ICAN CASE STUDY
SOLUTION TO REVIEW QUESTIONS

The case can be conveniently discussed under 4 headings, that is:

- Introduction
- Strategic turnaround
- Business success
- Shocks and set backs
Introduction
Formation of the company, the initial operating business environment, ownership structure, and the process that led to eventual takeover of the company by Mr. John Daribo were highlighted. A detailed description of the Alpha-Beta production process was also given. The over reliance of the company on imported raw material from the parent overseas company was mentioned.

At this level, candidates should bear in mind the likely problems associated with corporate governance, costing, purchasing of needed raw materials and processing of customers order.

STRATEGIC TURN AROUND
On taking over management of Alpha–beta, John Daribo embarked on strategic changes, culminating in staff retrenchment, retraining, employment of new hands, and raising extra third party finance. He also introduced the modern data processing method, thought it is restricted to the chairman’s office only. The aggressive marketing strategy adopted by the company led to dropping of built to order products in favour of mass produce standardized designs. Though some of the old methods and processes were retained.

This part of the cased draws candidates attention to human resources, information technology, marketing, and financial management aspects of their course of study.

Business success
The company experienced monumental success’s occasioned by increase in demand for mass produced designs which was complemented by improved quality of produce produced. To take advantage of the business environment, aggressive expansion program was embarked upon leading to diversification into petroleum product marketing and automobile businesses. This expansion program led to increased gearing and restructuring of the company along divisions. Not much attention was paid to the core line of business, that is steel fabrications resulting in loss of market to small-scale operators within the industry.
Candidates are advised to be sensitive to diversification to unrelated line of business as a means of embarking on expansion methods of financing it and their relative merits and demerits. They should also bear in mind
SHOCK AND SET BACKS
The lack of up to date financial information brought about by manual processing of data was highlighted. The first successfully completed financial report reveal that fabrication business suffered operational loss with only petroleum product marketing division returning marginal profit. The company was faced with a lot of problems ranging from loss of market share, illiquidity, tax evasion, reduced demand for mass produced standardized products to threat of John Daribo being arraigned before the Failed bank tribunal. The situation deteriorated to the point that appointing a receiver/manager was being contemplated by one of Alpha-beta Creditors, Naira Bank Plc. At the management meeting a new costing approach was suggested as a way of moving the company forward. The unceremonial removal of the Messrs tick, Check & Vouch and the appointment of Alexander right & Co without following due process being followed was discussed.

Based on the information provided, it is imperative for candidates to expect questions testing their knowledge of taxation, liquidation process, costing and ethical issues.

ANALYSIS OF QUESTIONS
Question 4.1
The question expects the candidates to discuss the merit and demerits of divisionalisation policy of the Managing Director.

Question 4.2
Candidates are expected to bench nark Alfa-beta Plc against a small scale operator and compute some financial ratios of Kadan Kadan Fabrication Engineering Enterprise.
Question 4.3
A critical review of the cost plus pricing method adopted by Alfa Beta is expected from candidates, they should also suggest ways of improving the pricing system.

Question 4.4
The question requires the knowledge of business law and business ethics. It also examines the changes of Naira bank recovering the outstanding advances.

Question 4.5
Ethical issues relating to appointment and disengagement of Auditors forms the main focus.

Question 4.6
The question tests candidate’s a knowledge of taxation and computation of tax liability.

Question 4.7
Product pricing using costing, quantitative techniques and model to determine the price of a product is expected from candidates.
SUGGESTED SOLUTION 4.1A
Comments on changes introduced by managing director

1. Retrenchment
Retrenchment of too old and inefficient staff is appropriate and commendable. However it ought to have been done gradually so that there could be people to train new hands; in effect, no succession plan.

2. Retraining
This is a good policy which will enhance the productivity of workers. There is however a possibility of labour turnover as trained workers might look for employment elsewhere.

3. Injection of new blood
This will bring new zeal and ideas that will increase productivity. However the recruitment of high flyers, that is, first class graduates may present a long term problem if there is no career path established for the new intake, which will lead to their exist.

4. Information technology
Introduction of information technology at this point in time is quite commendable because it would assist the timely production of management information for decision making.

   However, the Application of the system was too restrictive as it is apparent that the employment of the computer, in the office of the Chief Executive was ego-centric, because there was no company-wide application of the system.

5. Raising additional finances
It was quite commendable for the Chief Executive to have been able to raise needed finances to aid business expansion at this generous rate at that time.

