

STUDY MANUAL
CORPORATE REPORTING (PEA 5)



ASSOCIATION OF NATIONAL ACCOUNTANTS OF NIGERIA (ANAN)

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TABLE OF CONTENTS

MODULE 1

| | | |
|-------------|--|----|
| 1.00 | DEVELOPMENT OF NATIONAL & INTERNATIONAL STANDARDS | 1 |
| 1.01 | Learning Outcomes | 1 |
| 1.02 | International Federation of Accountants (IFAC). | 1 |
| 1.03 | Financial Reporting Council (FRC) of Nigeria | 2 |
| 1.04 | Statement of Standards Accounting Practice (SSAP) | 5 |
| 1.05 | Techniques of Standards Setting | 6 |
| 1.06 | Review Questions | 10 |

MODULE 2

| | | |
|-------------|--|----|
| 2.00 | INTERNATIONAL FINANCIAL REPORTING STANDARDS | 11 |
| 2.01 | Learning Outcomes | 11 |
| 2.02 | Structure of International Financial Reporting Standards (IFRS). | 11 |
| 2.03 | Objectives of Financial Statements | 12 |
| 2.04 | Underlying Assumptions | 12 |
| 2.05 | Characteristics of Financial Statements | 12 |
| 2.06 | Contents of Financial Statements | 12 |
| 2.07 | Presentation of Financial Statements | 13 |
| 2.08 | IFRS Statements | 16 |
| 2.09 | Review Questions | 25 |

MODULE 3

| | | |
|-------------|--|----|
| 3.00 | APPLICATION OF IFRS / IAS. | 30 |
| 3.01 | Learning Outcomes. | 30 |
| 3.02 | IFRS1: First-time Adoption of International Financial Reporting Standards | 30 |
| 3.03 | IAS 26: Accounting and Reporting by Retirement Benefit Plans. | 34 |
| 3.04 | IAS 29: Financial Reporting in Hyperinflationary Economies. | 38 |
| 3.05 | IAS 32: Financial Instrument: Presentation. | 46 |
| 3.06 | IAS 36: Impairment of Assets.. | 68 |
| 3.07 | IAS 39: Financial Instruments: Recognition and Measurement etc. | 79 |

MODULE 4

| | | |
|-------------|--|-----|
| 4.00 | MISCELLANEOUS ACCOUNTS | 98 |
| 4.01 | Learning Outcomes | 98 |
| 4.02 | Accounting for Lease/Contracts/Hire Purchase/Price Level Changes | 98 |
| 4.03 | Specialized Accounts | 128 |
| 4.04 | Review Questions | 162 |

MODULE 5

| | | | | | | | | | |
|-------------|--|---|---|---|---|---|---|---|-----|
| 4.00 | COMPANY ACCOUNTS | . | . | . | . | . | . | . | 167 |
| 5.01 | Learning Outcomes | . | . | . | . | . | . | . | 167 |
| 5.02 | Accounting for Companies Formation | . | . | . | . | . | . | . | 167 |
| 5.03 | Published Accounts of Quoted Companies | . | . | . | . | . | . | . | 194 |
| 5.04 | Companies Liquidation | . | . | . | . | . | . | . | 201 |
| 5.05 | Review Questions | . | . | . | . | . | . | . | 205 |

MODULE 6

| | | | | | | | | | |
|-------------|---|---|---|---|---|---|---|---|-----|
| 6.00 | GROUP ACCOUNTS AND BUSINESS COMBINATION | . | . | . | . | . | . | . | 209 |
| 6.01 | Learning Outcomes | . | . | . | . | . | . | . | 209 |
| 6.02 | Overview of Group Accounts | . | . | . | . | . | . | . | 209 |
| 6.03 | Consolidated Statement of Financial Position | . | . | . | . | . | . | . | 219 |
| 6.04 | Consolidated Statement of Profit or Loss/Other Comprehensive Income | . | . | . | . | . | . | . | 224 |
| 6.05 | Consolidated Statement of Cash flow | . | . | . | . | . | . | . | 224 |
| 6.06 | Takeover of Partnership and Sole Traders | . | . | . | . | . | . | . | 237 |
| 6.07 | Business Combination | . | . | . | . | . | . | . | 241 |
| 6.08 | Review Questions | . | . | . | . | . | . | . | 245 |

MODULE 7

| | | | | | | | | | |
|-------------|---|---|---|---|---|---|---|---|-----|
| 7.00 | ANALYSIS OF FINANCIAL STATEMENTS | . | . | . | . | . | . | . | 248 |
| 7.01 | Learning Outcomes | . | . | . | . | . | . | . | 248 |
| 7.02 | Ratio Analysis | . | . | . | . | . | . | . | 248 |
| 7.03 | Review Questions | . | . | . | . | . | . | . | 261 |

MODULE 1

1.00 DEVELOPMENT OF NATIONAL AND INTERNATIONAL STANDARDS

1.01 Learning Outcomes

On successful completion of this Module, Students should be able to:

- i. Elucidate the development of International Federation of Accountants (IFAC) and the Financial Reporting Council (FRC) of Nigeria;
- ii. Evaluate the process of standard setting;
- iii. Ascertain the standard setting bodies

1.02 International Federation of Accountants (IFAC)

International Federation of Accountants (IFAC), founded on October 7, 1977, is a Swiss-registered association whose members are professional accountancy organizations. It has its Headquarters in New York, United States. It currently has 179 members and associates in 130 countries and jurisdictions. The organisation has, through its independent standard setting Boards, established international standards on ethics, auditing and assurance, accounting education, and public sector accounting. It also issues guidance to encourage high performance by professional accountants in practice. It organises the World Congress of Accountants (WCA) every year as one of its key activities.

As the global organization representing the accountancy profession, IFAC is uniquely positioned to research and represent the views of the profession and its stakeholders. IFAC is committed to being the voice of the global profession and to taking a leadership position on public interest issues where the accountancy profession's expertise is most relevant. These areas include: international regulatory convergence; global adoption of high-quality international reporting and professional standards; standard-setting in the public interest; sustainability and integrated reporting; SME matters; and public sector reporting and transparency.

Formal policy positions are issued as Policy Position Papers. IFAC submits Comment Letters and recommendations to global and regional organizations, such as the IFRS Foundation.

IFAC's mission is to serve the public interest by: contributing to the development of high-quality standards and guidance; facilitating the adoption and implementation of high-quality standards and guidance; contributing to the development of strong professional accountancy organizations and accounting firms and to high-quality practices by professional Accountants, and promoting the value of professional Accountants worldwide; and speaking out on public interest issues.

IFAC's vision is that the global accountancy profession be recognized as a valued leader in the development of strong and sustainable organizations, financial markets, and economies.

1.03 Financial Reporting Council (FRC) of Nigeria

The Financial Reporting Council of Nigeria which was established in 2011, is a body corporate with perpetual succession and a common seal, which may sue and be sued in its corporate name. The Financial Reporting Council of Nigeria Act No 6 of 2011 charges the Council with the responsibility for, among other things, developing and publishing accounting and financial reporting standards to be observed in the preparation of financial statement of public entities in Nigeria; and for related matters.

The Council has a Governing Board which has overall control of the Council.

The Board consists of:

- (a) A Chairman who shall be a professional Accountant with considerable professional experience in accounting practices;
- (b) Two representatives from the Association of National Accountants of Nigeria; and
- (c) Two representatives from the Institute of Chartered Accountants of Nigeria;
- (d) One representative from each of the following:
 - (i) Office of the Accountant General of the Federation;
 - (ii) Office of the Auditor General for the Federation;
 - (iii) Central Bank of Nigeria;
 - (iv) Chartered Institute of Stockbrokers;
 - (v) Chartered Institute of Taxation of Nigeria;
 - (vi) Corporate Affairs Commission;
 - (vii) Federal Inland Revenue Service;
 - (viii) Federal Ministry of Commerce;
 - (ix) Federal Ministry of Finance;
 - (x) Nigerian Accounting Association;
 - (xi) Nigerian Association of Chambers of Commerce, Industries, Mines and Agriculture;
 - (xii) Nigerian Deposit Insurance Corporation;
 - (xiii) Nigerian Institute of Estate Surveyors and Valuers;
 - (xiv) Securities and Exchange Commission;
 - (xv) National Insurance Commission;
 - (xvi) Nigerian Stock Exchange;
 - (xvii) National Pension Commission; and
- (e) The Executive Secretary of the Council.

