	96
Depreciation of the property for 7 months	1,100
Security guard and gardener's wages for 7 months	140
Cost of renovating the property in March 2017	425
Commission and fees for the professional services on the disposal of the property	480
Transfer and conveyance fees	160

You are requested to:
(a) Compute the capital gains. (10 Marks)

(b) Compute the capital gains tax payable by Chukwudumeme Ezoego Ventures. (5 Marks)
(Total 15 Marks)

SOLUTION TO QUESTION 5
(a) Chukwudumeme Ezeego Ventures
Computation of Capital Gains Tax Payable for 2017 year of Assessment

	₦	₦
Sales proceeds of the property		9,600,000
Advertisement cost	33,000	
Commission and fees	480,000	

Transfer and conveyance fees	160,000	673,000
Net sales proceeds		8,927,000
Less:		
Cost of acquisition	3,200,000	
Cost of renovation	425,000	3,625,000
The capital gains		5,302,000

(b) Chuwudumeme Ezeego Ventures
Computation of capital Gains Tax Payable in 2017 Year of Assessment

	₦	₦
Capital gains		5,302,000
Capital gain tax @ 10%		530,200

EXAMINER'S REPORT

The question test issues on Capital Gain Tax. About 70% of the candidates attempted this question and, about 50% of them scored above 40% of marks obtainable.

Candidates' commonest pitfall was inability to compute the capital gain.

Candidates are advised to prepare well for future examination.

Candidates are also enjoined to make adequate use of the Institute's Study Packs and the previous examination's Pathfinders.

6. NAGODE Ventures Limited commenced business on 1 April 2019. Results of the business for the first three (3) years of operations are as follows:

	₦
1/4/2019 – 30/9/2019	2,250,000
12 months to 30/9/2020	14,720,000
12 months to 30/9/2021	30,350,000

Acquisition of assets (QCE) with dates are as shown below:

Date	**Asset**	**Cost** ₦
1/2/2019	Land	3,225,600
5/4/2019	Building	12,500,000
5/4/2019	Furniture & fittings	1,550,000
5/4/2019	Plant & Machinery	6,770,000
5/4/2020	Motor Vehicle	4,825,300

Required: Determine

(a) The Basis Period of assessment and the assessable profit. (5 Marks)

(b) Basis period for Capital Allowance and the year of assessment in which the QCE will be treated/considered for Capital Allowance. (4 Marks)

(c) Capital Allowance computation for the first year of assessment. (6 Marks)
(Total 15 Marks)

SOLUTION TO QUESTION 6

(a) Determination of Basis Period of Assessment and Assessable Profit

Year of Assessment	Basis period of assessment	Assessable Profit
		₦
2019	1/4/2019 – 30/9/2019	2,250,000
2020	1/10/2019 – 30/9/2020	14,720,000
2021	1/10/2020 – 30/9/2021	30,350,000

(b) Determination of Basis Period for Capital Allowance and QCE Applicable

Year of Assessment	Basis period for assessment	Basis period for capital allowance	QCE allocation
2020	1/4/2019 – 30/9/2019	1/4/2019 – 30/9/2019	Building; F & F, P & M
2021	1/10/2019 – 30/9/2020	1/10/2019 – 30/9/2020	MV
2022	1/10/2020 – 30/9/2021	1/10/2020 – 30/9/2021	Nil

(c) Determination of Capital Allowance for 2020 YOA

Year of Assessment	Capital allowance rates	Building	F & F	P & M	MV	Total capital allowance
	I. A.	15%	25%	50%	50%	
	A. A.	10%	20%	25%	25%	
	INV. A.	Nil	Nil	10%	Nil	
	Useful Life	10 years	5 years	4 years	4 years	
2020 Cost		12,500,000	1,550,000	6,770,000	--	
Less: I. A.		(1,875,000)	(387,500)	(3,385,000)	--	5,647,500
A. A. (6 months)		(531,250)	(116,250)	(423,125)	--	1,070,625
INV A.	--	--	--	--	--	677,000
T.W.D.V.		10,093,750	1,046,250	2,961,875	--	7,395,125

Note:

1. The basis period for assessment and for capital allowance were determined on the basis of the provisions of the Finance Act, 2020 (as amended).
2. Capital allowance was computed also on the basis of the provisions of the Finance Act, 2020 (as amended).

EXAMINER'S REPORT

The question tests issues on the Provision of Finance Act, 2019 as it relates to commencement of new business. About 60% of the candidates attempted this question. Performance was poor as only 30% scored above 40% of marks obtainable.

The commonest pitfalls in answering the question was that candidates have not mastered the basis period as stated in the Finance Act, 2019.

Candidates are advised to utilise the advantages of the Institute's Study Pack and the previous examinations Pathfinders when preparing for future examination.

7. "Tax system in Nigeria stands on three legs viz the tax policy, the tax laws and the tax administration". Discuss the following terms mentioned in the above statement.

(a) Tax policy (5 Marks)

(b) Tax laws (5 Marks)

(c) Tax administration (5 Marks)
(Total 15 Marks)

SOLUTION TO QUESTION 7

(a) Tax Policy

This can be described as the general statement of intention which guide the thinking and action of all concerned towards the realization of the tax objectives. Some of the tax policies pursued by the Federal Government in the past three decades include a shift of emphasis from income tax to consumption tax (e.g. VAT) and adoption of measures to enhance voluntary compliance rather than the use of coercive method of taxation (e. g. introduction of the self-assessment scheme).

(b) Tax Laws

These are the legislations promulgated by the government to address tax problems arising in the country. Nigeria tax laws include the following:

(i) Personal Income Tax Act CAP P8, LFN 2004;
(ii) Companies Income Tax Act, CAP C21, LFN 2004;
(iii) Petroleum Profit Tax Act CAP P13, LFN 2004;
(iv) Stamp Duties Act, CAP S8, LFN 2004;
(v) Capital Gains Tax Act, CAP C1, LFN 2004;
(vi) Value Added Tax Act, CAP VI LFN 2004;
(vii) Industrial Development (Income Tax Relief) CAP 17, LFN 2004;
(viii) National Information Technology Development Agency Act 2007;
(ix) Federal Inland Revenue Service (Establishment) Act, 2007;
(x) Tertiary Education Trust Fund (Establishment, etc), Act, 2011; and
(xi) Federal Capital Territory Internal Revenue Service (Establishment) Act, 2015.

Under the Nigerian Constitution, it is the National Assembly that is empowered to make laws with regards to the imposition, collection and administration of stamp duties and tax on income/profits and capital gains.

(c) Tax Administration

The administration involves practical interpretation and application of the tax laws. Three tiers of government in Nigeria (i.e. Federal, State and Local Government) are charged with the administration of various taxes in Nigeria, in accordance with the powers given to them in the relevant tax laws. The tax authorities of these tiers of government are Federal Inland Revenue Service, the State Internal Revenue Service and the Local Government Revenue Committee.

Currently, the tax administrative machinery in Nigeria are:
(i) The Joint Tax Board;
(ii) The Federal Inland Revenue Service;
(iii) The State Internal Revenue Service;
(iv) The Local Government Revenue Committee;

(v) The Joint State Revenue Committee; and
(vi) The Federal Capital Territory Internal Revenue Service.

EXAMINER'S REPORT

The question tests issues of the Tax Policy, Tax Laws and Administration in Nigeria. About 80% of the candidates attempted the question and only about 30% of them scored 40% of marks obtainable.

The commonest pitfall by the candidates was their inability to differentiate between Tax policies and Tax laws.

Candidates are advised to prepare more adequately for future examinations and should make use of the Institute's Study Pack and the previous examinations' Pathfinders.

THE CHARTERED INSTITUTE OF TAXATION OF NIGERIA

APRIL 2021: PROFESSIONAL EXAMINATION

PTE I: INDIRECT TAXATION

WEDNESDAY 14TH APRIL, 2021 **EXAM NO...............................**

ATTEMPT QUESTION ONE AND ANY OTHER FOUR QUESTIONS.

SHOW ALL WORKINGS. **TIME: 3 HOURS.**

1. Adelpat Nigeria Limited, an importer of alcoholic drinks and beverages, brought the following items from the United States (USA) through the Tin Can Island Port, Lagos, on
30 April, 2020.

Item	Quantity	Price ($)	Value ($)
Campari Soda	3,000	15.0	45,000
Hienikens Beer	5,000	5.0	25,000
Sapel Fruity Wine	6,000	2.0	12,000
Choco Drink	7,200	1.0	7,200
			89,200

The following additional information has been provided:

(i) The exchange rate on the form "M" used for the importation of the items is ₦360 to $1;

(ii) Duty rates for the items are as follows:

Campari Soda	100%
Hienikens Beer	50%
Sapel Fruity Wine	50%
Choco Drink	60%

(iii) The following additional charges are collectable by the Nigerian Customs. Surcharge of 10% of duty is payable.

(iv) The following costs were also incurred by the importer on the goods:

Insurance	1% of C & F value
Freight	5% of the value on the proforma invoice used for the form "M"

(v) The shipping company charges have been agreed to be 1% of the CIF value of the goods; and

(vi) The subsisting VAT rate is 7½%.

You are required to compute:

(a) CIF value of the goods. (8 Marks)

(b) Proforma invoice value of the goods. (5 Marks)

(c) Customs duties payable on the goods. (6 Marks)

(d) Surcharge payable on the goods. (3 Marks)

(e) Freight payable on the goods. (3 Marks)

(f) VAT payable through the Nigerian Customs on the goods. (10 Marks)

(g) Amount on the debit note of the shipping company to Adelpat Nigeria Limited. (5 Marks)

(Total 40 Marks)

SOLUTION TO QUESTION 1

(a) CIF value of the goods:

	Campari Soda	Hienikens Beer	Sapel Wine	Choco Drink
Quantity	3,000	5,000	6,000	7,200
Price per unit ($)	15	5	2	1
Total value ($)	45,000	25,000	12,000	7,200
Freight (5%)	2,250	1,250	600	360
Cost and Freight	**47,250**	**26,250**	**12,600**	**7,560**
Exchange rate	₦360	₦360	₦360	₦360
Cost and freight (N)	17,010,000	9,450,000	4,536,000	2,721,600
Insurance (1%)	170,100	94,500	45,360	27,216
CIF	**₦17,180,100**	**₦9,544,500**	**₦4,581,360**	**₦2,748,816**

(b).

The proforma invoice value of goods:

	$
Campari Soda (3,000 x 15)	45,000

Hienikens Beer (5,000x 5)	25,000
Sapel Fruity Wine (6,000 x 2)	12,000
Choco Drink (7,200 x 1)	7,200
Cost	**89,200**
Freight (5%)	4,460
Cost and freight ($)	**93,660**
Exchange rate	₦360
Cost and freight	**₦33,717,600**

(c). Custom Duty payable

	Campari Soda ₦	Hienikens ₦	Sapel ₦	Choco ₦
CIF	17,180,100	9,544,500	4,581,360	2,748,816
Duty rate	100%	50%	50%	60%
Duty payable	17,180,100	4,772,250	2,290,680	1,649,290

	Total Duty ₦
Campari Soda	17,180,100
Hienikens Beer	4, 772,250
Sapel fruity wine	2,290,680
Choco drink	1,649,290
Total duty payable	25, 892,320

(d).