   However. It can be deduced from the case that funds were diverted to other businesses apart from the steel business, for example, petroleum products marketing operations; rather than for the servicing of the loans.
6. Marketing strategy
Shifting away form specific customer specification to standard design was a wise decision that increased the market potential of the company. However, only one of the four PS of marketing, that is, the product was considered; ignoring price, but place and people are paramount.

The continuation of buying through Alpha – Epsilon in Paris is not considered wise enough as it increases cost of importation.

7. Change of Auditors
There is nothing wrong with the change of auditors. However, the procedure was fundamentally unethical.

**SUGGESTED SOLUTION 4.1B**
Criticism of divisionalisation of the organization.

a. Although the organization was divisionalised, no authority was given to divisional heads.
b. He did not put the right caliber of staff at the head of the division e.g the placement of Sule, recruited in 1994 to head the alpha Petroleum.
c. No appropriate transfer pricing system among the divisions
d. Additional burden was created for the accounting staff due to the divisionalisation thereby hindering the timely production of management information for the efficient running of the organization.

Suggested solution 4.2
Factors responsible of the poor performance of Alpha – beta Ltd compared to small scale operators.

a. The concentration of the pricing decision in the hand of the Chief Executive probably led to the omission to review the selling price when there were cost increases due to his very busy schedule for instance.
i. The industry was able to sell at N150 per k unit in 1998 and N130 per k unit in 1997 whereas Alpha-Beta price remained at N100 per k unit due to its inability to update its selling price
ii. Also, the production cost of the industry was N90 in 1998 and N80 in 1997 but Alpha steel division produced at N108 and N105 respectively indicating some inefficiency in the production cost.

b. The sourcing of raw materials abroad put unnecessary pressure on the liquidity and profitability of Alpha Steel division especially with additional cost, that is, buying commission of 1% for buying through Alpha Epsilon S. A in France. This could be avoided since the local operators in the industry source their materials locally. Hence Alpha beta ltd profit margin decline to -8% whereas the local operators recorded 40% in 1998 (see working Note 4).

c. The interest expense on borrowed funds became an addition to overheads without a corresponding increase in selling price. For instance Alpha – beta had an interest expense on sales of 13% in 1998 whereas the industry averaged 5% in the same period (see note 7).

d. Inappropriate jobbing/pricing policy adopted by Alpha Steel division does not help its profitability, for instance, the debtor collection period of alpha-Beta Ltd worsened from 61 days to 94 days through the period came down to 80 days in 1998. The period of credit allowed to customers at an interest fee rate compared is higher compare to the high interest cost borne by the company,. I a jobbing concern, it is expected that deposit should be collected from customers before commencing their jobs.

e. Declining current and liquidity ratios indicate a weakness in the management of working capital as indicated in the current and quick assets ratio in notes 9 and 10.

f. Information technology was wrongly applied. Prompt generation of pricing and accounting information would have assisted the management to take timely and corrective decision which would have enhanced its competitiveness.
SUGGESTED SOLUTION 4.3

The pricing method used by the Alpha Beta Ltd is the cost plus method, that is a method by which costs are ascertained and a mark up added to arrive at the selling price.

a. In the case of Alpha Beta, the extent of the ascertainment of cost before the addition of the mark up in that the landed cost information was used in valuing unused stocks and also in updating the price calculation sheet when it was to review prices, was not stated.

b. Since there are delays in providing historical cost information to update landed cost, it is unlikely that the selling price calculation can recover current cost. This is because the experience in Alpha – Beta is that input costs have been changing more frequently than selling price reviews. This would therefore explain the huge losses suffered between 1995 and 1998 especially that whereas the industry sold at N130 in 1997 and 150 in 1998. Alpha Beta sold at 100. The price it sold in 1995.

c. Another disadvantage of the method is that operational inefficiencies will shoot up costs and lead to a selling price which the market may not be able to accept.

4. Although, the selling price of Alpha Beta was not rejected by the market the committed purchase of its steel from abroad at an additional cost of 1% buying commission, when its competitors were managing to get it locally would have shot up costs and selling above those of its competitors.

The following are suggested improvements of the costs plus method if the existing pricing method is to continue:

i. Cost information must be provided on a much more timely basis. The use of a computer in the processing of cost information will facilitate the timely provision of an accurate cost information.

ii. Since the industry is characterized by ever changing (increasing) input costs, there should be a constant review of selling prices to ensure the absorption of cost increases.

iii. The use of the landed cost calculation sheet primarily for historical accounting purposes should be changed to have its emphasis on selling price determination.
iv. Since the organization is now divisionalised, the selling price determination should be delegated to the Divisional manager of the steel division.