Functions of the Council are to:

- (a) Develop and publish accounting and financial reporting standards to be observed in the preparation of financial statement of public interest entities;
- (b) Review, promote and enforce compliance with the accounting and financial reporting standards adopted by the Council;
- (c) Receive notices of non-compliance with approved standards from preparers, users, other third parties or auditors of financial statements;
- (d) Receive copies of annual reports and financial statements of public interest entities from preparers within 60 days of the approval of the Board;
- (e) Advise the Federal Government on matters relating to accounting and financial reporting standards;
- (f) Maintain a register of professional Accountants and other professionals engaged in the financial reporting process;
- (g) Monitor compliance with the reporting requirements specified in the adopted code of corporate governance;
- (h) Promote compliance with the adopted standards issued by the International Federation of Accountants and International Accounting Standards Board;
- (i) Monitor and promote education, research and training in the fields of accounting, auditing, financial reporting and corporate governance;
- (j) Conduct practice reviews of registered professionals;
- (k) Review financial statements and reports of public interest entities;
- (l) Enforce compliance with the Act and the rules of the Council on registered professionals and the affected public interest entities;
- (m) Establish such systems, schemes or engage in any relevant activity, either alone or in conjunction with any other organization or agency, whether local or international, for the discharge of its functions;
- (n) Receive copies of all qualified reports together with detailed explanations for such qualifications from auditors of the financial statements within a period of 30 days from the date of such qualification and such reports shall not be announced to the public until all accounting issues relating to the reports are resolved by the Council;
- (o) Adopt and keep up-to-date accounting and financial reporting standards, and ensure consistency between standards issued and the International Financial Reporting Standards;
- (p) Specify, in the accounting and financial reporting standards, the minimum requirements for recognition, measurement, presentation and disclosure in annual financial statements, group annual financial statements or other financial reports which every public interest entity shall comply with, in the preparation of financial statements and reports;

- (q) Develop or adopt and keep up-to-date auditing standards issued by relevant professional bodies and ensure consistency between the standards issued and the auditing standards and pronouncements of the International Auditing and Assurance Standards Board; and
- (r) Perform such other functions which in the opinion of the Board are necessary or expedient to ensure the efficient performance of the functions of the Council.

The Council may issue rules and guidelines for the purpose of implementing auditing and accounting standards.

Powers of the council

The Council has powers to do all things necessary for or in connection with the performance of its functions and this includes the power to:

- (a) Enforce and approve enforcement of compliance with accounting, auditing, corporate governance and financial reporting standards in Nigeria;
- (b) Enter into such contracts as may be necessary or expedient for the purpose of discharging its functions;
- (c) Borrow such sums of money or raise such loans as it may require for the purpose of discharging its functions;
- (d) Co-operate with, or become a member or an affiliate of any similar international body the objects or functions of which are similar to, or connected with those of the Council ;
- (e) Exercise such powers as are necessary or expedient for giving effect to the provisions of the Act ;
- (f) Require management assessment of internal controls, including Information Systems controls with independent attestation ;
- (g) Require code of ethics for financial officers and certification of financial statement by Chief Executive Officer and Chief Financial Officer; and
- (h) Require entities to provide real time disclosures on material changes in financial conditions or operations.

Reviewing and Monitoring of Standards by FRC of Nigeria

The Council adopts and keeps up-to-date accounting and financial reporting standards, and ensures consistency between standards issued under the International Financial Reporting Standards.

The Council specifies, in the accounting and financial reporting standards, the minimum requirements for recognition, measurement, presentation and disclosure in annual financial statements, group annual financial statements or other financial reports which every public interest entity shall comply with, in the preparation of financial statements and reports.

The Council develops or adopts and keeps up-to-date auditing standards issued by relevant professional bodies and ensures consistency between the standards issued and the auditing standards and pronouncements of the International Auditing and Assurance Standards Board.

The Council may issue rules and guidelines for the purpose of implementing auditing and accounting standards.

Every registered professional Accountant shall, in the practice of his profession, comply with

- (a) Such minimum requirements as shall be specified by the Council in the auditing and accounting standards; and
- (b) Any rule and guideline issued under this Act.

In the exercise of its powers for developing and issuing standards, a Directorate of the Council shall adopt the following procedures—

- (a) Identify accounting, auditing or financial reporting issues that require standardization, prepare and publish exposure drafts, conduct a public hearing where necessary and prepare a draft statement of accounting standards;
- (b) Submit the draft statement of accounting, auditing or financial standards prepared in accordance with sub-section 1(a) of this section to the Council for ratification and thereafter, the Council shall issue the standards;
- (c) Ratify such statements of accounting, auditing and financial reporting standards prepared in accordance with this section ; and
- (d) Thereafter, the statements of accounting, auditing or financial reporting standards shall be published.

2) Any relevant standard issued by a relevant international body shall be adopted by the Council in accordance with the procedure in sub-section (1) of this section.

Each Directorate shall appoint working groups in order to accomplish its objectives and where appropriate, in consultation with the Chairman of the Council.

1.04 Statements of Standard Accounting Practice (SSAP)

Statements of Standard Accounting Practice (SSAP) are rules laid down by the United Kingdom (UK) Accounting Standards Council (ASC) which must be followed by all companies when reporting information on its financial statements.

Although many have been superseded by Financial Reporting Standards (FRS) issued by the Accounting Standards Board (ASB) (which succeeded ASC), some are still in force. The first SSAP was issued in 1971, and in total twenty-five (25) SSAPs were issued up to 1990, when ASC was replaced by ASB. There are currently 31 FRS including the three (3) issued recently by the Financial Reporting Council (FRC); FRS 100, FRS 101, and FRS 102. There are also eleven (11) SSAPs which are still in force apart from the Financial Reporting Standard for Smaller Entities (FRSSE) which is still undergoing amendments.

1.05 Techniques of Standard Setting

i. Setting the Agenda

The International Accounting Standard Board (IASB), by developing high quality accounting standards, seeks to address a demand for better-quality information that is of value to all users of financial statements. Better-quality information will also be of value to preparers of financial statements.

The IASB evaluates the merits of adding a potential item to its agenda mainly by reference to the needs of investors.

The IASB considers:

- a. The relevance to users of the information and the reliability of information that could be provided whether existing guidance is available the possibility of increasing convergence the quality of the standard to be developed resource constraints. (Please recast this statement, it does not make meaning.)
- b. To help the IASB in considering its future agenda, its staff is asked to identify, review and raise issues that might warrant the IASB's attention.
- c. New issues may also arise from a change in the IASB's conceptual framework. In addition, the IASB raises and discusses potential agenda items in the light of comments from other standard-setters and other interested parties, the IFRS Advisory Council and the IFRS Interpretations Committee, and staff research and other recommendations.
- d. The IASB receives requests from constituents to interpret, review or amend existing publications.

- e. The staff considers all such requests, summarises major or common issues raised, and presents them to the IASB from time to time as candidates for when the IASB is next considering its agenda. (Please recast this statement in order to bring out the meaning)

ii. IASB meetings

The IASB's discussions of potential projects and its decisions to adopt new projects take place in public IASB meetings.

Before reaching such decisions the IASB consults the IFRS Advisory Council and accounting standard-setting bodies on proposed agenda items and setting priorities. In making decisions regarding its agenda priorities, the IASB also considers factors related to its convergence initiatives with accounting standard-setters.

The IASB's approval to add agenda items, as well as its decisions on their priority, is by a simple majority vote at an IASB meeting.

iii. Project planning

When adding an item to its active agenda, the IASB also decides whether to:

- a. Conduct the project alone, or
- b. Jointly with another standard-setter.

Similar due process is followed under both approaches.

After considering the nature of the issues and the level of interest among constituents, the IASB may establish a working group at this stage.

A team is selected for the project by the two most senior members of the technical staff:

- a. The Director of Technical Activities; and
- b. The Director of Research.

The project manager draws up a project plan under the supervision of those Directors. The team may also include members of staff from other accounting standard-setters, as deemed appropriate by the IASB.

iv. Development and publication

Although a discussion paper is not mandatory, the IASB normally publishes it as its first publication on any major new topic to explain the issue and solicit early comment from constituents.