Surcharge payable

Product	Duty payable (₦)	Surcharge rate	₦
Campari Soda	17, 180, 100	10%	1,718,010
Hienikens beer	4,772, 250	10%	477,225
Sapel Fruit wine	2,290,680	10%	229,068
Choco Drink	1,649,290	10%	164,929
	25,892,320		**2,589,232**

(e). Freight payable

Product	Cost per unit ($)	Quantity	Amount ($)
Campari Soda	15	3,000	45,000
Hienikens beer	5	5,000	25,000
Sapel Fruit wine	2	6.000	12,000
Choco Drink	1	7,200	7,200
			89,200
Freight ($) at 5%			4,460
Exchange rate			₦360
Freight in N			**=₦1,605,600**

(f). VAT payable to the Nigeria Customs Service

	₦

CIF values of the goods:	
Campari Soda	17,180,100
Hienikens beer	9,544,500
Sapel Fruit wine	4,581,360
Choco Drink	2,748,816
	34,054,776
Add: Duty payable	25,892,320
Surcharge	2,589,232
	62,536,328
VAT payable at $7^1/_2$%	**4,690,225**

(g). SHIPPING COMPANY DEBIT NOTE

	₦
CIF value of the goods:	
Cost and freight	33,717,600
Insurance (1%)	337,176
	34,054,776

Shipping company charges (1% of ₦34,053,776) = ₦340,548

EXAMINER'S REPORT

The question tests candidates' knowledge of computations of the landing cost (CIF) of imported goods and other related costs payable to Nigeria Customs, such as customs duties, surcharge, VAT, etc.

Candidates' performance was very poor as most of them that attempted the question scored less than 25% of the allocated marks.

The commonest pitfall of the candidates was their inability to compute the landing cost (CIF) of imported goods, hence, the poor performance in other computations relating to custom duties, surcharge, freight, VAT, etc.

Candidates are advised to read widely and make use of the Institute's Pathfinders and Study texts when preparing for future examinations.

2. Value Added Tax (VAT) as a consumption tax is a multi-stage levy collected at every stage of production and sale of goods or rendition of services.

Required:

(a) List Five (5) objectives of VAT. (5 Marks)

(b) Discuss how VAT liability is calculated;

(i) Where there are no opening and closing inventories. (3 Marks)

(ii) Where there are opening and closing inventories. (3 Marks)

(c) Input VAT has certain limitations in its scope. Discuss these limitations and mention Two (2) input VAT which are not allowed for deduction in computing VAT payable. (4 Marks)

(Total 15 Marks)

SOLUTION TO QUESTION 2

(a). The objectives of VAT are:

i. To increase government revenue;
ii. To make tax system more transparent;
iii. To avoid cascading effect;
iv. To reduce tax evasion;
v. To increase export;
vi. To simplify tax collection procedure; and
vii. To check income tax evasion by concealment of actual income by taxpayers.

(b). Calculation of VAT liability:

i. Where there are no opening and closing inventories: The output VAT is first determined by applying VAT rate of 7.5% on the total sales net of available sales adjustments. This gives the output VAT.
Then the VAT input is determined by applying VAT rate 7.5% on purchases net of allowable purchases adjustments. This gives the input Vat. Vat liability is the determined by removing the input VAT from the output VAT.

ii. Where there are opening and closing inventories: The output Vat is calculated as in (i) above. Then to calculate the input VAT, the period purchases is first adjusted by adding cost of opening inventory and deducting the cost of closing inventory. Input VAT is thereafter computed by applying the VAT rate of 7.5%. The difference between the output VAT and the input VAT in the VAT liability.

(c). The limitation of input VAT is that the input VAT allowed to be deducted from the output VAT is limited to the tax on goods purchased or imported directly for resale and goods which form the stock – in – trade used for the direct production of any new production on which output tax is charged.
Some input VAT which are not allowed for deduction in computing VAT payable are :

i. Input VAT on overhead, security and general administration of any business which otherwise can be expanded through the statement of profit or loss; and
ii. Input VAT on any capital item and asset, which is to be capitalised along with the cost of capital item and asset.

EXAMINER'S REPORT

The question tests candidates' knowledge of the objectives of VAT, computations of input VAT and output VAT, and situations when input VAT cannot be deducted from output VAT in arriving at VAT remittable to the Federal Inland Revenue Service (FIRS).

Candidates' performance was poor as most of them that attempted the question scored less than $33^1/_3$% of the allocated marks.

Most of the candidates that attempted this question demonstrated lack of understanding of the treatment of opening and closing inventories in the computation of VAT, candidates spent time defining VAT instead of stating the objectives and others wrote about items exempted from VAT instead of stating the limitations of input VAT.

Candidates are advised to cover all the topics in the syllabus when preparing for the Institute's examinations.

3. "Stamp" means an impressed pattern or mark by means of an engraved or inked die, an adhesive stamp, an electronic stamp or an electronic acknowledgement for denoting any duty or fee, provided that the Service shall utilise adhesive stamp produced by the Nigerian Postal Services pursuant to its enabling Act" (section 46, Finance Act 2020).

Stamp duties are duties basically on instruments.

Required:

(a) List three (3) instruments that are specifically exempted from stamp duties. (3 Marks)

(b) State the relevant tax authority to which stamp duties are payable. (2 Marks)

(c) List four (4) methods of stamping. (4 Marks)

(d) Discuss the implications of not stamping an instrument. (3 Marks)

(e) List three (3) conditions under which an unstamped or improperly stamped instrument may be admissible as evidence in the law court. (3 Marks)

(Total 15 Marks)

SOLUTION TO QUESTION 3

(a) . Instruments exempted from stamp duties

Instrument that are specifically exempted are as follows:

i. Those relating to agreements between the Federal Government and other foreign governments;
ii. Instruments relating to reconstruction and amalgamation; subject to specified condition under section 104(1) of the Act;
iii. Transactions and sales of properties of a company under liquidation arising from a compulsory winding up by a court or creditors' voluntary winding up;
iv. Based on Central Bank circular number CBN/GEN/DMB/02/006 dated January 15, 2016, titled "Currency and Remittance of Statutory Charges or Receipt of Nigeria Postal Service under the Stamp Duties Act", the following transactions are exempted from stamp duties:
    a. Transactions relating to savings accounts holders, salary accounts or students savings accounts;

b. Payments for goods supplied or services rendered if the amount is under N1,000, payment of salaries or wages, pensions, gratuities, etc; and
c. Payment and deposits for self to self – transactions whether inter or intra- bank.

vii. Section 56 of the Finance Act, 2019, exempts the following "exempt receipts" and "general exemptions" from stamp duties;
  a. Exempt receipts
     Receipts given by any person in a regulated securities lending transaction carried out under regulation issued by the Securities and Exchange Commission
  b. General exemptions which include the following:
     ❖ Shares, stocks or securities transferred by a lender to its approved agent or a borrower in furtherance of a regulated security lending transaction;
     ❖ Shares, stock or securities returned to lender or its approved agent by a borrower in pursuant to a regulated securities lending transaction; and
     ❖ All documents relating to a regulated securities lending transactions carried out under regulations issued by the Securities and Exchange Commission; and

viii. Share transfer based on FIRS information circular on "clarifications on the provisions of the Stamp Duties Act "No: 2020/05 dated April 29, 2020.

(b). **Relevant tax authorities for collection**

The relevant tax authorities for collection of stamp duties are FIRS and the relevant State tax authority (RSTA).

While FIRS collects stamp duties on instruments executed between two companies or a company and individual, RSTA collects stamp duties on instruments executed by two or more individuals.

(c). **Modes of denoting stamp duties**

The stamping of duties can be effected through the underlisted methods:

i. Affixing printed adhesive stamps issued by the Service on instrument;
ii. Electronic tagging;
iii. Employing a die impressed on an instrument as an adhesive stamp.;
iv. Issuance of stamp duties certificates;
v. Direct electronics printing or impression on the instrument; and
vi. Any other form of acknowledgement of payment for stamp duties adopted by the Service.

(d). The implications of not stamping an instrument are:

i. Such an instrument, which is not duly stamped in accordance with the law is force at that time it was first executed, shall not be given in evidence. This disadvantage cannot be remedied by an agreement between the parties in a case;
ii. Such an instrument is not admissible whether directly or for collateral purposes. The secondary evidence of the instrument is not admissible either; and
iii. Cross – examination upon an unstamped document is not allowed.

(e). The conditions under which an unstamped or in properly stamped instrument may be admissible in evidence in the law court are:

i. Where a criminal proceeding is being held. This is also applicable before a rent tribunal or a proceeding before the Commissioner of Stamp Duties;
ii. Where it is imperative to refresh the memory of a witness;
iii. Where it is necessary to prove an act of bankruptcy;
iv. Where a plaintiff is trying to prevent a transaction from being implemented if it is believed that the agreement is void;
v. Where the instrument may be admitted subject to an undertaking that the instrument would be stamped later; and
vi. Where it may be used to prove a fraud.

EXAMINER'S REPORT
The question tests candidates' understanding of the instruments exempted from stamp duties, collection, methods of stamping, implications and admissibility of evidence in respect of unstamped and improperly stamped instruments.

Candidates' performance was poor as most of them that attempted the question scored less than 45% of the allocated marks.

Most of the candidates could not explain the implications of not stamping an instrument and the conditions under which an unstamped or improperly stamped instrument may be admissible in evidence in the law court.

Candidates are advised to read the Institute's Pathfinders and other relevant tax laws when preparing for future examinations.

4. The Value Added Tax Act 2004 (as amended) identifies different categories of persons that are required to register with the Federal Inland Revenue Service (FIRS) for VAT purposes.

Required:
(a) Discuss three (3) of the categories that are required to register with the FIRS. (6 Marks)

(b) List three (3) merits and three (3) demerits of VAT. (9 Marks)
(Total 15 Marks)

SOLUTION TO QUESTION 4

(a) The three groups that are required to register with the FIRS for VAT purposes are:
i. **Taxable persons:** A taxable person shall on commencement of business, register with the FIRS for the purpose of the tax;
ii. **Government ministries, etc, as agents of the Service:** Every government ministry, statutory body and other agency of government shall register as agents of the FIRS for the purpose of collection of tax under the Act.

Every contractor transacting business with a government ministry, statutory body and other agency of the federal, state or local government shall produce evidence of registration with the FIRS as a condition for obtaining a contract.

iii. **Non- resident companies**: The Act specifies that a non- resident company that carries on business in Nigeria shall register for the tax with the FIRS, using the address of the person with whom it has a subsisting contract as its address for purposes of correspondence relating to the tax. A non – resident company shall include the tax in its invoice and the person to whom the goods or service is supplied in Nigeria shall remit the tax in the currency of the transaction.

(b). The merits of VAT are:

i. Reliable source of government revenue;
ii. It eliminates the narrow scope and cascading effect of the repealed sales tax;
iii. It is a consumption tax, hence very easy to collect;
iv Fairness is established because consumers pay the tax in time with their consumption of goods and services received;
iv. It can be used as a tool of fiscal policy, items can be exempted; tax rate can be changed to achieve specific economic objective;
vi. Promotes better accounting system as tax on records of purchases are kept;
vii. It reduces tax evasion;
viii. Increase tax compliance; and
ix. When compared with other indirect taxes, VAT is easier to manage.