**SUGGESTED SOLUTION 4.4**

**a. Problem faced by Naira bank ltd**

The banks could have had no problem getting back their money since the loans were secured, but a particular problem that Naira Bank Ltd would face is that the fixed charge created in favour of the Bank were on assets that had either been previously pledged to another creditor or did not legally belong to Alpha Beta Ltd. For example:

i. The assets pledged included the assets which had been pledged to All States Bank by a debentured trust deed.

ii. The Assets also included machines financed by a finance lease form All State Bank. Although, the intention was to transfer ownership to alpha Beta, this could not be done because the rentals are still outstanding and the option to purchase is yet to be exercised.

**b. due process for granting loan was not followed, for example**

i. No official application was made for the loan. It was the Managing Director that offered and ensured that N50m. loan was granted without appropriate documentation.

ii. Audited Accounts of Alpha Beta were not ready and none was presented for the loan. This is contrary to the requirement of BOFID. 1991.

iii. Collateral security given was based on “just” a list of assets, some belonged to alpha Beta Ltd while others were on lease.

iv. No search was conducted by Naira Bank on the assets of the company

v. Alpha Beta Ltd gave collateral security to which he does not have title contrary to the legal maxim memo dat quod non habet
C. CONCLUSION

In view of the above, the suggestion of the other friend to the MD of Naira bank Ltd to appoint a receiver/manager over Alpha beta ltd cannot be easily implemented.

The manager of Naira Bank ltd, had not been careful enough in his lending to Alpha-beta. Perhaps, a way out of Naira Bank Ltd is to consult with All State Bank to examine the possibility of Jointly appointing the Receiver/Manager otherwise All States Bank had a better right in laws being holder of a fixed charge. Since the other operators in the industry are not facing the same problem.

It would appear that the options to alpha beta lies between a rescue operation o an outright sale of the company.

SUGGESTED SOLUTION 4.5

a. It is unethical for the new auditor, M/S Alexander Right & Co. to accept the appointment without due reference to the former auditor
b. It is unethical to dismiss an auditor without due notice of appropriate resolution by members to that of the company
c. It is considered unethical for the bank to grant loans of such magnitude without following due process provided in BOFID as amended.
d. The retiring auditor should not have insisted on holding on to his appointment up to a specified period once the company has indicated that it is longer interested in his services.
e. It is unethical to raise a BOJ on a Tax payer and issue a threat for immediate payment within 7 days. When the tax laws prescribed initial notice of 30 days, followed by another 231 days and finally 7 days notice before such action could be taken
f. An auditor has a right of lien over his working papers, especially where he is owed fees on the audit.
SUGGESTED SOLUTION 4.6

a. i. The company is expected to file tax returns each year of assessment.
   ii. Where a company fails to file returns, the federal board of Inland Revenue is empowered by CITA to raise Best of Judgment assessment.

b. i. It is not possible for the team leader of the tax inspectors to force the company to pay tax liabilities within seven (7) days.
   ii. The CITA provided that an assessment has to be paid within 30 days effective from the date of the notice.
   iii. In case the company failed to pay within 30 days a second notice can be given in which case 21 days will be allowed.
   iv. In the event of failure a final notice could be served which must be settled within 7 days.

<table>
<thead>
<tr>
<th>Accounting year</th>
<th>1997</th>
<th>1998</th>
<th>1999</th>
</tr>
</thead>
<tbody>
<tr>
<td>Year of assessment</td>
<td>N.000</td>
<td>N'000</td>
<td>N'000</td>
</tr>
<tr>
<td>Net profit/(Loss) per Ac1,730</td>
<td>(3,110)</td>
<td>(4,530)</td>
<td></td>
</tr>
<tr>
<td>Add: Depreciation</td>
<td>2,860</td>
<td>2,860</td>
<td>3,000</td>
</tr>
<tr>
<td>Adjusted profit/(loss)</td>
<td>4,590</td>
<td>(250)</td>
<td>(1,530)</td>
</tr>
<tr>
<td>Less: Loss Relief C/F</td>
<td>-</td>
<td>250</td>
<td>(250)</td>
</tr>
</tbody>
</table>
Assessable profit $4,590 - - - - (1,780)
Less: Capital Allowance B/f. - - - - 2,860
Claim for the year 2,860 2,860 3,000
5,860
Utilized 2,860 2,860
Unutilized c/f
Chargeable Profit/(loss) - 2,860 5,860
Tax liability 30% 1,730 (1,780)
Education tax 2% 519 94
SUGGESTED SOLUTION 5.7
CALCULATION OF SELLING PRICE USING HIGH/LOW METHOD