If the IASB decides to omit this step, it will state why.

Typically, a discussion paper includes:

- a. A comprehensive overview of the issue;
- b. Possible approaches in addressing the issue;
- c. The preliminary views of its authors or the IASB; and
- d. An invitation to comment.

This approach may differ if another accounting standard-setter develops the research paper.

Discussion papers may result either from:

- a. A research project being conducted by another accounting standard-setter; or
- b. As the first stage of an active agenda project carried out by the IASB.

In the first case, the discussion paper is drafted by another standard-setter and published by the IASB. Issues related to the discussion paper are discussed in IASB meetings, and publication of such a paper requires a simple majority vote by the IASB.

If the discussion paper includes the preliminary views of other authors, the IASB reviews the draft discussion paper to ensure that its analysis is an appropriate basis on which to invite public comments.

For discussion papers on agenda items that are under the IASB's direction, or include its preliminary views, the IASB develops the paper or its views on the basis of analysis drawn from staff research and recommendations, as well as suggestions made by the IFRS Advisory Council, working groups and standard-setters and presentations from invited parties.

All discussions of technical issues related to the draft paper take place in public sessions.

v. Development and publication of an Exposure Draft

Publication of an exposure draft is a mandatory step in due process irrespective of whether the IASB has published a discussion paper; an exposure draft is the IASB's main vehicle for consulting the public.

Unlike a discussion paper, an exposure draft sets out a specific proposal in the form of a proposed standard (or amendment to an existing standard).

The development of an exposure draft begins with the IASB considering:

- i. Issues on the basis of staff research and recommendations;
- ii. Comments received on any discussion paper; and

iii. Suggestions made by the IFRS Advisory Council, working groups and accounting standard-setters, and arising from public education sessions.

After resolving issues at its meetings, the IASB instructs the staff to draft the exposure draft. When the draft has been completed, and the IASB has balloted on it, the IASB publishes it for public comment.

vi. Development and publication of an IFRS

The development of an IFRS is carried out during IASB meetings, when the IASB considers the comments received on the exposure draft.

After resolving issues arising from the exposure draft, the IASB considers whether it should expose its revised proposals for public comment, for example by publishing a second exposure draft.

In considering the need for re-exposure, the IASB:

- a. Identifies substantial issues that emerged during the comment period on the exposure draft that it had not previously considered.
- b. Assesses the evidence that it has considered.
- c. Evaluates whether it has sufficiently understood the issues and actively sought the views of constituents.
- d. Considers whether the various viewpoints were aired in the exposure draft and adequately discussed and reviewed in the basis for conclusions.

vii. Drafting the IFRS

The IASB's decision on whether to publish its revised proposals for another round of comments is made in an IASB meeting. If the IASB decides that re-exposure is necessary, the due process to be followed is the same as for the first exposure draft.

When the IASB is satisfied that it has reached a conclusion on the issues arising from the exposure draft, it instructs the staff to draft the IFRS.

Pre-ballot draft

A pre-ballot draft is usually subject to external review, normally by the IFRIC. Shortly before the IASB ballots the standard, a near-final draft is posted on e-IFRS.

Finally, after the due process is completed, all outstanding issues are resolved, and the IASB members have balloted in favour of publication, the IFRS is issued.

Procedures after an IFRS is issued

After an IFRS is issued, the staff and the IASB members hold regular meetings with interested parties, including other standard-setting bodies, to help understand unanticipated issues related to the practical implementation and potential impact of its proposals.

The IFRS Foundation also fosters educational activities to ensure consistency in the application of IFRSs.

After a suitable time, the IASB may consider initiating studies in the light of:

- i. Its review of the IFRS's application,
- ii. Changes in the financial reporting environment and regulatory requirements, and
- iii. Comments by the IFRS Advisory Council, the IFRS Interpretations Committee, standard-setters and constituents about the quality of the IFRS.

Those studies may result in items being added to the IASB's agenda.

1.06 Review Questions

1. Highlight the techniques of standards setting.
2. Enumerate the functions and powers of the Financial Reporting Council of Nigeria (FRCN)
3. Explain the development of Statements of Standard Accounting Practice (SSAP)
4. There is need for a set of accounting and financial reporting standards if comparability between and among firms is of any importance. Elucidate.
5. Accounting is a language with a special vocabulary aimed at conveying the financial information of organizations. To understand both corporate and public financial reports therefore, a user of accounting information must learn the fundamentals of accounting language. Discuss.

MODULE 2

2.00 INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)

2.01 Learning Outcomes

On successful completion of this Module, Students should be able to:

- i. Explicate the structure of IFRS, as well as the objectives and underlying assumptions of IFRS financial statements;
- ii. Describe the composition of the IFRS Statements till date;
- iii. Expound with deep understanding the characteristics and contents of Financial statements.

2.02 Structure of International Financial Reporting Standards (IFRS)

The International Accounting Standard Committee (IASC) Foundation is an independent body that oversees the International Accounting Standard Board (IASB). The IASC appoints Standard Advisory Council, The IASB and International Financial Reporting Interpretations Committee (IFRIC).

1. IASB consists of 14 members for the initial term of three to five years. IASB is responsible for technical matters including:-

- a. Preparation & issue of IFRS
- b. Preparation & Issue of exposure draft,
- c. Setting up procedures for reviewing comments received on documents published for comments.
- d. Issuing bases for conclusions.

2. Standard Advisory Council (SAC) consists of 40 members appointed by IASC Foundation trustees. They are appointed for a renewable term of three years from a diverse geographical and functional background SAC meets in public at least 3 times a year with IASB. Their main objectives are to advise the IASB on agenda decisions, to pass views of the council members on the major standard setting project and other works.

3. IFRIC consists of accounting experts from 12 countries appointed by trustees.

The main objective of IFRIC is to develop conceptually sound & practicable interpretations of IFRSs to be applied on a global basis:

- i. For newly identified financial reporting issues not specifically addressed in IFRSs
- ii. Where unsatisfactory, conflicting, divergent or other unacceptable interpretations have developed or seem likely to develop in the absence of authoritative guidance.

2.03 Objectives of Financial Statements

According to the International Accounting Standard Board Framework, the objective of financial statements is to provide information about:

- a. Financial position,
- b. Financial performance, (provided in an income statement or profit and loss account), and
- c. Changes in financial position of an enterprise (primarily provided in a separate statement).

The information contained in financial statements are useful to a wide range of users in making economic decisions.

Financial statements also show the results of the stewardship of management, or the accountability of management for the resources entrusted to it.

2.04 Underlying Assumptions

The following are the three underlying assumptions in IFRS:

1. Going concern: an entity will continue for the foreseeable future under the Historical Cost paradigm.
2. Stable measuring unit assumption (Traditional Historical Cost Accounting).
3. Units of constant purchasing power.

2.05 Characteristics of Financial Statements

1. Understandability. The information must be readily understandable to users of the financial statements.
2. Relevance. The information must be relevant to the needs of the users, which is the case when the information influences the economic decisions of users. This may involve reporting particularly relevant information, or information whose omission or misstatement could influence the economic decisions of users.
3. Reliability. The information must be free of material error and bias, and not misleading. Thus, the information should faithfully represent transactions and other events, reflect the underlying substance of events, and prudently represent estimates and uncertainties through proper disclosure.
4. Comparability. The information must be comparable to the financial information presented for other accounting periods, so that users can identify trends in the performance and financial position of the reporting entity.

2.06 Contents of Financial Statements

- 1) Statement of financial position
- 2) Statement of comprehensive income

- 3) Statement of changes in equity
- 4) Statement of cash flows
- 5) Notes to the financial statements
- 6) A statement of financial position as at the beginning of the earliest comparative period when an entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements.

Others in GAAP are:

- 7) Chairman's report
- 8) Director's report
- 9) Audit committees' report
- 10) Auditor's report
- 11) Value added statement
- 12) Five-year financial summary

2.07 Presentation of Financial Statements (IAS 1)

IAS 1 prescribes the basis for presentation of general purpose financial statements to ensure comparability both with the entity's financial statements of previous periods and with the financial statements of other entities.

The standard shall apply in preparing and presenting general purpose financial statements; it does not apply to the structure and content of condensed interim financial statements; it applies equally to all entities, including those that present consolidated financial statements and those that present separate financial statements.