The demerits of VAT are:

i. High administrative cost on the part of the government;
ii. High cost of keeping records by the companies agents;
iii. Injustice in the distribution of the VAT proceeds;
iv. Corruption on the part of tax officials can render VAT ineffective;
v. Problem of inadequate information can make VAT administration ineffective; and
vi. VAT is regressive in nature.

EXAMINER'S REPORT

The question tests candidates' knowledge of registration of taxable persons for VAT purposes, merits and demerits of VAT.

The candidates' performance was average as most of them that attempted the question scored 59% of the allocated marks.

Most of the candidates were not able to explain the registration of government ministries as agents of the FIRS and the requirement that non- resident companies should also register for VAT using the address of the person with whom it has an existing contract.

Candidates are advised to prepare adequately for future examinations.

5. (a) Explain briefly five (5) problems of VAT Administration in Nigeria. (5 Marks)

(b) State clearly the following as provided in the Value Added Tax Act 2004 (as amended):

(i) Destination of goods and services principle. (1 Mark)

(ii) Origin or source of goods and services principle. (1 Mark)

(c) Danladi Enterprises Limited produces vatable products and during the month of July 2020, sold the products to wholesalers and distributors amounting to ₦11,500,000 (VAT inclusive). The value of raw materials utilized in the manufacturing of these products amounted to ₦8,500,000.00. The wholesalers sold the products to other dealers at a total price of ₦15,000,000.00 (VAT inclusive), and the dealers to retailers at a total price of ₦18,000,000, the retailers sold 1,000,000 units to the final consumers at ₦21.00 per unit.

Required:
Compute the input and output VAT payable at each stage of the transactions. (8 Marks)
(Total 15 Marks)

SOLUTION TO QUESTION 5

(a) i. Lack of or inadequate records or accounting by businesses with which to determine accurately the VAT payable.
ii. Some companies maintain more than one VAT accounts for the purpose of evading payment of Value Added Tax.
iii. Corruption on the part of tax collectors.
iv. Inadequate tax enlightenment education and public awareness.
v. Inadequate qualified personnel to administer the operation of VAT.
vi. Late remittance and sometimes non-payment of VAT payable by VATable persons and organizations.
vii. Problem of getting a satisfactory sharing ratio among the three tiers of government.

(b) i. Destination of Goods and Services Principle suggest that only goods imported into the country are to be subjected to VAT.
ii. Origin or Source of Goods and Services Principle suggest that goods and services exported out of the country would be subjected to VAT at the source or origin of the goods and services.

(c). Danladi Enterprises Limited
Computation of VAT payable for the month of July 2020

	₦	₦
a. Suppling raw materials		
Output VAT (₦8,500,000 x $7^1/_2$%)	637,500	
Input Vat	-	
Amount payable		637,500
b. Producer		
Output VAT $\left[₦11{,}500{,}000 \times \frac{7^1/_2}{107^1/_2} \right]$	802,326	
Input VAT (₦8,500,000 x $7^1/_2$)	(637,500)	

Amount payable			164,826
c. Wholesalers			
Output VAT	$\left[₦15{,}000{,}000 \times \frac{7^1/_2}{107^1/_2}\right]$	1, 046,512	
Less input VAT	$\left[₦11{,}500{,}000 \times \frac{7^1/_2}{107^1/_2}\right]$	(802,326)	
Amount payable			244,186
d. Dealers			
Output VAT	$\left[₦18{,}000{,}000 \times \frac{7^1/_2}{107^1/_2}\right]$	1,255,814	
Less: Input VAT	$\left[₦15{,}000{,}000 \times \frac{7^1/_2}{107^1/_2}\right]$	(1, 046,512)	
Amount payable			209,302
e. Retailer			
Output VAT (₦1,000,000 x 21 x $7^1/_2$)		1,575,000	
Input VAT	$\left[₦18{,}000{,}000 \times \frac{7^1/_2}{107^1/_2}\right]$	(1,255,814)	
Amount payable			319,186
Total VAT payable			1,575,000

EXAMINER'S REPORT

The question tests candidates' knowledge of VAT administration, principles of VAT relating to imported and exported goods, and the computation of input and output VAT.

Candidates' performance was very poor as most of them that attempted the question scored less than 40% of the allocated marks.

Most of the candidates that attempted the question could not compute the VAT payable at each stage of the transactions.

Candidates are advised to read the Institute's Pathfinders and Study Packs when preparing for subsequent examinations.

6. WTO Agreement on implementation of Article VII of the GATT 1994 stipulates among other things, the methods of valuation of imported goods for the purpose of levying ad-valorem duties on such goods.

Required:
Discuss any five (5) of the methods of valuation of imported goods in accordance with the agreement. (15 Marks)

SOLUTION TO QUESTION 6

Methods of Valuation of Imported Goods

1. **Transaction value**
   The price actually paid or payable is the total payment made or to be made by the buyer to or for the benefit of the seller for the imported goods. It includes all payments made as a condition of sale of the imported goods by the buyer to the seller, or by the buyer to a third party to satisfy an obligation of the seller.
2. **Transaction value of identical goods**
   The transaction value is calculated in the same manner on identical goods if the goods are:
   - The same in all respects including physical characteristics, quality and reputation;
   - Produced in the same country as the goods being valued; and
   - Produced by the producer of the goods being valued.
3. **Transaction value of similar goods**
   The transaction value is calculated in the same manner on similar goods if:
   - Goods closely resembling the goods being valued in terms of component materials and characteristics.
   - Goods which are capable of performing the same function and the commercially interchangeable with the goods being valued.
   - Goods which are produced in the same country as and by the producer of the goods being valued.
4. **Deductive value method**
   When custom value cannot be determined on the basis of the transaction value of the imported goods or identical or similar goods, it will be determined on the basis of the unit price at which the imported goods or identical or similar goods are sold to an unrelated buyer in the greatest aggregate quantity in the country of importation.
5. **Computed Value**
   Computed value determines the customs value on the basis of the cost of production of the goods being valued, plus an amount for profit and general expenses usually reflected in sales from the country of exportation to the country of importation of goods of the same class or kind.
6. **Fall back or Derivative or Residual valuation method**
   Customs value determination based on "reasonable means consistent with the principles and general provisions of the Agreement, ARTICLE VII GATT and on the basis of available data.

EXAMINER'S REPORT

The question tests candidates' understanding of methods of valuation of imported goods in accordance with WTO agreement or implementation of Article VII of the GATT 1994.

The candidates' performance was satisfactory as most of them that attempted the question scored 60% of the allocated marks.

Despite the satisfactory performance of the candidates, some of them could not explain the "deductive value" and the "computed value" methods.

Candidates are advised to study widely and should always ensure adequate coverage of the syllabus before sitting for subsequent examinations.

7. Nigeria Export Promotion Council (NEPC) is the government agency established to promote and regulate non-oil commercial exports in Nigeria.

   State Ten (10) functions of this agency. (15 Marks)

SOLUTION TO QUESTION 7

Functions of the Nigeria Export Promotion council

a. To promote the development and diversification of Nigeria's export trade.
b. To assist in promoting the development of export oriented industries in Nigeria.
c. To spearhead the creation of necessary export incentives.
d. To co -operate and monitor export promotion activities in the country.
e. To collect and disseminate to local manufacturers exports information on foreign outlet.
f. To provide technical assistance to local exporters in such areas as export procedures and documentation, transportation, market techniques, quality control, export packaging, costing and pricing, publicity and in other similar areas.
g. To collect and disseminate information on products available for export.
h. To maintain adequate and effective representation in other countries.
i. To provide directly or jointly with training institutions, training for its staff and assist with manpower development of the export community in Nigeria.
j. To organize the participation of Nigeria in Trade fairs and exhibitions in other countries.
k. To undertake studies of the economic conditions with special attention to the export sector with a view to advising government on necessary policy measures.
l. To cooperate with other institutions on matters relating to export financing, export incentives and specialized services to exporters.
m. To establish trade promotion facilities in Nigeria and other countries including the establishment of permanent show rooms at important commercial centres in other countries.
n. To pursue the simplification and stream lining of trade procedures and documentation on continuous basis.
o. To provide services to trade delegations on matters relating to export activities.

EXAMINER'S REPORT

The question tests candidates' understanding of the functions of Nigeria Export Promotion Council (NEPC).

The candidates' performance was average as most of them that attempted the question scored 50% of the allocated marks.

Despite the average performance of the candidates, most of them did not state the function of NEPC as it relates to the provision of services to trade delegations on matters relating to export activities.

Candidates are strongly advised to prepare adequately for future examinations of the Institute by making use of the Institute's Study packs.

THE CHARTERED INSTITUTE OF TAXATION OF NIGERIA

APRIL 2021: PROFESSIONAL EXAMINATION

PTE I: GOVERNANCE RISK & ETHICS

TUESDAY 13TH APRIL, 2021 **EXAM NO.................................**

ATTEMPT QUESTION ONE AND ANY OTHER FOUR QUESTIONS.

TIME: 3 HOURS.

1. Several years ago, Equality & Social Justice (ESJ), a well-known charity published a report on the activities of three major food companies in their marketing of manufactured baby foods in the country. The report, titled 'KILLER COMPANIES', stated that it had evidence that the three companies were aggressively mis-selling manufactured baby food products in the country. It was argued in the report that several problems arose with the use of these products which negatively affected the health of the babies. These problems were traced to the use of poorly treated water in the preparation of the baby food, and the inability of parents to read the instructions on the packages, thereby malnourishing the babies. Doctors often advised against the use of these products for babies because natural feeding solutions were considered safer and more beneficial in most cases.

When the 'KILLER COMPANIES' report was published, it was widely reported upon and received a lot of social and political attention. Two of the three companies immediately decided to withdraw from the business, but the third, Zedex Nigeria Plc (Zedex) recognised what it believed to be an opportunity to take the market share left by the other two companies. It decided to increase its production capacity accordingly. When asked by journalists why it had not also withdrawn from the criticised business activity, the Chief Executive issued a press statement saying that it was a profitable business opportunity and, as the steward of shareholders' interest, he owed it to the shareholders to maximise their returns.

When it became widely known that Zedex had decided to expand and develop its baby food business in the country, 'Save A Child' (SC) another non-governmental organisation concerned with infant nutrition, organised a campaign against Zedex, strongly believing in the breast feeding of infants. SC organised protests outside the Zedex head office and also encouraged the public to boycott a wide range of Zedex products in addition to the baby food products. SC popularised the phrase "Zedex kills babies" hoping it will become widely adopted.

Institutional investors hold large volume of Zedex shares. Despite the impressive financial of Zedex, some Institutional investors were getting concerned about the baby food issue. A prominent fund manager, Resolute Funds Limited, organised a meeting for Institutional shareholders. Fifty of them which attended the meeting became known as the 'Resolute Group'. Though all of them wanted to retain their holdings in Zedex because of the good returns, a number of questions bothered them and they decided to put them to Zedex management, thus:

(i) Can the company explain the strategy or logic behind pursuing the baby food business despite the strong protest against them?