<table>
<thead>
<tr>
<th>Year</th>
<th>volume</th>
<th>total price</th>
<th>total production</th>
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<tbody>
<tr>
<td></td>
<td>(K Units)</td>
<td>Production Cost</td>
<td>Index</td>
</tr>
<tr>
<td>1993</td>
<td>100</td>
<td>6,000</td>
<td>80</td>
</tr>
<tr>
<td>1994</td>
<td>150</td>
<td>10,500</td>
<td>100</td>
</tr>
<tr>
<td>1995</td>
<td>350</td>
<td>28,000</td>
<td>100</td>
</tr>
<tr>
<td>1996</td>
<td>520</td>
<td>44,200</td>
<td>137.5</td>
</tr>
<tr>
<td>1997</td>
<td>600</td>
<td>63,000</td>
<td>187.5</td>
</tr>
<tr>
<td>1998</td>
<td>400</td>
<td>43,200</td>
<td>170</td>
</tr>
</tbody>
</table>

Calculation of variable cost of “K” using high/low method
Level of activity volume Cost N’000
Highest 600 33,600
Lowest 100 7,500
Changes 500 26,100
B (v/c per unit) = \( \frac{N26,100}{500} = N52.20 \)

\[ Y = a + bx \]

Fixed cost 9a) = \( y - bx \)

\[ Fc = 33,600 - (N52.20 \times 600) \]
\[ = N2,280 \]

Applying Yakubu formula of \( SP = (VK + 38) \frac{P1}{Po} \times 1.20 \)

\[ Sp = (N52.20 + 38) \frac{185}{100} + 120 = N200 \]

Alternative method \( (\sum Y = (an + b\sum x - (1)) \)

\( (\sum xy = a \sum x + b\sum x^2 - (ii)) \)

Using the linear regression analysis

<table>
<thead>
<tr>
<th>X</th>
<th>Y</th>
<th>XY</th>
<th>X2</th>
</tr>
</thead>
<tbody>
<tr>
<td>100</td>
<td>7,500</td>
<td>750,000</td>
<td>10,000</td>
</tr>
<tr>
<td>150</td>
<td>10,500</td>
<td>1,575,000</td>
<td>22,500</td>
</tr>
<tr>
<td>350</td>
<td>28,000</td>
<td>9,800,000</td>
<td>122,500</td>
</tr>
<tr>
<td>520</td>
<td>32,145</td>
<td>16,072,500</td>
<td>270,400</td>
</tr>
<tr>
<td>600</td>
<td>33,600</td>
<td>20,160,000</td>
<td>360,000</td>
</tr>
<tr>
<td>400</td>
<td>25,412</td>
<td>10,164,800</td>
<td>160,000</td>
</tr>
<tr>
<td>2,100</td>
<td>137,157</td>
<td>58,522,300</td>
<td>945,000</td>
</tr>
</tbody>
</table>

The equation becomes:

\[ 137,157 = 69 + 2120b \quad \text{(i)} \]
\[ 58,522,300 = 2,120a + 94500b \quad \text{(ii)} \]

i. \( x \times 2120 \)
\[ 290772840 = 12.720a + 4494400b \quad \text{(iii)} \]

ii. \( x \times 6 \)
\[ 351,133800 = 12,720a + 5672400b \quad \text{iv} \]
iv. - (iii) \[ 60,360,960 = 1,178,000b \]
\[ b = N51.24 \]

To determine the FC
\[ Y = a + bx \]
\[ a = Y - bx \]
\[ a = 25,412 - 51.24(400) = N4916 \]

Therefore, selling price by the Yakubu model
\[ S = (Ivk + 38) \times \frac{P_1}{P_2} \times 1.20 \]
\[ S = (51.24 + 38) \times \frac{165}{100} \times 1.20 = N198 \]

Alternatively
B can be obtained directly as:
\[ B = \frac{n \sum xy - \sum x \sum y}{n \sum x^2 - (\sum x)^2} \]
\[ = \frac{58522300 \times 6 - (2120 \times 137,157)}{(945,400 \times 6) - 92120^2} \]
\[ = \frac{351,133,800 - 290,772,840}{5,672,400 - 4,494,400} \]
\[ = \frac{60,410,960}{1,178,000} \]
\[ = N51.28 \]

Sp \[ = (51.28 + 38) \times \frac{185}{100} = 1.20 \]
\[ = N198 \]