Key terms defined in IAS 1 include:

General purpose financial statements: Financial statements intended to meet the needs of users who are not in a position to require an entity to prepare reports tailored to their particular information needs.

Impracticable: Applying a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so.

The Complete set of financial statements as prescribed by IAS 1 to be presented by an entity comprises:

- i. A statement of financial position as at the end of the period;
- ii. A statement of comprehensive income for the period;
- iii. A statement of changes in equity for the period;
- iv. A statement of cash flows for the period;

- v. Notes, comprising a summary of significant accounting policies and other explanatory information; and
- vi. A statement of financial position as at the beginning of the earliest comparative period when an entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements.

The Statement of financial position as a minimum shall include line items that present the following amounts:

- a) Property, plant and equipment;
- b) Investment property;
- c) Intangible assets;
- d) Financial assets;
- e) Investments accounted for using the equity method;
- f) Biological assets;
- g) Inventories;
- h) Trade and other receivables;
- i) Cash and cash equivalents;
- j) the total of assets classified as held for sale;
- k) Trade and other payables;
- l) Provisions;
- m) Financial liabilities;
- n) Liabilities and assets for current tax,
- o) Deferred tax liabilities and deferred tax assets;
- p) Liabilities included in disposal groups classified as held for sale;
- q) Non-controlling interest, presented within equity; and
- r) Issued capital and reserves attributable to owners of the parent.

The Statement of comprehensive income shall present all items of income and expense recognized in a period:

- a) In a single statement of comprehensive income, or
- b) In two statements: a statement displaying components of profit or loss (separate statement of comprehensive income) and a second statement beginning with profit or loss and displaying components of other comprehensive income (statement of comprehensive income).

As a minimum, the statement of comprehensive income shall include line items that present the following amounts for the period:

- a) Revenue;
- b) Finance costs;

- c) Share of the profit or loss of associates and joint ventures accounted for using the equity method;
- d) Tax expense;
- e) A single amount comprising the total of:
 - i. the post-tax profit or loss of discontinued operations and
 - ii. the post-tax gain or loss recognized on the measurement to fair value less costs to sell or on the disposal of the assets or disposal group(s) constituting the discontinued operation;
- f) Profit or loss;
- g) Each component of other comprehensive income classified by nature (excluding amount in (h));
- h) Share of the other comprehensive income of associates and joint ventures accounted for using the equity method; and
- i) Total comprehensive income.

An entity shall disclose the following items as allocations of profit or loss for the period:

- (a) Profit or loss for the period attributable to:
 - i. Non-controlling interest, and
 - ii. Owners of the parent.
- (b) Total comprehensive income for the period attributable to:
 - i. Non-controlling interest, and
 - ii. Owners of the parent.

The Statement of changes in equity includes the following information:

- a) Total comprehensive income for the period, showing separately the total amounts attributable to owners of the parent and to non-controlling interest;
- b) For each component of equity, the effects of retrospective application or retrospective restatement recognized in accordance with IAS 8; and
- c) For each component of equity, a reconciliation between the carrying amount at the beginning and the end of the period, separately disclosing changes resulting from:
 - (i) profit or loss;
 - (ii) other comprehensive income; and
 - (iii) transactions with owners in their capacity as owners, showing separately contributions by and distributions to owners and changes in ownership interests in subsidiaries that do not result in a loss of control.

The Statement of cash flows provides users of financial statements with a basis to assess the ability of the entity to generate cash and cash equivalents and the needs of the entity to utilize those cash flows. IAS 7 sets out the requirements for the presentation and disclosure of cash flow information.

The Notes shall present information about the basis of preparation of the financial statements and the specific accounting policies used

- i. Disclose the information required by IFRSs that is not presented elsewhere in the financial statements
- ii. Provide information that is not presented elsewhere in the financial statements, but is relevant to an understanding of any of them.

The accounting policies shall disclose the measurement basis (or bases) used in preparing the financial statements, and the other accounting policies used that are relevant to an understanding of the financial statements.

2.08 IFRS Statements

International Financial Reporting Standards

- i. [IFRS 1](#) First-time Adoption of International Financial Standards
- ii. [IFRS 2](#) Share-based Payment
- iii. [IFRS 3](#) Business Combinations
- iv. [IFRS 4](#) Insurance Contracts
- v. [IFRS 5](#) Non-current Assets Held for Sale and Discontinued Operations
- vi. [IFRS 6](#) Exploration for and Evaluation of Mineral Assets
- vii. [IFRS 7](#) Financial Instruments: Disclosures
- viii. [IFRS 8](#) Operating Segments
- ix. [IFRS 9](#) Financial Instruments
- x. [IFRS 10](#) Consolidated Financial Statements
- xi. [IFRS 11](#) Joint Arrangements
- xii. [IFRS 12](#) Disclosure of Interests in Other Entities
- xiii. [IFRS 13](#) Fair Value Measurement
- xiv. [IFRS 14](#) Regulatory Deferrals Accounts
- xv. [IFRS 15](#) Revenue from contracts with customers

International Accounting Standards

- i. [IAS 1](#) Presentation of Financial Statements
- ii. [IAS 2](#) Inventories
- iii. [IAS 7](#) Statement of Cash Flows

- iv. [IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors](#)
- v. [IAS 10 Events after the Reporting Period](#)
- vi. [IAS 11 Construction Contracts](#)
- vii. [IAS 12 Income Taxes](#)
- viii. [IAS 14 Segment Reporting](#). Superseded by IFRS 8 effective 1 January 2009
- ix. [IAS 16 Property, Plant and Equipment](#)
- x. [IAS 17 Leases](#)
- xi. [IAS 18 Revenue](#)
- xii. [IAS 19 Employee Benefits](#). Superseded by IAS 19 (2011) effective 1 January 2013
- xiii. [IAS 19 Employee Benefits \(2011\)](#)
- xiv. [IAS 20 Accounting for Government Grants and Disclosure of Government Assistance](#)
- xv. [IAS 21 The Effects of Changes in Foreign Exchange Rates](#)
- xvi. [IAS 23 Borrowing Costs](#)
- xvii. [IAS 24 Related Party Disclosures](#).
- xviii. [IAS 26 Accounting and Reporting by Retirement Benefit Plans](#)
- xix. [IAS 27 Consolidated and Separate Financial Statements](#). Superseded by IFRS 10, IFRS 12 and IAS 27 (2011) effective 1 January 2013
- xx. [IAS 28 Investments in Associates and Joint Ventures \(2011\)](#)
- xxi. [IAS 28 Investments in Associates](#). Superseded by IAS 28 (2011) and IFRS 12 effective 1 January 2013
- xxii. [IAS 29 Financial Reporting in Hyperinflationary Economies](#)
- xxiii. [IAS 31 Interests in Joint Ventures](#). Superseded by IFRS 11 and IFRS 12 effective 1 January 2013
- xxiv. [IAS 32 Financial Instruments: Presentation](#)
- xxv. [IAS 33 Earnings Per Share](#)
- xxvi. [IAS 34 Interim Financial Reporting](#)
- xxvii. [IAS 36 Impairment of Assets](#)
- xxviii. [IAS 37 Provisions, Contingent Liabilities and Contingent Assets](#)
- xxix. [IAS 38 Intangible Assets](#)
- xxx. [IAS 39 Financial Instruments: Recognition and Measurement](#). Superseded by IFRS 9 effective 1 January 2015
- xxxi. [IAS 40 Investment Property](#)
- xxxii. [IAS 41 Agriculture](#)

IFRIC Interpretations

- i. [IFRIC 1 Changes in Existing Decommissioning, Restoration and Similar Liabilities](#)
- ii. [IFRIC 2 Members' Shares in Co-operative Entities and Similar Instruments](#)
- iii. [IFRIC 3 Emission Rights](#). Withdrawn June 2005