(ii) Is the board not concerned about the potential reputational damage with phrases like "Zedex kills babies" being used widely in the media?

(iii) Would Zedex board consider withdrawing from the baby food business because of the alleged negative health impacts on the babies?

The Company issued a statement through its Investor Relations Department that the strategy was based on activities that provided the highest profit to shareholders, regardless of the effects on other stakeholders. Secondly, the board was not concerned with reputation risks because it believed that these were 'temporary concerns' which will soon be forgotten. Thirdly the board will not withdraw from the baby food market because with the exit of the two competitors, profit margins were likely to be higher and with little or no competition. The Resolute Group expressed its dissatisfaction with this reply and said it might seek to influence the appointment of non-executive directors (NEDs) to Zedex board to increase the scrutiny of the executive members and their discussions on the subject.

As the ESJ and SC continued their campaigns against Zedex, some other groups became aware of the baby food through media campaigns aimed at de-marketing Zedex baby food products. The aim is to put pressure on Zedex's management to change their policy on baby food.

Partly in response to these pressures, the Zedex board decided to consider two new initiative. The first of these is to introduce a corporate code of ethics. By carefully drafting this and placing it prominently on its website, the board believes that this could achieve a number of favourable outcomes including improving its reputation.

The second initiative was to consider instituting a full risk audit system in response to the negative publicity it had experienced, especially from SC, whose members were considered to be natural customers of Zedex's other products. A private research commissioned by Zedex showed that the baby food business was damaging Zedex's reputation and possibly the willingness of some talented people working with the company. Political support for other company plans had also suffered, such that a recent application to the Ministry of Town Planning to set up a new factory by Zedex in a business with no connection with baby food was denied. Due to the fact that the idea of risk auditing was a new initiative for Zedex, the board has asked a local consulting firm to advise the company on risk audit and business ethics.

Required:

(a) Corporate Governance principles include, Transparency, Judgment and Reputation. Explain these Three (3) terms and assess the Zedex board's performance against each one. (12 Marks)

(b) What are the purposes of a Corporate Code of ethics and examine how the adoption of such code might make Zedex reconsider its marketing of baby food. (8 Marks)

(c) Institutional investors are influential stakeholders in business entities.

(i) Explain with clear examples types of institutional investors. (4 Marks)

(ii) Give reasons why the Resolute Group should attempt to intervene in the governance of Zedex following the events described in the case. (6 Marks)

(d) (i) What do you understand by risk audit in the context of Zedex and explain the stages in a risk audit. (5 Marks)

(ii) Distinguish between Internal and External risk audit and enumerate the advantages of risk audit. (5 Marks)

(Total 40 Marks)

SOLUTION TO QUESTION 1

1. (a) The principles or concepts of cooperate governance are as follows:
- Fairness
- Openness / Transparency
- Independence
- Honesty and Integrity (Probity)
- Responsibility and Accountability
- Reputation
- Judgement
- Nolaks 7 principle of public life

Transparency:

This involve full disclosure of material matter which could influence the decisions of stakeholders. Assessing the board of Zedex on this will prove that it is guilty with the following points:

- Non – disclosure of the ingredients used in the production of the baby food;
- Not recognising the importance of local language of the people by not having the instructions for the usage also written in Hausa language; and
- Failure to inform the board about the published report of Equality and Social Justice (ESJ) Foundation and subsequent withdrawal of the two other competitors companies from the business.

Judgement:

This refers to the skill with which management make decisions which will improve the wealth and prosperity of the organisation.

The judgement of the Managing Director to continue the business after publication of the "KILLER COMPANIES" report and even after the withdrawal of the two competitors all because of the profitable business opportunity he saw in the withdrawal of the competitors, which he perceived will increase shareholders' wealth in the long run. But he forgot to realise that the "KILLER COMPANIES" publication is a damage to the goodwill of the company and the sales of bad baby food is against business ethics.

Reputation:

This is synonymous to company goodwill and it is usually built -up by the personality of the Managing Director, Chairman or other members of the board, products/customers' patronage and Corporate Social Responsibility (CSR) Compliance level.

The insensitivity of the Managing Director to recognise the extent of the damage to the reputation /goodwill of the company as regards the "KILLER COMPANIES" publication, the campaign by the "Safe a Child" organisation to the other protests is seen in his intention to expand and develop its baby food business in other parts of the country.

(b). The purpose of corporate code of others are:

i. Inspiration and Guidance:- code of ethics provide stimulus for ethical conduct, helpful foundation and advice concerning the main obligation of business entities. The design and adoption of set of codes will guide the activities of Zedex, ensuring that it conducts its business in an ethical manner;

ii. Support: Code of ethics give positive support to those seeking to act ethically;

iii. Contribution to public image: Codes can present a positive image to the public of an ethically guided organisation. To this ends, it will help Zedex better serve the public; and

iv. Shared Standard: The diversity of viewpoints among individual practitioner makes it essential that a profession, organisation or practice established explicit standards, in particular minimum standard beyond what the law, market, morality or public opinion require. In this way, the public is assured of good conduct by the business entity.

(c) i. Institutional investors are entities which accrue funds from various sources and specialises in investing in shares and bonds. Examples are:

- Insurance companies
- Mutual Funds
- Pension Funds
- Portfolio Managers

They may intervene in the governance of a company in the occurrence of any of the following:

- Where the Managing Director is perceived not carrying along the board of directors in the management.
- Where there is public outcry or protest against the products or management of the company.

ii. i. Individual investor contabalance the tendency of members of the board to pressure self interest with furthering the entity's interest

ii. Institutional investors ensures that longer terms interest of the organisation is pursued. From the given scenario, there is the need to counterbalance the maximisation of short terms profit which seem to be the force of the board with the long term interest of the organisation.

iii. Institutional investors are much stronger than minority shareholders in forcing the organisation to behave in a more ethical manner. They have the numbers to force such changes as altering board composition, and increase in the number of non-executive directors due to the value of their shareholding

iv. Institutional investors could also provide stability during turbulence periods.

(d). i. Risk audit can be defined as the comprehensive identification and examination of all possible (i.e real and potential) challenges an organisation is exposed to in its operations.

Zedex Plc should have undertaken a risk audit to identify and recognise that the KILLER COMPANIES publications, the SC campaign and other protests are enough reputation risk that may affect the company's going – concern, reduced customers' patronage and possible government punishment in the long –run for unethical conduct or operation.

The risk audit stages will involve the following:

- Risk Identification;
- Risk Assessment;
- Risk Review; and
- Risk Reporting (i.e IRRR).

ii. Risk audit as defined in (d) (i) above can be undertaken internally or externally. Internal risk audit is when the assignment is undertaken by operational risk department, committees, functional section or individual within the organisation while external risk audit is when the assignment is conducted by out-sourced risk professionals.

In another perspective internal risk audit is conducted on internal operations of the company while external risk audit is conducted on individual, business and general environment of the company.

The advantages of risk audit

- ❖ Enhances familiarity of company's system, procedures and culture
- ❖ Understanding of relevant technical issues, business operations and legal frameworks.
- ❖ Easy comprehension of the report compared to when written by external auditors.

EXAMINER'S REPORT

The question is a scenario – based question and it requires candidates, in relation to the scenario to:

a. Explain three corporate governance principles;
b. Explain the purpose of Corporate Code of Ethics;
c. Explain influence of institutional investors in corporate governance; and
d. Explain risk audit.

Being a compulsory question, all the candidates attempted the question but their performance was very poor. None of the candidates scored up to 50% of the allocated marks.

The candidates demonstrated lack of understanding of the various issues raised in the scenario and their relationship with good corporate governance.

Candidates are advised to make use of the Institute's Study Pack and prepare adequately for future examinations.

2. A Professional misconduct or unethical behaviour is a deviation or violation of some of the principles and rules guiding good moral conduct.

You are required to state Five (5) points for each of the following:

(a) Causes or reasons for unethical behaviour. (5 Marks)

(b) Consequences of unethical behaviour. (5 Marks)

(c) Advantages of code of ethics. (5 Marks)
(Total 15 Marks)

SOLUTION TO QUESTION 2

(a). **Causes or reasons for unethical behaviour**

i. Inordinate desire for personal gain or greed.
ii. Family or peer pressure.
iii. Deteriorating and debilitating poverty
iv. Wide spread corruption in all spheres of the society.
v. Propensity to live beyond current income level
vi. Accruing high personal debt.
vii. Indiscipline.

(b) **Consequences of unethical behaviour**

i. Reprimand or warning.
ii. Withdrawal of practicing rights.
iii. Suspension from membership for a period.
iv. Expensive litigation and possible imprisonment.
v. Expulsion from membership.
vi Loss of reputation.
vii. Payment of costs or claims or damages

(c). **Advantages of code of ethics**

i. It controls the autocratic power of employers.
ii. It ensures uniformity of job performance.
iii. It serves as a check on members conduct.
iv. It specifies the social and moral responsibilities of corporations.
v. It provides the frame work for developing good corporate governance.
vi. It provides guidance, especially in dilemma situations.
vii. It helps to standardise the operations and methodology of professional tax practitioners.

EXAMINER'S REPORT

The question tests issues around professional misconduct and unethical behaviour.

Candidates' performance was very poor as most of the candidates that attempted the question scored less than 20% of the allocated marks.

Candidates demonstrated lack of understanding of what constitute professional misconduct and unethical behaviours.
Candidates are advised to prepare adequately for future examination and make use of the Institute's Study Pack and previous examinations' Pathfinders.

3. Environmental analysis is one of the stages in strategic planning process.

Explain PESTEL analysis model, as a tool for environmental analysis. (15 Marks)

SOLUTION TO QUESTION 3

PESTEL analysis is a structural approach to analyse the external environment of an entity or an organisation. There are six categories of environmental influence, the main influences are identified as follows:

1. **Political**
   The political environment consists of political factors that can have a strong influence on business entities and other organisation. Investment decisions by companies will be influenced by factors such as:
   - ❖ The stability of the political system in particular countries;
   - ❖ The threat of government action to nationalise the individual and seize ownership from private business;
   - ❖ War and civil unrest; and
   - ❖ The threats of terrorist or kidnapping activities.

   Political considerations are particularly important for business entities operating in countries with an unstable political regime or a dictatorship regime.
2. **Economic**
   The economic environment consists of the economic influences on an entity and the effect of possible changes in economic factors or future business prospects.
   Factors in the economic environment include:
   - ❖ The growth rate of the economy;
   - ❖ The rate of inflation and the level of interest rates and whether interest rates may rise up or fall;
   - ❖ Foreign exchange rates and whether particular currencies are likely to get weaker or stronger;
   - ❖ Unemployment level and the availability of skilled or unskilled workers;
   - ❖ Government tax rates and government subsidiaries to industry;
   - ❖ The existence or non - existence of free tax trade between countries, and whether trade barriers may be removed; and
   - ❖ The existence of trading blocks of countries, such as the European Community.

   Economic factors could affect a decision by a company about where to invest. Tax incentives, the availability of skilled labour, a good transport infrastructure, a stable currency and other factors can all influence strategic choices.
3. **Social and Cultural**

An entity is affected by social and cultural influences in the countries or regions in which it operates, and by customs and attitudes. Some influences are more significant than others. Factors in the social and cultural environment include:

- The values, attitudes and beliefs of customers, employees and the general public;
- Partners of work and leisure, such as the length of the working week and popular views about what to do during leisure time;
- The ethnic structure of the society;
- The influences of religion and religious attitude in the society; and
- The relative proportions of different age groups in the society.

4. **Technological**

   The technological environment consists of the science and technology available to an organisation (and it competitors) and changes and developments in science and technology. Some aspects of technology and technological changes affect vertically all organisation. Developments in information technology and computer technology, including the internet, are the most obvious example. Business entities that do not respond to changes in IT and computerisation risk losing their share of the market to competitors. For strategic planning, companies need to be aware of current technological changes and possible nature of changes in the future. Technology could have an important influence, for example, on investment decisions in research and development, and investment in new technology.

5. **Ecological influence**

   For business entities in some industries, environmental factors have important influence on strategic planning and decision making. They are particularly important for industries that are:

   - Subject to strict environmental legislation, or the risk of stricter legislation in the future (for example, legislation to cut levels of atmospheric pollution)
   - Faced with the risk that their source of raw materials will be used up (for example, parts of the fishing industry and timber industry).

6. **Legal**

   The legal environment consists of laws and regulations affecting an entity and the possibility of major new laws or regulations in the future. Laws and regulations vary between different countries, although international regulation is accepted in certain areas of commercial activity.

   - An international company might locate some operations for tax reasons in a country with favourable tax system.
   - Decisions to relocate operations from one country to another could be affected by the differences in employment law in the two countries or by the new employment legislation.
   - In many industries, companies are faced with environmental legislation or health and safety legislation, affecting the ways in which they operate, as well as the design of the products they make or sell

EXAMINER'S REPORT

The question tests candidates' understanding of PESTEL as a tool for environmental analysis.

Candidates demonstrated a fair understanding of the question and performance was fairly good. The commonest pitfall of the candidates was their lack of ability to explain adequately each component of PESTEL.

Candidates are advised to read extensively when preparing for the future examination and make use of the Institute's Study Pack and previous examinations' Pathfinders.

4. (a) What is Business Policy? (2 Marks)

(b) Highlight any FOUR differences between Business Policy and Strategy. (4 Marks)

(c) Explain briefly six basic features of a Business Policy. (9 Marks)
(Total 15 Marks)

SOLUTION TO QUESTION 4

(a). Definition of Business Policy

Business policy can be regarded as a standing guide for administrative decisions on any given subject. It is a corporate guide developed by top management for making and implementing decisions.

Business Policy is concerned with an organisation's basic direction for the future which encompasses its purpose, its ambitions, its resources and its relationship with the environment in which it operates.

Stated differently, business policies are guidelines stating how an organisation will work towards its goals. Business policies are guidelines that indicates limits or prescribed, the permitted and prohibited forms of behaviuor in organisations.

It is an established way of doing business and an internal administrative law governing executive actions within the organisation.

From the above, business policy can be regarded as a general principle or decision rule that summarises the thinking and guides the actions of company's executives. For instance business policies will state:

i. Whether or not a business should sell on credit;

ii. Whether a business should be finance through retained earnings;

iii. Whether to make or purchase the most critical components for the manufacturing of a product;

iv. Whether to employ disabled individual or not; and

v. Expected behaviour of an organisational members over a given subject e.t.c.

(b). Difference between business policy and strategy are as follows:

i. Business policy is a bluerprint of organisational activities which are repetitive /routine in nature, while strategy is concerned with those organisational decisions which have not been dealt with or faced before in same form;

ii. Policy formation is the responsibility of top management while some levels of strategy formation may be done by middle level management;

iii. Policy deals with routine daily activities essential for the effective and efficient running of an organisation. Strategy on the other hand deals with strategic decisions;

iv. Policy is concerned with both thought and action while strategy deals mostly with actions; and

v. A policy is what can and should be done, while strategy is the methodology used to achieve the target as prescribed by a policy.

(c). Features of Business Policy

i. A good business policy should be simple and relevant to the business.

ii. It should be flexible and adaptable enough to adjust to changing scio – economic and organisational conditions.

iii. It should be adequate and up-to-date : policy must be reviewed from time to time to capture new trends and development within business environment.

iv. Business policy should be consistent with and not conflicting with the operations of business.

v. It should be clear, definite and reduce to writing in order to prevent employees from formulating their personal opinions on different matters and denying their knowledge of what they are suppose to do in a specific situation.

vi Business policy should be planned within and systematically developed.

vii. It should be easy to implement within the limit of the company's resources.

viii. Business policy should be consistent with or conform to ethical standards and not conflicting with the values of the organisation.

EXAMINER'S REPORT

The question tests candidates' understanding of Business Policy and the difference between business policy and strategy. Candidates' performance was very good. Some candidates' demonstrated lack of understanding of business policy and the differences between it and strategy.

Candidates are advised to prepare adequately for future examination and makes use of the Institute’s Study Pack and Pathfinders of previous examinations.

5. In an analytical risk management process, there are certain steps that strategic risk managers should follow.

   Highlight and explain these steps. (15 Marks)

SOLUTION TO QUESTION 5

Steps involve in risk management.

i. Establishing the context of the risk.
ii. Identification of potential risks
iii. Assessment of risk.
iv. Risk management options.
v. Potential Risk Treatments.
vi. Risk management plan
vii. Implementation of planned methods for risk management
viii. Review and evaluation plan.

Explaining the steps

i. Establishing the context of the risk: this involves observing the scope of risk management and identification of the objectives of stakeholders. It also involve a thorough analysis of the risk that is involve in the business to determine its magnitude.

ii. The second step is identification of potential risk which can start with the source of the problem and identification of its consequences. When the source or problem is known, the events that a source may trigger or the event can lead to a problem can be investigated. The method of identifying risks may depend on culture; industry practice and compliance.

iii. Assessments of risk is the third step in risk management which is critical to make the best decisions in order to properly prioritise the implementation of risk management plan. Once risk have been identified, they must then be assessed as to their potential severity of impact and the probability of occurrence.

iv. Risk management option: risk mitigation measures are usually formulated according to one or more of the following risk option, which are:
   - ❖ Design a new business process with adequate built –in risk control and containment measures from the start;
   - ❖ Periodic re-assessment of risks that are accepted in ongoing processes as a normal features of business operations;
   - ❖ Transfer risks to an external (agency e.g insurance company); or
   - ❖ Avoid risks altogether.

v. Potential Risk Treatments: once risks have been identified and assessed, the techniques to manage the risk fall into one or more of the following:
   - ❖ Avoidance (eliminated, withdrawal from the risk);
   - ❖ Reduction (optimise – mitigate);
   - ❖ Sharing (transfer – outsource or insure); and
   - ❖ Retention (accept and budget).

vi. Risk management plan: This involves selecting appropriate controls or counter measures to mitigate each risk. The risk management plan should propose applicable and effective security control for managing risks.

vii. Implementation of planned methods for mitigating risks: implementation usually follows all the planned methods from mitigating the effect of the risks. This may involve purchasing insurance policy for the risk that the organisation has decided to transfer to an insurer, or avoid all the risk that can be avoided without sacrificing the organisation's goals e.t.c.

viii. Review and Evaluation of the plan: Initial risk management plans will never be perfect hence, the need to evaluate the practice, experience and actual loss results that will necessitates changes in the plan and contribute information to allow possible different decisions to be made in dealing with the risk being faced.

EXAMINER'S REPORT

The question tests candidates' understanding of the risk management process. Candidates' performance was very poor as the few candidates that attempted the question performed very poorly.

Candidates demonstrated lack of understanding of risk management process.

` Candidates are advised to ensure that they prepare adequately for future examination by covering the contents of the syllabus and make use of the Institute's Study Pack.

6. Corporate Social Responsibility can be seen as operating a business in a manner that meets or exceeds the ethical, legal, commercial and public expectations that society has of businesses.

   You are required to explain Six (6) major areas by which organisations can be socially responsible. (15 Marks)

SOLUTION TO QUESTION 6

Key principles of social responsible behaviuor.

1. Accountability
2. Transparency
3. Ethical behaviour
4. Respect for the stakeholders' interest
5. Respect for the rule of law
6. Respect for lawful norms of behaviour
7. Respect for human rights.

The major areas of socially responsibility of business are as follows:

1. Towards shareholders or owners: the shareholders get dividend at the prevailing rate of returns at the capital market. Dividends should be paid every year at regular intervals;
2. Toward customers: the business should produce why those commodities which are needed by consumers. Every business aims at producing goods at the minimum cost.
3. Towards workers: to pay reasonable amount of wages and salaries to employees. Workers must be safe and secured. Working condition must be healthy and refreshing.
4. Toward government: the business must honour the constitution and the various provisions of different laws of the country. The business should be well behaved and honest in its dealings and pay its due tax.
5. Towards society: the business has its first responsibility toward the society where its situated. The business should make proper arrangement for the disposal of smoke, dust, waste and scraps etc.
6. Towards the organisation itself: The atmosphere must be created where the business entity can adhere strictly to its corporate goals and sustain the existence of the organisation.
7. The organosation should position itself in a way to effectively respond to changes in its environment for the achievement of its corporate goals.

EXAMINER'S REPORT

The questions tests candidates' knowledge of major areas of which organisations can be socially responsible.

Candidates demonstrated understanding of corporate social responsibility but concentrated on just one area and thus performance was poor.

Candidates are advised to prepare adequately for future examination and make use of the Institute's Study Pack and Pathfinders of previous examinations

7. The society at large expects professionals to possess some qualities/attributes.

You are required to state and explain any Five (5) of such attributes. (15 Marks)

SOLUTION TO QUESTION 7

Qualities tax practitioners should possess

The society at large usually expects professionals to comply with some forms of ethical standards. They are also expected to possess certain attributes / qualities. These qualities include:

a. Integrity

Webster Third New International Dictionary defines integrity as "an unimpaired or unmarred condition, soundness and uncompromising adherence to a code of moral artistic or other value, sincerity, honesty and candor, avoidance of deception, expediently, artificiality or shallowness of any kind". From the above definition, it is clear that integrity cannot be qualified. You either have integrity or you do not have it. There is no midway or short cut to it.