- iv. [IFRIC 4](#) Determining Whether an Arrangement Contains a Lease
- v. [IFRIC 5](#) Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds
- vi. [IFRIC 6](#) Liabilities Arising from Participating in a Specific Market - Waste Electrical and Electronic Equipment
- vii. [IFRIC 7](#) Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies
- viii. [IFRIC 8](#) Scope of IFRS 2. Withdrawn effective 1 January 2010
- ix. [IFRIC 9](#) Reassessment of Embedded Derivatives
- x. [IFRIC 10](#) Interim Financial Reporting and Impairment
- xi. [IFRIC 11](#) IFRS 2: Group and Treasury Share Transactions. Withdrawn effective 1 January 2010
- xii. [IFRIC 12](#) Service Concession Arrangements
- xiii. [IFRIC 13](#) Customer Loyalty Programmes
- xiv. [IFRIC 14](#) IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction
- xv. [IFRIC 15](#) Agreements for the Construction of Real Estate
- xvi. [IFRIC 16](#) Hedges of a Net Investment in a Foreign Operation
- xvii. [IFRIC 17](#) Distributions of Non-cash Assets to Owners
- xviii. [IFRIC 18](#) Transfers of Assets from Customers
- xix. [IFRIC 19](#) Extinguishing Financial Liabilities with Equity Instruments
- xx. [IFRIC 20](#) Stripping Costs in the Production Phase of a Surface Mine

SIC Interpretations

- i. SIC 1 Consistency – Different Cost Formulas for Inventories. Superseded
- ii. SIC 2 Consistency – Capitalisation of Borrowing Costs. Superseded
- iii. SIC 3 Elimination of Unrealised Profits and Losses on Transactions with Associates. Superseded
- iv. SIC 5 Classification of Financial Instruments - Contingent Settlement Provisions. Superseded SIC 6 Costs of Modifying Existing Software. Superseded
- v. SIC 7 Introduction of the Euro
- vi. [SIC 8](#) First-Time Application of IASs as the Primary Basis of Accounting. Superseded
- vii. [SIC 9](#) Business Combinations – Classification either as Acquisitions or Uniting of Interests. Superseded
- viii. [SIC 10](#) Government Assistance – No Specific Relation to Operating Activities
- ix. [SIC 11](#) Foreign Exchange – Capitalisation of Losses Resulting from Severe Currency Devaluations. Superseded
- x. [SIC 12](#) Consolidation – Special Purpose Entities

- xi. SIC 13 Jointly Controlled Entities – Non-Monetary Contributions by Venturers
- xii. SIC 14 Property, Plant and Equipment – Compensation for the Impairment or Loss of Items. Superseded
- xiii. SIC 15 Operating Leases – Incentives
- xiv. SIC 16 Share Capital – Reacquired Own Equity Instruments (Treasury Shares). Superseded
- xv. SIC 17 Equity – Costs of an Equity Transaction. Superseded
- xvi. SIC 18 Consistency – Alternative Methods. Superseded
- xvii. SIC 19 Reporting Currency – Measurement and Presentation of Financial Statements under IAS 21 and IAS 29. Superseded
- xviii. SIC 20 Equity Accounting Method – Recognition of Losses. Superseded
- xix. SIC 21 Income Taxes – Recovery of Revalued Non-Depreciable Assets
- xx. SIC 22 Business Combinations – Subsequent Adjustment of Fair Values and Goodwill Initially Reported. Superseded
- xxi. SIC 23 Property, Plant and Equipment – Major Inspection or Overhaul Costs. Superseded
- xxii. SIC 24 Earnings Per Share – Financial Instruments and Other Contracts that May Be Settled in Shares. Superseded
- xxiii. SIC 25 Income Taxes – Changes in the Tax Status of an Enterprise or its Shareholders
- xxiv. SIC 27 Evaluating the Substance of Transactions in the Legal Form of a Lease
- xxv. SIC 28 Business Combinations – 'Date of Exchange' and Fair Value of Equity Instruments. Superseded
- xxvi. SIC 29 Disclosure – Service Concession Arrangements
- xxvii. SIC 30 Reporting Currency – Translation from Measurement Currency to Presentation Currency. Superseded
- xxviii. SIC 31 Revenue – Barter Transactions Involving Advertising Services
- xxix. SIC 32 Intangible Assets – Web Site Costs
- xxx. SIC 33 Consolidation and Equity Method – Potential Voting Rights and Allocation of Ownership Interests. Superseded

IFRS STATEMENTS

(1) Statement of Financial Position as at December 31, 2012

| | | 2012 | 2011 |
|-------------------------------|-------|-------------------|-------------------|
| Assets | Notes | N | N |
| Property, plant and equipment | 2 | 449,000 | 898,000 |
| Intangible assets | 3 | 22,000 | 44,000 |
| Long-term financial assets | 4 | 13,561,000 | 27,122,000 |
| Deferred taxation assets | 5 | <u>65,000</u> | <u>130,000</u> |
| Total noncurrent assets | | <u>14,097,000</u> | <u>28,194,000</u> |

| | | | |
|--|----|-------------------|-------------------|
| Trade and other receivables | 6 | 3,000 | 6,000 |
| Cash and cash equivalent | 7 | 1,316,309 | 2,632,618 |
| Assets classified as held for sale | 8 | <u>1,000</u> | <u>2,000</u> |
| Total current assets | | <u>1,320,309</u> | <u>2,640,618</u> |
| Total assets | | <u>15,417,309</u> | <u>30,834,618</u> |
| Equity | | | |
| Share capital and premium | 9 | 49,000 | 98,000 |
| Other reserves | 10 | 160,000 | 320,000 |
| Retained income | 11 | <u>8,232,000</u> | <u>16,464,000</u> |
| Total equity of shareholders of Abuja Plc | | <u>8,441,000</u> | <u>16,882,000</u> |
| Liabilities | | | |
| Interest bearing – debentures | 12 | 3,578,000 | 7,156,000 |
| Provisions (long term) | 13 | 3,309 | 6,618 |
| Other noninterest bearing loan | 14 | <u>3,336,978</u> | <u>6,673,956</u> |
| Total noncurrent liabilities | | <u>6,918,287</u> | <u>13,836,574</u> |
| Trade and other payables | 15 | 54,000 | 108,000 |
| Provisions (due in 12 months) | 16 | 2,000 | 4,000 |
| Amount due to bankers and short term loans | 17 | <u>2,022</u> | <u>4,044</u> |
| Total current liabilities | | <u>58,022</u> | <u>116,044</u> |
| Total liabilities | | <u>6,976,309</u> | <u>1,394,618</u> |
| Total equity and liabilities | | <u>15,417,309</u> | <u>30,834,618</u> |

(2) Statement of Comprehensive income for the Year 31st December, 2013
[Single Statement Approach]

| | 2013 | 2012 |
|--|------------------|------------------|
| | N'000 | |
| Revenue | 1,170,000 | 1,065,000 |
| Expenses | <u>(750,000)</u> | <u>(825,000)</u> |
| Profit before tax | 420,000 | 240,000 |
| Income tax expense | <u>(75,000)</u> | <u>(45,000)</u> |
| Profit for the year from continuing operations | 345,000 | 195,000 |
| Loss for the year from discontinued operations | <u>(91,500)</u> | <u>—</u> |
| Profit for the year | 253,500 | 195,000 |
| Other Comprehensive Income: | | |
| Exchange differences on translating foreign operations | 15,000 | 30,000 |
| Available-for-sale financial assets | 7,200 | 10,500 |

| | | |
|---|----------------|----------------|
| Cash flow hedges | 3,600 | 6,660 |
| Gains on property revaluation | 24,000 | 21,000 |
| Actuarial (losses) gains on defined benefit pension plans | (2,001) | 3,999 |
| Share of other comprehensive income of associates | 1,200 | (2,100) |
| Income tax relating to components of other comprehensive income | (12,000) | (11,700) |
| Other comprehensive income for the year, net of tax | <u>36,999</u> | <u>58,359</u> |
| Total comprehensive income for the year | <u>290,499</u> | <u>253,359</u> |
| Profit attributable to: | | |
| Owners of the parent | 228,813 | 176,670 |
| Minority interest | <u>24,687</u> | <u>18,330</u> |
| | <u>253,500</u> | <u>195,000</u> |
| Total comprehensive income attributable to: | | |
| Owners of the parent | 258,812 | 225,369 |
| Minority interest | <u>31,687</u> | <u>27,990</u> |
| | <u>290,499</u> | <u>253,359</u> |

[Two Statements Approach]

(1) Income Statement

| | 2013 | 2012 |
|--|------------------|------------------|
| | N'000 | N'000 |
| Revenue | 1,170,000 | 1,065,000 |
| Expenses | <u>(750,000)</u> | <u>(825,000)</u> |
| Profit before tax | 420,000 | 240,000 |
| Income tax expense | <u>(75,000)</u> | <u>(45,000)</u> |
| Profit for the year from continuing operations | 345,000 | 195,000 |
| Loss for the year from discontinued operations | <u>(91,500)</u> | <u>—</u> |
| Profit for the year | <u>253,500</u> | <u>195,000</u> |
| Profit attributable to: | | |
| Owners of the parent | 228,813 | 176,670 |
| Non-controlling interest | <u>24,687</u> | <u>18,330</u> |
| | <u>253,500</u> | <u>195,000</u> |

(2) Statement of Comprehensive Income

| | 2010 | 2009 |
|--|---------|---------|
| | N'000 | N'000 |
| Profit for the year | 235,500 | 195,000 |
| Other Comprehensive Income: | | |
| Exchange differences on translating foreign operations | 15,000 | 30,000 |
| Available-for-sale financial assets | 7,200 | 10,500 |

| | | |
|---|----------------|----------------|
| Cash flow hedges | 3,600 | 6,660 |
| Gains on property revaluation | 24,000 | 21,000 |
| Actuarial (losses) gains on defined benefit pension plans | (2,001) | 3,999 |
| Share of other comprehensive income of associates | 1,200 | (2,100) |
| Income tax relating to components of other comprehensive income | (12,000) | (11,700) |
| Other comprehensive income for the year, net of tax | <u>36,999</u> | <u>58,359</u> |
| Total comprehensive income for the year | <u>290,499</u> | <u>253,359</u> |
| Total comprehensive income attributable to: | | |
| Owners of the parent | 258,812 | 225,369 |
| Minority interest | <u>30,687</u> | <u>27,990</u> |
| | <u>290,499</u> | <u>253,359</u> |

(3) Statement of Changes in Equity

Statement of Changes in Equity for the Year ended 31st December, 2010

| | Share Capital | Retained Earnings | Foreign Currency Translation Adjustment- Consolidated Subsidiary | Foreign Currency Translation Adjustment- Associate A | Revaluation Surplus | Unrealized Gain on Cash Flow Hedge | Unrealized Gain on available-for-sale Financial Assets | Total Equity |
|----------------------------|---------------|-------------------|--|--|---------------------|------------------------------------|--|--------------|
| Balance at 31 Dec. 2008 | 1,265,000 | 280,250 | 50,200 | 37,000 | 800 | 31,000 | 6,000 | 1,670,250 |
| Issue of share capital | 78,000 | | | | | | | 78,000 |
| Dividends | | (80,000) | | | | | | (80,000) |
| Total comprehensive income | | 448,039 | (1,492) | (1,300) | – | 1,690 | 15,275 | 462,212 |
| Balance at 31 Dec. 2009 | 1,343,000 | 648,289 | 48,708 | 35,7090 | 800 | 32,690 | 21,275 | 2,130,462 |
| Issue of Share Capital | 84,240 | | | | | | | 84,240 |

| | | | | | | | | |
|----------------------------|-----------|-----------|--------|---------|-------|--------|--------|-----------|
| Dividends | | (86,400) | | | | | | (86,400) |
| Total comprehensive Income | | 538,469 | 2,094 | (1,404) | 3,653 | 1,825 | 17,193 | 561,830 |
| Balance at 31 Dec. 2010 | 1,427,240 | 1,100,358 | 50,802 | 34,296 | 4,453 | 34,515 | 38,468 | 2,690,132 |

(4) Cash Flow Statement

| | Note | 2010 N |
|---|------|------------------|
| Cash flows from operating activities | | |
| Cash receipts from customers | | 693,200 |
| Cash paid to suppliers and employees | | (59) |
| Cash generated from operating activities | | 693,141 |
| Interest paid | | (100) |
| Income tax paid | | (278) |
| Net cash from operating activities | | 1,385,904 |
| Cash flows from investing activities | | |
| Interest received | | 456 |
| Dividends received | | 65,643 |
| Proceeds from sale of property, plant and equipment | | 56 |
| Proceeds from sale of investments | | 456 |
| Disposal of discontinued operation, net of cash disposed of | | 565 |
| Acquisition of subsidiary, net of cash acquired | | (75,000) |
| Acquisition of property, plant and equipment | | (456) |

| | |
|---|------------------|
| Acquisition of investment property | (456) |
| Plantations and acquisitions of non-current biological assets | (6,857) |
| Acquisition of other investments | (67,897) |
| Development expenditure | (8,874) |
| Net cash used in investing activities | (92,364) |
| Cash flows from financing activities | |
| Proceeds from issue of share capital | 346 |
| Proceeds from issue of convertible notes | 454 |
| Proceeds from issue of redeemable preference shares | 6,754 |
| Proceeds from sale of own shares | 474 |
| Proceeds from exercise of share options | 878 |
| Proceeds from settlement of derivatives | 6 |
| Payment of transaction costs related to loans and borrowings | (678) |
| Acquisition of non-controlling interests | (687) |
| Repurchase of own shares | - |
| Repayment of borrowings | (56) |
| Payment of finance lease liabilities | (65) |
| Dividends paid | (345) |
| Net cash from (used in) financing activities | 7,081 |
| Net increase/(decrease) in cash and cash equivalents | 1,300,621 |
| Cash and cash equivalents at 1 January | 15,700 |
| Effect of exchange rate fluctuations on cash held | (12) |
| Cash and cash equivalents at 31 December | 1,316,309 |

2.09 Review Questions

1. Enumerate the objective of IAS 1 and discuss the underlying assumptions of IFRS.
2. With reference to IAS 1, identify the financial statements prescribed for publication.
3. Highlight the minimum line items to be included in the statement of comprehensive income.
4. Currently in publication are IAS 1-41 and IFRS 1-13. List any five (5) IFRS and highlight their main provisions.
5. Enumerate the Benefits and Challenges associated with IFRS adoption in Nigeria.
6. Abuja Plc was registered in Nigeria and commenced operations in January, 2008. The company prepared its financial statements for 2008 according to the provisions of GAAP and SAS. However, in 2009, the management adopted the IFRS and prepared its financial statements based on the provisions of IFRS. In respect to the preparation of the financial statements for the year ended 31st December, 2010, the following information was extracted from the books of Abuja Plc as at 31st December, 2010.

Trial Balance as at 31st December 2010

| | Dr | Cr |
|------------------------------------|------------|-----------|
| | N | N |
| Property, Plant and Equipment | 449,000 | |
| Intangible assets | 22,000 | |
| Long term financial assets | 13,561,000 | |
| Deferred taxation assets | 65,000 | |
| Interest bearing- Debenture | | 3,578,000 |
| Provisions (Long term) | | 3,309 |
| Other non-interest bearing Loan | | 3,336,978 |
| Trade and other receivables | 3,000 | |
| Cash and cash equivalents | 1,316,309 | |
| Assets classified as held for sale | 1,000 | |
| Share capital and premium | | 49,000 |
| Other reserves | | 160,000 |
| Retained income | | 8,232,000 |
| Trade and other payables | | 54,000 |

| | | |
|--|-----------------------------|--------------------------|
| Provisions (due in 12 months) | | 2,000 |
| Amount due to bankers and short-term loans | <u> </u> | <u>2,022</u> |
| | <u>15,417,309</u> | <u>15,417,309</u> |

Required: Prepare the statement of financial position in accordance with the provisions of IAS 1.