Therefore a tax practitioner must have integrity and should be able to critically examine the peculiarity of any professional assignment before accepting it.

b. Independence

This is an attitude of mind based on integrity and an objective approach to work. A member must perform his work objectively and impartially and free from influence by any consideration which might appear to be in conflict with this requirement. The principle of objectivity imposes on the professional tax practitioner the obligation to be fair, intellectually honest and free from conflict of interest. He should maintain objectivity in his judgements in all circumstances.

c. Confidentiality

A tax practitioner should respect the confidentiality of information entrusted to him by his client or employer and should not disclose any such information to third party without the specific authority of his client or employer unless in special circumstances as indicated by the exigencies of the law. The duty of confidentiality continues even after the end of the relationship between tax practitioner and his client or employer.

d. Maintenance of technical competence

The role of tax practitioner nowadays has gone beyond just computing tax and submitting returns. The maintenance of professional competence requires a continuing awareness of developments in the taxation practice including relevant national and international pronouncements on taxation and other relevant regulations and statutory requirements. A tax practitioner should, therefore, adopt a programme designed to ensure quality control in the performance of professional services consistence with appropriate national and international pronouncements. To facilitate this and as part of its responsibility to its member, the Institute established the mandatory Professional Training program (MPTP) which every member is compulsorily required to attend annually in order to retain his/her membership of the Institute.

e. Conformity with technical standards

Every tax practitioner must conform to the practice standards as issued by the Institute. It is worth mentioning the Institute has joined other leading professional bodies in Nigeria with the presentation of nine Statements of Taxation Standards for use as practice guide by all tax practitioners in the country.

f. Courteous

A tax practitioner should be courteous and considerate towards all with whom he comes in contact with during the course of performing his work.

g. Skill of due care and diligence

Tax practitioners should ensures that they carry out whatever assignment given with skill, due care and diligence and with proper regards for the technical and professional standards expected of them.

h. Obligation

Tax practitioners should be committed to their duties. They should be able to know at any point in time when they are expected to discharge their duties, more so when under pressure.

EXAMINER'S REPORT

The question tests candidates understanding of professional qualities / attributes a tax practitioner should possess.

Candidates' performance was very good. Candidates are advised to study widely and adequately prepare for future examination. They are also enjoined to make use of the Institute's Study Pack and Pathfinders of previous examination

THE CHARTERED INSITUTTE OF TAXATION OF NIGERIA

APRIL 2021: PROFESSIONAL EXAMINATION

PTE I: FINANCIAL REPORTING

WEDNESDAY 14TH APRIL, 2021 **EXAM NO.................................**

ATTEMPT QUESTION ONE AND ANY OTHER FOUR QUESTIONS.

SHOW ALL WORKINGS. **TIME: 3 HOURS.**

1. (a) Explain the treatment of 'gain on a bargain purchase' according to IFRS 3 Business Combinations. (7 Marks)

(b) The statements of financial position of three companies: Major, Super and Minor, all public limited liability companies, as at 31 March 2020 are shown below:

	Major Plc ₦'m	**Super Plc ₦'m**	**Minor Plc ₦'m**
ASSETS			
Non-current Assets:			
Property, plant and equipment	2,400	1,800	840
Financial assets-equity	3,720	--	--
Other financial assets	384	--	--
	6,504	1,800	840
Current Assets:			
Inventories	150	990	54
Receivables	330	984	12
Cash	66	672	3
Total current assets	546	2,646	69
Total assets	7,050	4,446	909
EQUITY AND LIABILITIES			
Equity:			
Equity shares (₦1.00 each)	3,000	1,200	300
Retained earnings	2,700	2,160	576
Share premium	--	780	--
Total equity	5,700	4,140	876
Current Liabilities:			

Trade payables	1,100	156	9
Current tax payable	250	150	24
Total liabilities	1,350	306	33
Total equity and liabilities	7,050	4,446	909

Notes

i. On 1 January 2016, Major acquired 80% of Super for ₦3 billion when Super's share capital and reserves were ₦2.52 billion.

Major has a policy of revaluation of property at fair value. At the date of acquisition, Super had a property with a fair value of ₦160 million higher than the book value. Additional depreciation of ₦24 million needs to be recognised in the post-acquisition period at 31 March 2020.

Super had an internally generated brand with a fair value of N540 million at the acquisition date which was disclosed in the notes to the financial statements. The brand was not qualified to be recognised in the individual financial statements of Super under IAS 38 but met the requirements for recognition in the consolidated financial statements. The useful life of the brand is estimated at 10 years.

The fair value of non-controlling interest at the acquisition date was ₦1,915 million. The full goodwill method is used.

ii. On 1 October 2018, Major acquired 30% of the equity shares of Minor for ₦720 million when the fair value of the net assets of Minor was ₦620 million.

iii. Since acquisition, there had been no impairment loss in Super but the accumulated impairment losses in Minor at 31 March, 2020 had been 40% of the goodwill acquired.

iv. Major's other financial asset was 10% equity holding that was acquired in Tiny on 1 April with cash of ₦392 million. Major elected to classify the equity investment at fair value through profit or loss at the date of acquisition. ₦384 million was the fair value at 1 April, 2019 while the fair value at 31 March, 2020 was ₦478 million. Dividends received on this investment had been reported in the financial statements of Major but the fair value at 31 March 2020 had not been adjusted for.

v. At the year-end, Major had inventory acquired from Super. Super had invoiced the inventory to major for ₦600 million but was at a cost of ₦420 million to Super.

vi. After the year-end but before the financial statements were approved for issue, it was discovered that the inventories of Super at a cost of ₦480 Million had a net realisable value of ₦300 million; a condition that existed at the year-end.

vii. At 31 March 2020, there was an intra-group trade receivables of ₦120 million owed by Major to Super but in the payables of Major, it showed a balance of ₦103 million owed to Super. The difference is due to cash-in-transit.

viii. There had been no changes in the equity of the three companies since acquisition.

Required:
Prepare the consolidated statement of financial position of Major Group Plc as at 31 March 2020. (Approximate your figures to the nearest ₦0.1 million).
(25 Marks)

(c) (i) Explain what is meant by non-current assets held for sale and disposal group according to IFRS 5 Non-current Assets Held for Sale and Discontinued Operations. (3 Marks)

(ii) State the criteria to be met before a non-current asset or disposal group be classified as held for sale. (5 Marks)
(Total 40 Marks)

SOLUTION TO QUESTION 1

(a) A gain on a bargain purchase arises when fair values of the net assets acquired exceeds the total of the consideration plus the fair value of the non-controlling interest at the acquisition date.
--
IFRS 3 Business combination is based on the possibility that all assets acquired and liabilities assumed may not have all been captured or there may be information that warrant that the measurement of the acquired and assumed items be reviewed in addition to the consideration transferred. The first action is to re-assess the identification and measurement of the net assets and purchase consideration transferred checking in particular whether the fair values of the net assets acquired correctly reflect the future costs arising in respect of the acquirer. If the gain still remains after these re-assessment then the difference is attributable to a bargain purchases gain. The gain is then recognised in the acquirer's statement of profit or loss for the period.

(b). **Major Group Plc**
Consolidated Statement of Financial Position as at 31 March 2020

	₦' m	₦' m
Property, Plant and Equipments (2,400 + 1,800+ 136) (w1)	4,336.0	
Investment in Associate (w6)	583.2	
Other financial assets	478.0	
Goodwill acquired (w2)	915.0	
Brand (w1)	310.5	**6,622.7**
Current Assets:		
Inventory ₦(150 +990+ -360)	780.0	

Receivables ₦(330+ 984-120)	1,194.0	
Cash ₦(66+672+17)	755.0	2,729.0
Total assets		**9,351.7**
Equity and Liabilities	₦' m	
	₦' m	
Equity		
Equity shares ₦1	3,000.0	
Retained earnings (w4)	2,838.4	
	5,838.4	
Non – controlling interest (w5)	1,960.3	**7,798.7**
Current Liabilities		
Trade payables ₦(1100 +156-103)	1,153.0	
Taxation ₦(250+150)	400.0	
Total current liabilities		**1,553.0**
Total equity and liabilities		**9, 351.7**

Workings

1. Super Plc net assets

	At reporting date	**At acquisition**	**Post – Acquisition**
	₦' M	**₦' M**	**₦' M**
Ordinary shares	1,200.0	1,200	-
Retained profits	2,160.0	1,320	840
Revaluation reserve	136.0	160	(24)
Share premium	780.0	780	-
Brand	310.5	540	(229.5)
	4,586.5	**4,000**	**586.5**

Amortisation of brand 1/1/2016 – 31/3/2020 = ₦540 x 10% x $4^1/_4$ years = ₦229.5

2. Goodwill in Super Plc.

	₦' M
Purchase consideration	3,000
Fair value of NCI	1,915
	4,915
Net assets at acquisition	4,000
Goodwill	**915**

3. Goodwill in Minor Plc

	₦' M
Purchase consideration	720
Net assets acquired ₦620 x 30%	(186)
Goodwill	**534**
Impairment 40% x ₦534	213.6

4. Consolidated Retained earnings

	₦' M
Parent's	2,700.0
Super Plc ₦586.5 x 80% (w1)	469.2
Fair value increase in financial assets ₦(478 – 384)	94.0

Share of associate's profit ₦(876 -620)x 30%	76.8
Unrealised profit ₦180 x 80%	(144.0)
Obsolete inventory ₦180 x 80%	(144.0)
Impairment loss on goodwill of minor	(213.6)
	2,838.4

5. Non – controlling interests

	₦' M
Fair value at acquisition	1,915.0
Share of post- acq profit ₦586.5 x 20%	117.3
Unrealised profit ₦(600-420) x 20%	(36.0)
Obsolete inventory ₦(480 -300) x 20%	(36)
	1,960.3

6. Investment in associate

	₦' M
Cost at acquisition	720.0
Share of post- acq profits ₦(876 – 620) 30%	76.8
Impairment loss (w3)	(213.6)
	583.2

(c). (i) IFRS 5 defines non- current assets held for sales as those assets or group of assets whose carrying amount will be realised or recovered through a sale transaction rather than through continuing use.

A disposal group is a group of assets that an entity intends to dispose off in a single transaction.

(ii) The following conditions must be met before a disposal group can be classified as held for sale.

- The asset must be available for immediate sale in its present condition and the sale must be highly probable.
- The asset must be marketed at a price that is reasonable in relation to its current fair value.
- The sale should be completed or expected to be completed within a year from the date of the classification.
- For the sale to be highly probable, management must be committed to selling the assets and must be actively looking for a buyer.
- If the sale is not completed within a year, the delay must have been caused by events beyond the entity's control.

EXAMINER'S REPORT

Part "a" of the question tests treatment of gain on bargain purchase according to IFRS 3 - Business Combination. The part "b" tests preparation of consolidated statement of financial position while part "c" tests the meaning and the criteria to be met for an asset to be classified as Non – current assets held for sales and Discontinued Operations.

All the candidate attempted the questions and their performance was very poor.

The commonest pitfalls were the inability of some candidates to explain gain on bargain purchase, while others were unable to prepare consolidated statement of financial position incorporating the adjustments in the note. Also, other candidates could not correctly state the criteria to be met for an asset to be classified as non – current assets held for sales.

Candidates are advised to study all the area of the syllabus using the relevant Institute's Study Pack for better performance in the future examination.

2. According to the IASB Conceptual Framework of Financial Reporting, the objective of general purpose financial statements is that they should provide information about an entity that is useful to a wide range of users of the entity's financial statements.