7. The following information was extracted from the books of Adejare Manufacturing Plc as at 31st December, 2010.

| | Dr | Cr |
|--|-----------|--------|
| | N | N |
| Selling expenses: | | |
| Advertising | 60,000 | |
| Wages, salaries and benefits | 56,700 | |
| Bad debt | 23,068 | |
| Others | 13,500 | |
| Investing: | | |
| Dividend income | | 54,000 |
| Realized gain on available-for-sale securities | | 18,250 |
| Share of profit of associate – B | | 7,500 |
| General and Administrative expenses: | | |
| Wages, salaries and benefits | 321,300 | |
| Depreciation | 59,820 | |
| Pension | 51,975 | |
| Share-based remuneration | 22,023 | |
| Interest on lease liability | 14,825 | |
| Research and development | 8,478 | |
| Others | 15,758 | |
| Cost of goods sold: | | |
| Materials | 1,043,100 | |
| Labour | 405,000 | |
| Overhead – depreciation | 219,300 | |
| Overhead – transport | 128,640 | |
| Overhead – others | 32,160 | |
| Change in inventory | 60,250 | |
| Pension | 51,975 | |
| Loss on obsolete and damaged inventory | 29,000 | |
| Other operating income/ expense: | | |

| | | |
|---|------------------|------------------|
| Share of profit of associate A | | 23,760 |
| Gain on disposal of property, plant and equipment | | 22,650 |
| Realized gain on cash flow hedge | | 3,996 |
| Loss on sale of receivables | 4,987 | |
| Impairment loss on goodwill | - | |
| Financing: | | |
| Interest incomes on cash | | 8,619 |
| Interest expense | 111,352 | |
| Income Taxes: | | |
| Income tax expense | 333,625 | |
| Discontinued Operations: | | |
| Loss on discontinued operations | 32,400 | |
| Tax benefit | | 11,340 |
| Other Comprehensive Income (after tax): | | |
| Revaluation surplus (operating) | | 3,653 |
| Unrealized gain in available for sale securities | | 17,193 |
| Foreign currency translation adjust | | 2,094 |
| Unrealized gain on cash flow hedge (operating) | | 1,825 |
| Foreign currency translation adjust Associate A | | 1,404 |
| Sales – wholesale | | 2,790,080 |
| Sales – retail | | 697,520 |
| Total Assets | 6,000,000 | |
| Ordinary Shares | | 1,400,000 |
| Liabilities | | <u>4,038,160</u> |
| | | <u>9,100,640</u> |
| | <u>9,100,640</u> | <u>9,100,640</u> |

Required:

Prepare the Statement of comprehensive income for the year ended 31st December, 2010 using:

- i. Single statement approach
- ii. Two statements approach

8. The following information was extracted from the books of White Knight Plc for the year ended 31st December, 2010 in respect of Equity:

31 Dec. 2008

N

| | |
|--|-----------|
| Share Capital | 1,900,000 |
| Retained Earnings | 400,220 |
| Foreign Currency Translation Adjustment (Subsidiary) | 80,400 |
| Foreign Currency Translation Adjustment (Associate) | 66,000 |
| Revaluation Surplus | 1,000 |
| Unrealized Gain on Cash Flow Hedge | 92,000 |
| Unrealized Gain on Available for Sale Financial Assets | 18,000 |

During the year (2009), issued share capital was N98,000; Dividends paid N90,000; Retained Earnings N550,000, Foreign Currency Translation Adjustment of Subsidiary (N2,500); Foreign Currency Translation Adjustment of Associate (N2,600) ; Revaluation Surplus Nil; Unrealized Gain on Cash Flow Hedge N2,890; Unrealized Gain on Available for Sale Financial Assets N 20,400.

During the year (2010), issued share capital was N90,400; Dividends paid N70,000; Retained Earnings N400,500; Foreign Currency Translation Adjustment of Subsidiary N3,700; Foreign Currency Translation Adjustment of Associate (N2,800) ; Revaluation Surplus N9,500; Unrealized Gain on Cash Flow Hedge N1,800; Unrealized Gain on Available for Sale Financial Assets N20,000.

Required: Prepare the Statement of Changes in Equity for the year ended 31st December, 2010.

9. Daniel Plc is preparing its statement of cash flows and has provided this information for the year ended 31st December, 2010:

| | N'000 |
|---|---------|
| Cash and cash equivalents at 1 January | 20,800 |
| Cash receipts from customers | 900,000 |
| Cash paid to suppliers and employees | 80 |
| Cash Generated from operating activities | 780,000 |
| Interest paid | 400 |
| Income tax paid | 380 |
| Interest received | 600 |
| Dividend received | 70,000 |
| Proceeds from sale of property, plant and equipment | 60 |
| Proceeds from sale of investments | 600 |
| Disposal of discontinued operation, net of cash disposed of | 700 |
| Acquisition of subsidiary, net of cash acquired | 90,000 |
| Acquisition of property, plant and equipment | 500 |
| Acquisition of investment property | 490 |
| Plantations and acquisitions of non-current biological assets | 8,600 |
| Acquisition of other investments | 88,000 |
| Development expenditure | 9,000 |
| Proceeds from issue of share capital | 500 |

| | |
|--|-------|
| Proceeds from issue of convertible notes | 680 |
| Proceeds from issue of redeemable preference shares | 7,600 |
| Proceeds from sale of own shares | 570 |
| Proceeds from exercise of share options | 990 |
| Proceeds from settlement of derivatives | 10 |
| Payment of transaction costs related to loans and borrowings | 720 |
| Acquisition of non-controlling interests | 590 |
| Repurchase of own shares | - |
| Repayment of borrowings | 40 |
| Payment of finance lease liabilities | 30 |
| Dividends paid | 440 |
| Effect of exchange rate fluctuations on cash held | 50 |

Required: Prepare a Statement of Cash-flows as recommended by IAS 7.

10. Enumerate key items to be disclosed in notes to the account and accounting policies according to the provisions of IFRS.

MODULE 3

3.00 APPLICATION OF IFRS/IAS

3.01 Learning Outcomes

On successful completion of this Module, Students should be able to:

- i. Elucidate the nature, of ifrs and provide a suitable starting point, are transparent to users, and are comparable over all periods presented.
- ii. Specify measurement and disclosure principles for all retirement benefit plans
- iii. Establish Specific standards for enterprises reporting in the currency of a hyperinflationary economy
- iv. The student would understand the importance of financial instrument to an entity's financial position, performance, and cash flows.
- v. To know that assets are carried at no more than their recoverable amount, and also discover how discoverable is computed
- vi. Understand how lease recoverable are recognize and measured

3.02 IFRS 1: FIRST-TIME ADOPTION OF INTERANTIONAL FINANCIAL REPORTING STANDARDS

IFRS 1 sets out the precise way in which companies should implement a change from local accounting standards (their previous GAAP) to IFRS. One of the main reasons for issuing a new standard was that listed companies in the EU were required to prepare their consolidated financial statements in accordance with IFRS from 2005 onwards.

The standard is intended to ensure that an entity's First IFRS financial statement contain high quality information that: is transparent for users and comparable over all periods presented; provides a suitable starting point for accounting under IFRS; and can be generated at a cost that does exceed the benefits to users.

Date of transaction to IFRs: The beginning of the earliest period for which an entity presents full comparative information under IFRs in its first IFRS financial statements.

Deemed cost: An amount used as a surrogate for cost or depreciated cost at a given date.

Fair value: The amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

First IFRS financial statements: The first annual financial statements in which an entity adopts international Financial Reporting Standards (IFRSs), by an explicit and unreserved statement of compliance with IFRSs.

Opening IFRS statement of financial position: An entity's statement of financial position (published or unpublished) at the date of transition to IFRSs.

Previous GAAP: The basis of accounting that a first-time adopter used immediately before adopting IFRSs.

Reporting date: The end of the latest period covered by financial statements or by an interim financial report.

Note that the definition of fair value has now been amended by IFRS 13 to:

The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

IFRS 1 only applies where an entity prepares IFRS financial statements for the first time. Changes in accounting policies made by an entity that already applies IFRSs should be dealt with by applying either IAS 8 or specific transactional requirements in other standards.

Making the transition to IFRS

An entity should:

- (a) Select accounting policies that comply with IFRSs at the reporting date for the entity's first financial statements.
- (b) Prepare an opening IFRS statement of financial position at the date of transition to IFRSs. This is the starting point for subsequent accounting under transition to IFRSs is the beginning of earliest comparative period presented in an entity's first IFRS financial statements.
- (c) Disclose the effect of the change in the financial statements.

Example: reporting date and opening IFRS statement of financial position

A listed company has a 31 December year-end and will be required to comply with IFRSs from 1 January 2012.

What is the date of transition to IFRSs?

The company's first IFRS financial statements will be for the year ended 31 December 2012.

IFRS 1 requires that at least one year's comparative figures are presented in the first IFRS financial statements. The comparative figures for year ended 31 December 2011.

Therefore, the date of transition to IFRSs is 1 January 2011 and the company prepares an opening IFRS statement of financial position at this date.