Required:

(a) Identify six users of financial statements and their likely information needs. (9 Marks)

(b) Identify and explain the assumptions underlying the preparation and presentation of financial statements, as enunciated by the Conceptual Framework. (6 Marks)

(Total 15 Marks)

SOLUTIONS TO QUESTION 2

(a) The following are users of financial statements and their likely information needs.

i. Existing and potential investors:- This group is the provider of risk capital hence user in this group are concern with the risk inherent and return provided by their investment.

ii. Suppliers and trade creditors:-They are interested in the information that shows the ability of the entity to meet their financial obligations.

iii. Loan Creditors:- This group wants information that will enable them to decide whether their loans will be paid when due, and whether to grant new loans to the entity,

iv. Customers:- The customers will be interested in the continuity of the entity, especially if they depend mainly on the entity for their supply.

v. Employees: They wish to know about the stability and profitability so as to determine their job security and upward advancement. They could also use the information to negotiate for better condition of employment.

vi. Government:- They are interested in taxation and regulation of the entities.

vii. General public and Analysts:- They want to decide on whether the entity is carrying out social responsibility to the community.

(b) Two of the assumptions underlying the preparation and presentation of financial statements are the accrual basis and the going concern basis.

i. Accrual basis: - The effects of transactions and other events are recognised when they occur and they are recorded in the accounting records and reported in the financial statements of the period in which they relate. However, there are exceptions like the statement of cash flows which is prepared on a cash basis.

ii. Going concern basis:- Financial statements are prepared under the assumption that the entity will continue to operate for the foreseeable future and does not intend and does not have the need to go into liquidation. It also presumes that an entity will not scale down its operations. Where the going concern assumption is no more valid, the financial statements may need to be prepared on a different basis and, if so the basis used must be disclosed.

EXAMINER'S REPORT

The question tests identification of users of financial statement and their information needs as well as explanation of financial statement as enuciated by the Conceptual Framework.

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

Commonest pitfall was the inability of the candidates to identify and explain the assumptions underlying the preparation and presentation of financial statements.

Candidates are advised to study the IASB conceptual framework of financial reporting for better performance in the future examination.

3. One of the main arguments against accounting for deferred tax in the financial statements is that it is not a legal liability until it accrues but this is countered by the fact that deferred tax satisfies the criterion of substance over form.

In the Conceptual Framework, this means that if information is to represent faithfully the transactions and other events that it purports to represent, it is necessary that they are accounted for and presented in accordance with their substance and economic reality and not merely their legal form.

Required:

(a) (i) Explain the nature and purpose of deferred tax. (5 Marks)

(ii) Explain the basic accounting provisions on deferred tax under IAS 12. (5 Marks)

(b) The deferred tax assets balance and the deferred tax liability balance of Exclusive Plc were ₦80,000,000.00 and ₦96,000,000.00 as at January 1, 2018.

Deferred tax movements were as follow for the year ended December 31, 2018:

Deferred tax income	₦10,000,000.00
Deferred tax expense	₦30,000,000.00

The income tax obligation and credit relate to a single tax authority.

Required:

(i) What amount of deferred tax movement is presented together as a line item with current tax movement in profit or loss? (2 Marks)

(ii) What is the carrying amount of deferred tax in the statement of financial position as at December 31, 2018? (3 Marks)

(Total 15 Marks)

SOLUTION TO QUESTION 3

(a). i. Deferred tax is defined as the estimated future tax consequences of transactions and events recognised in the financial statements of current and previous periods due to temporary differences. Temporary differences are differences between the carrying amounts of an asset or liability in the financial statements and the value of such asset or liability as stated for tax purpose (that is tax base). Temporary differences could also arise when income or expenditure is recognised in the financial statement in one year but is charge or allowed for tax in another year. Deferred tax does not apply to permanent differences'.

A typical example of temporary difference is the difference between the tax base of property, plant and equipments and their carrying amount in the statement of financial position at the end of the reporting period.
Deferred tax provision need to be made because management has an obligation to accurately report based on temporary differences of assets and liabilities that exist at a reporting date, the tax effects that have arisen which will be recovered or reverse in the future. There is a potential benefits or obligation based on transaction or events at the reporting date.

ii. The movement in deferred tax for the year is generally charge to or deducted from tax expense for the period, unless it relates to items recognised in other comprehensive income, then it is recognised in Other Comprehensive Income (OCI).

Deferred tax liabilities or (assets) are recognised in the statement of financial position as non-current and they are not to be discounted.

A deferred tax asset should be recognised for deductible temporary differences unused tax losses carried forward and unused tax credits but only to the extent that if is probable that taxable profits will be available against which they can be offset.

Deferred tax asset or liability should be offset but only to the extent that the entity has a legally enforcement rights to set off current tax assets against current tax liability and the deferred taxes relates to taxes levied by the same authority.

Deferred tax should be measured using the tax rates which are expected to apply when the asset is realised or the liability is settled based on laws that have been enacted or substantially enacted by the end of the period.

(b) i. The amount of deferred movement presented together as a line item is the deferred tax movement.

Deferred tax income	₦10,000,000.00
Deferred tax expense	(₦30,000,000.00)
Net deferred tax expense	(₦20,000,000.00)

ii. The carrying amount as at December 31, 2018 to be presented in statement of financial position in the net opening deferred tax balance increased/decreased by movement in the period.

Deferred tax liability balance	1/1/2018	(₦96,000,000.00)
Deferred tax asset balance	1/1/2018	₦80,000,000.00
Net deferred tax expense movement		(₦20,000,000.00)
Deferred tax carrying amount	31/12/2018	(₦36,000,000.00)

EXAMINER'S REPORT

Part "a" of the question tests the understanding of the nature and purpose of deferred tax and its basis according to provisions for deferred tax under IAS 12. Part "b" tests the amount of deferred tax movement in a profit or loss and the carrying amount of deferred tax in statement of financial position.

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

Commonest pitfalls were lack of good understanding of the provisions of the accounting standards IAS 12 – Income taxes. They demonstrated incompetence in the computation of deferred tax movement in profit or loss and carrying amount in the statement of financial position.

Candidates are advised to pay more attention to all accounting standards in the syllabus in order to perform better in future examinations.

4. (a) IAS 38 Intangible Assets sets out disclosures to be applied on the recognition and measurement of intangible assets.

Required:

(i) Identify the criteria that must be met before an item can be recognised as intangible asset in the financial statements. (5 Marks)

(ii) What are the information that needs to be disclosed in the financial statements with respect to intangible assets? (4 Marks)

(b) Sacrosanct Plc has entered into the following transactions during the financial year ended 31 October, 2019. The company seeks your opinion on the following matters:

(i) During the year, a staff training programme was carried out at a cost of ₦108 million. The external training provider has demonstrated to the management of Sacrosanct that the training should result in cost savings of ₦445 million over the next 3 years.

(ii) Sacrosanct has a portfolio of patents developed over few years. These represent technologies and processes in use in the company's business to generate economic benefits. The total carrying amount of the patents was ₦670 million at 1 November, 2018.

The patents originally had an economic useful life of 12 years but now has 8 years remaining to the end of their useful life. The directors propose to revalue this portfolio to its estimated value of ₦960 million at 31 October, 2019.

Required:
Advise the directors of Sacrosanct Plc. on the accounting treatment of the above two issues. (6 Marks)
(Total 15 Marks)

SOLUTION TO QUESTION 4

(a). i. An intangible asset is an identifiable non-monetary asset without physical substance. The enterprise must have the ability to control the asset in order to obtain economic benefits from it and the asset must be identifiable. Recognition of intangible assets is made if the following conditions are met.

- Identifiability :- item must be separable and must have risen from contractual legal rights.
- Control :- An entity must have the power to obtain the future benefits contained in the item and can prevent others from accessing the benefits.
- Future economic benefits must flow from the intangible item. The benefits must be in form of revenue, cost, savings etc.

ii. The following disclosures are required:

- Useful life of the assets
- Split between internally generated intangible assets and other intangible assets.
- Amortisation rates or methods.
- Amortisation charges
- Whether the useful lives are indefinite or finite
- The gross carrying amount and any accumulated amortisation at the beginning and end of the period.
- The line items in the statement of comprehensive income in which any amortisation of intangible assets is included.
- A reconciliation of the carrying amount at the beginning and end of the period.
- Disclosure about the effective date of a revaluation surplus at the beginning and the end of the period.

(b). (i) Training costs are not allowed to be capitalised under IAS 38, the reason being that the staff are not under the control of the entity Sacrosanct Plc. The entity cannot control when the employee would leave the company and when the staff leaves, the benefits of training is lost by the entity. Therefore, the costs of the training (₦108m) should be expensed in full during the year ended 31 October, 2019.

(ii) A patent cannot be revalued under IAS 38 as there is generally no active market since patent is unique. IAS 38 does not permit revaluation without an active market as the value cannot be reliably measured in the absence of a commercial transaction.

However, the patents satisfy all the criteria for recognition as intangible assets. Therefore, it is recognised initially at cost. Subsequently it should be carried at cost less accumulated amortisation. Amortisation should be charged for the remaining 8 years which means that charge for the year ended 31 October, 2019 is ₦83.75m (₦670/8). This amount should be charged to statement of profit or loss, unless it qualifies to be capitalised as part of a development project or production of other assets.

EXAMINER'S REPORT

Part "a" of the question tests identification of the criteria to be met before an item can be recognised as intangible assets in accordance to IAS 38 – Intangible assets and the information to be disclosed in the financial statement. Part "b" of the question tests the accounting treatment of practical application of the staff training cost and patents.

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

Commonest pitfall was lack of understanding of the provisions of IAS 38 – Intangible assets and practical application of the standard to real life situation.

Candidates are advised to concentrate more on the provisions of relevant accounting standards in the syllabus and their practical application to real life situation for better performance in future examinations.

5. (a) IFRS 9-Financial Instruments replaced IAS 39-Financial Instruments: Recognition and Measurement. IFRS 9 requirements are meant to enhance the ability of investors and other users of financial information to understand the accounting for financial assets, financial liabilities and some contracts on non-financial items, and to reduce complexity. Classification determines how financial assets are measured and accounted for.

Required:

Discuss the approach taken by IFRS 9 in classifying financial assets, giving relevant examples under each classification. (9 Marks)

(b) Prospect Plc. intends to build up a portfolio of equity instruments. During the year ended 31 December 2019, the entity acquired 300 million shares in Highrising Plc. Prospect Plc. felt that the company's shares are undervalued and therefore plans to sell the shares as soon as the price rises.

The shares were purchased for ₦0.98 each on 1 April 2019. The commission paid to stockbrokers on the purchase of the shares amounted to ₦600,000.00. Highrising's share price increased to ₦1.56 on 31 December, 2019.

The accountant was not sure how to account for this transactions and had capitalised the original investment amount plus the broker's commission in the financial statements of Prospects Plc.

Required:

Explain the necessary accounting treatments for the transactions in Prospect Plc. for the year ended 31 December, 2019 to reflect all the information provided. You should include the journal entries in your explanation. (6 Marks)

(Total 15 Marks)

SOLUTION TO QUESTION 5

IFRS 9 requires, that financial assets are classified at initial recognition into the categories amortised cost, fair value through other comprehensive income or fair value through profit or loss which are relevant for assets subsequent measurement. The classification is effected on the basis of both:

- the entity's business model for managing the financial assets; and
- the contractual cash flow characteristics of the financial asset.

i. Financial asset measured at amortised cost. A financial asset is classified into the categories of amortised cost if both the following conditions are met;
   - the asset is held within a business model whose objective is to hold the assets in order to collect contractual cash flows; and
   - the contractual terms of the financial asset give on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding. Loan and receivables that satisfy the amortised cost criteria are examples.

ii. Financial assets at fair value through other comprehensive income:-
   If the following criteria are met;
   - The financial asset is held within a business model whose objective is achieved both collecting contractual cash flows and selling financial assets; and
   - The contractual terms of the financial assets give rise on specific dates to cash flows that are solely payments of principal and interest on the principal outstanding. Examples are loan and receivables that satisfy the above criteria and equity that has been subjected to a declaration.

   Fair value through profit or loss: - A financial asset must be measured at fair value through profit or loss unless it is measured at amortised cost or at fair value through Other Comprehensive Income (OCI). Examples are equity, derivatives and loan and receivables that fail the amortised cost criteria.

(b). The relevant standard is IFRS 9. From the information, the portfolio of investment is held for trade, hence, it must be accounted for using a fair value through profit or loss (FVTPL) under the FVTPL model, the equity investment should initially be measured at its fair value. Transaction costs should be expensed through the profit or loss as incurred by;

	Dr. ₦'000	Cr.₦'000
Dr. Transaction cost expense to P or L	600	
Cr. Financial asset		600

Being reversal of transaction cost on equity investment wrongly capitalised.

The financial assets should be measured at its fair value at each subsequent reporting date, with any changes in fair value taken to profit or loss for the year.

The fair value of the equity investment has increased by ₦174m (₦300m x 1.56 – ₦0.98), this gain should be recognised in prospects profit or loss for 2019.

Journal entries

	Dr ₦	Cr ₦
Dr financial asset – Equity investment	174,000	
Cr Gain on equity investment (P or L)		174,000
Being gain on equity investment held for trade.		

EXAMINER'S REPORT

The question tests classification and examples of financial assets according to IFRS 9 – Financial Instrument and the accounting treatment using journal entries for transactions on equity instrument.

Few candidates attempted the question and their performance was poor.

Commonest pitfalls were candidates' inability to understand the provisions of IFRS 9 – Financial Instruments. Also some candidates could not give relevant examples of the financial assets, while others could not raise correct journal entries for the financial assets.

Candidates are advised to pay more attention to all accounting standards in the syllabus, they should also make use of the CITN study text for better performance in future examinations

6. JohnBull Plc. is an entity quoted on the Nigerian Stock Exchange.

You are provided with the following set of summarised published financial statements of the company for the year ended 30 September, 2018.

Statement of Profit or Loss and Other Comprehensive Income for the year ended 30 September, 2018

	₦'000
Revenue	500,000
Cost of goods sold	(300,000)
Gross profit	200,000
Administrative expenses	(29,000)
Finance Cost	(1,000)
Profit before tax	170,000
Income tax expense	(40,000)
Profit for the year	130,000

Statement of Financial Position as at 30 September, 2018 (together with its comparative figures)

	2018	**2017**
	₦'000	**₦'000**
Assets		
Non-current assets:		
Property, plant and equipment	200,000	220,000
Goodwill acquired	--	10,000

	200,000	230,000
Current Assets:		
Inventories	100,000	80,000
Trade receivables	75,000	60,000
Bank balances	20,000	5,000
	195,000	145,000
	395,000	375,000
Equity and liabilities		
Equity:		
Ordinary share at N1.25k each	10,000	8,000
Retained earnings	250,000	197,000
Total equity	260,000	205,000
Non-current liabilities		
10% Loan notes	10,000	--
Current Liabilities		
Trade payables	60,000	90,000
Other payables	20,000	40,000
Current tax payable	20,000	30,000
Bank overdraft	25,000	10,000
	125,000	170,000
	395,000	375,000

The following information is relevant:

(i) during the financial year, the company paid dividend of ₦87,000,000.00 to equity holders and this had been accounted for during the year. The current market price of the company's share is N10.00 per share; and

(ii) the company is planning to take a long-term loan of N400,000,000.00 from a consortium of banks. The company's financial statements and loan application have already been submitted to the bank.

Required:

(a) Prepare the company's statement of cash flows to be submitted to the bank in accordance with the provisions of IAS 7 Statement of Cash Flows for the relevant period, using the direct method. (10 Marks)

(b) Comment briefly on the cash flow management strategies of JohnBull Plc. (5 Marks)

(Total 15 Marks)

SOLUTION TO QUESTION 6.

(a).

JOHN BULL PLC
Statement of cash flow for the year ended
30 September 2018

	Notes	**₦'000**

Operating activities:		
Cash receipt from customers	1	485,000
Cash payments to suppliers	2	(350,000)
Cash payment for operating expenses	3	(19,000)
Company income tax paid	4	(50,000)
Cash interest paid	5	(1,000)
Net cash inflow from operating activities		65,000
Investing activities:		
Net cash out flow from investing activities		-
Financing activities:		
Issue of new shares (including share premium)	6	12,000
10% loan notes proceeds		10,000
Dividend paid		(87,000)
Net cash flow from financing activities		**(65,000)**
Net increase /decrease on cash and cash equivalent		0
Cash and cash equivalent opening balance		5,000
Bank overdraft		(10,000)
Cash and cash equivalent closing balance	7	**(5,000)**

WORKINGS:

Cash receipts from customers:	₦'000
Opening balance of accounts receivable:	60,000
Add: Revenue for the year	500,000
Expected cash from customers	560,000
Deduct: closing cash receipt from customers during the year	(75,000)
Actual cash receipts from customers during the year	**485,000**

Calculation of purchase during the year:	₦'000
Cost of sales	300,000
Add: closing inventory	100,000
Cost of goods available for sales	400,000
Deduct: opening inventory	(80,000)
Actual cash receipts from customers during the year	320,000
Payment in respect of trade payable	30,000
	350,000

Cash payments for operating expenses	₦'000
Cash expenses incurred for the year:	
₦(29,000,000 -20,000,000 -10,000,000)	(1,000)
Add closing balance of other payables	-
Opening balance of other payable	40,000
Expected payments	39,000
Deduct: opening balance of payments	**-**
Closing balance of other expenses payable	(20,000)
Actual cash payments for operating expenses during the year.	**19,000**

Company income Tax paid:	₦'000
Opening balance of income tax payable	30,000

Add: Income tax expenses for the year	40,000
Expected income tax payable	**70,000**
Deduct: closing balance of income tax payable	(20,000)
Actual company income tax paid during the year	**50,000**

Cash interest payments:	₦'000
Opening balance of accrued interest	-
Add: Interest incurred for the year	1,000
Expected interest paid	**1,000**

	₦'000	₦'000
Issue of new shares		
Closing share capital	10,000	
Less opening share capital	(8,000)	2,000
Share premium:		
Opening reserve	197,000	
Add profit for the year	130,000	
	327,000	
Deduct: Dividend paid	(87,000)	
Reserve	(240,000)	
Retained earnings	**250,000**	10,000
		12,000

Cash and Cash equivalent balance	₦'000
Bank balance	20,000
Bank overdraft	(25,000)
	(5,000)

(b). Comments:-

i. The company has not manage its cash flows properly despite net cash inflow of ₦65,000,000 generated from operation, since the company still went to pay dividend of ₦87,000,000.

ii. As a result of high dividend payment, the company depleted all funds generated from operations, share premium and part of other revenue reserve.

iii. The company might be profitable but the profit is not reflected in its liquidity position, hence the request for additional long term loan of ₦400 million

iv. Their bankers may not be willing to extend the additional loan request in view of the poor state of short –term liquidity which may jeopardize the long – term position of the company.

v. If the loan is to be granted, the bank might impose conditions on the company to moderate its dividend payment policy.

vi. There is no cash inflow or outflow from investing activities during the year. This is an indication that John Bull PLC may have poor investment culture or that the company has sold all its assets and money realised is shared to shareholders in form of dividend.

EXAMINER'S REPORT

The question tests preparation of statement of cash flows in accordance with the provisions of IAS 7- Statement of Cash Flow, using direct method. Candidates are also required to comment on the cash flow management strategies of the company.

Few candidates attempted the questions and their performance was poor.

The commonest pitfalls were inability of the candidates to differentiate between Direct and Indirect method. Candidates do not know the technicalities of preparing cash flow using any of the method. Also, they do not know what cash flow management strategies are.

Candidates are advised to focus on the preparation of statement of cash flows using both direct and indirect method in accordance with IAS 7 – Statement of Cash Flow in order to perform well in the future examinations.

7. The following information is extracted from the records of Superb Plc. for the year ended 31 December, 2019:

Superb Plc

Financial information extracts for the year ended 31 December, 2019:

	₦'000
Inventories	311,600
Trade receivables	174,800
Trade payables	104,600
Purchases	950,600
Revenue	1,171,200
Cost of goods sold	1,425,000

The directors of Superb Plc. provided you with the average working capital cycle of companies that operate in the same industry as theirs to be 80 days.

Required:

(a) Explain the significance of working capital cycle. (4 Marks)

(b) Calculate the working capital cycle of Superb Plc. for the year ended 31 December, 2019. (3 Marks)

(c) Assess the working capital cycle of Superb Plc relative to the industry average. (4 Marks)

(d) Suggest two steps that should be taken by the directors of Superb Plc. to improve the working capital cycle of the company. (4 Marks)

(Total 15 Marks)

SOLUTION TO QUESTION 7

(a) Working capital cycle is the length of time between a firm's purchases of inventory and the receipt of cash from credit customers. It is the number of days required to turn purchases of raw materials (for manufacturing companies) or finished goods into cash receipt from customers.

A relatively short period in the working capital cycle between the end and beginning of Superb PLC reporting period is an improvement of working capital management.

The lower the working capital cycle, the more healthy a company generally is. If a company's working capital cycle is long, it can create cash flow problems. Business often attempt to shorten the cycle by speeding up collection from customers than paying to suppliers.

(b). Calculation of working capital cycle of Superb PLC.

		Days
Inventory days	$\frac{311,600}{1,425,000}$ x 365 days	79.81
Receivable days	$\frac{174,800}{1,171,200}$ x 365 days	54.48
Payable days	$\frac{104,600}{950,600}$ x 365 days	(40.16)
		94.13

(c). The working capital cycle of Superb PLC at 94 days does not compare favourably with the industry average of 80days. Two main reasons can be adduces for this. It takes longer time to collect cash from customers than paying for goods to the suppliers. Payable days is shorter than receivable days by more than 14days, which means that Superb PLC working capital cycle is longer than the industry usage. Secondly there seems to be slow turnover rate of inventory.

(d). The working capital cycle can be improved in the following ways;

- Improve the time needed to collect receivables more quickly than it makes payment to suppliers. This can be achieved by offering cash discounts to customers.
- The company can speed up the sale of its inventory for cash by offering its goods at competitive prices.
- The company can use just –in – time techniques to ensure that inventory holding period is reduced.
- The company should negotiate for longer credit period from suppliers.

EXAMINER'S REPORT

The question tests the explanation of the significance, calculation, assessment and how to improve working capital cycle.

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

Commonest pitfalls were the inability of the candidates to understand any of the requirement of the question as this was demonstrated in their poor attempt on each of the requirements-.

Candidates are advised to cover all areas of the examination syllabus by reading wide especially on analysis of financial statement for better performance in future examination.