Preparing the opening IFRS statement of financial position

IFRS 1 states that in its opening IFRS statement of financial position an entity shall:

- (a) Recognised all assets and liabilities whose recognition is required by IFRSs
- (b) Not recognise items as assets or liabilities if IFRS do not permit such recognition.
- (c) Reclassify items that it recognised under previous GAAP as one type of asset, liability or component of equity, but are a different type of asset liability or component of equity under IFRSs.
- (d) Apply IFRS in measuring all recognised assets and liabilities

The involves restating the statement of financial position prepared at the same date under the entity's previous GAAP so that it complies with IASs and IFRSs in force at the first reporting date. In our example above, the company prepares its opening IFRS statement of financial position at 1 January 2008, following accounting policies that comply with IFRSs in force at 31 December 2009.

The accounting policies that an entity uses in its opening IFRS Statement of financial position may differ from those it used for the same date using its previous GAAP.

The resulting adjustments are recognised directly in retained earnings (in equity) at the date of transition. (This is because the adjustments arise from events and transition. (This is because the adjustments arise from events and transactions before the date of transition to IFRS).

Exemptions from other IFRSs

A business may elect to use any or all of a range of exemptions. These enable an entity not to apply certain requirements of specific accounting standards retrospectively in drawing up its opening IFRS statement of financial position. Their purpose is to ensure that the cost of producing IFRS financial statements does not exceed the benefits to users.

Business combinations

IFRS 3 need not be applied retrospectively to business combinations that occurred before the date of the opening IFRS statement of financial position. This has the following consequences.

- a) Combinations keep the same classification (e.g. acquisition, uniting of interests) as in the previous GAAP financial statements.
- b) All acquired assets and liabilities are recognised other than:
 - i. Some financial assets and financial liabilities derecognized under the previous GAAP (derivatives and special purpose entities must be recognised);
 - ii. Assets (including goodwill) and liabilities that was not recognised under previous GAAP and would not qualify for recognition under IFRSs.

Any resulting change is recognised by adjusting retained earnings (i.e. equity) unless the change results from the recognition of an intangible asset that was previously subsumed within goodwill.

- c) Items which do not qualify for recognition as an asset or liability under IFRSs must be excluded from the opening IFRS statement of financial position. For example, intangible assets that do not qualify for separate recognition under IAS 38 must be reclassified as part of goodwill.

- d) The carrying amount of goodwill in the opening IFRS statement of financial position is the same as its carrying amount under previous GAAP. However, goodwill must be tested for impairment at the transition date.

3.03 IAS 26: ACCOUNTING AND REPORTING BY RETIREMENT BENEFIT PLANS

Basically, this standard provides guidelines on how retirement benefit plan should be accounted for by the plan to all participants. It states the financial statement required and also explain the measurement of various line items, particularly the actuarial present value of promised retirement benefits for defined benefits plan.

Definitions

1. Retirement benefits: these are employee's benefits (other than termination benefits) which are payable after the completion of employment or after retirement.
2. Retirement (post – employment benefits plans: these are arrangements (formal or informal) under which an entity provides retirement or post – employment benefits for one or more employees.
3. Defined contribution plan: these are retirement or employment benefit plans under which an entity pays fixed contributions into a separate entity (a fund) and in which the entity will have no legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current or prior periods. That is, the entity is only responsible for the amount of annual contribution payable into the fund and not the amount of benefits receivable by the employees.
4. Defined benefit plans: these are retirement or post-employment benefits plans other than defined contribution plans.
5. Vested employee benefits: these are employee benefits that are not conditional on future employment.
6. Actuarial present value of promised retirement benefits: this is the present value of the expected payments by a retirement benefit plan to existing and past employees, attributable to the service already rendered. That is, the present value of expected future payments required to settle the obligation resulting from employee service in the current or prior periods (without deducting any plan assets). It can be referred to as present value of a defined benefits obligation.
7. Plan assets: this comprises assets held by a long- time employee benefits funds and qualifying insurance policies.
8. The return on plan assets: these are interest, dividends, and other revenues derived from the plan assets, together with realised and unrealized gain or losses on the plan assets, less any cost of administering the plan and less any tax payable by the plan itself.

9. Fair value: this is the price that would be received to sell an asset or paid to transfer or settle a liability in an orderly transaction between market participants at the measurement date.
10. **Trustee:** these are parties who administer separate funds in which contributions are made and out which benefits are paid. They act independently in managing fund assets regardless whether trust has been formed.
11. **Net asset available for benefits:** these are the assets of a plan less liabilities other than the actuarial present value of a promised retirement benefits.
12. **Funding:** this is the transfer of assets to an entity (the fund) separate from the employee's entity to meet future obligations for the payments of the retirement benefits.
N.B: present value of defined benefits obligation is the same with actuarial present value of promised retirement benefits.

SCOPE OF IAS 26

IAS 26 is not to applied when preparing s financial statements of employer but only applicable to the financial statements of the retirement benefit plans. That is, applicable to the financial statements of the entity that manages or administers the contributed funds. Some retirement benefit plans have sponsors other than employers and IAS 26 also applies to the financial statements of such plan. Some entity will create a separate fund for their retirement benefit plans to which contributions are made and from which retirement benefits are paid. Such separate funds may or may not have a separate legal identity, and they may or may not have appointed trustees. IAS 26 applies regardless of whether a separate fund has been established and regardless whether there are trustees.

DEFINED CONTRIBUTION PLANS

As stated earlier, these are retirement or post-employment benefit plans under which an entity pays a fixed contributions into a separate entity (a fund) and in which the entity will have no legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods. That is defined contribution plans are retirement benefit plans under which amounts to be paid as retirement benefits are determined by contributions to a fund with investment earnings on those funds.

According to IAS 26, the financial statements of a defined contribution plan should contain:

1. A statement of net assets available for benefits
2. A description of the funding policy.

Net assets available for benefits: these are the assets of a plan less liabilities other than the actuarial present value of a promised retirement benefits.

Funding: this is the transfer of assets to an entity (the fund) separate from the employer's entity to meet future obligations for the payment of retirement benefits.

These disclosure requirements are designed to address the needs of the participants of the defined contribution plans, under which the amount of a participant's future benefits is determined by the contributions paid by the employer, the participant, or both, and the operating efficiency and investment earnings of the funds.

An employer's obligation is usually discharged by contributions to the fund. An actuary's advice is not normally required although such advice is sometimes used to estimate future benefits that may be achievable based on present contributions and varying levels of the future contributions and investment earnings.

DEFINED BENEFIT PLANS

As stated earlier, these are retirement or post-employment benefit plan other than defined contribution plans. Defined benefits plans are retirement benefit plans under which amounts to be paid as retirement benefits are determined by reference to a formula which is usually based on employees' earnings and years of service.

1. A statement that shows:
 - The net assets available for benefits
 - The actuarial present value of promised retirement benefits distinguishing between vested benefits and non-vested benefits
 - The resulting excess or deficit; or
2. The statement of net assets available for benefits including either:
 - A note disclosing the actuarial present value of promised retirement benefits, distinguish between vested benefits and non- vested benefits;
 - A reference to this information in an accompanying actuarial report

MEASUREMENT OF PLAN ASSETS

IAS 26 requires that retirement benefit plan investments should be carried at fair value. In the case of marketable securities, fair value is market value

When plan investment are held for which an estimate of fair value is not possible disclosure is required of the reason why fair value is not used.

For marketable securities, fair value is usually market value because this is considered the most useful measure of the securities at the report date and of the investment performance for the period.

Those securities' that have a fixed redemption value and that have been acquired to match the obligations of the plan, or specific parts thereof, be carried at amounts based on their ultimate redemption value assuming a constant rate of return to maturity.

When plan investments are held for which an estimate of fair value is not possible, such as total ownership of an entity, disclosure is made of the reasons why fair value is not used.

DISCLOSURES

The following are some of the disclosures of IAS 26 'Requires that retirement benefit plan''

1. A summary of significant of accounting policies
2. Description of the funding policy
3. A description of the plan and the effects of any changes in the plan during the period
4. Assets at the end of the period suitably classified
5. The basis of valuation of assets
6. Details of any single investment exceeding either 5 per cent of the net assets of any class or type of security
7. Detail of any investment in the employer
8. Liabilities other than the actuarial present value of the promised retirement benefits
9. The names of the employer and the employee covered
10. The type of plan- defined contribution or defined benefit
11. A note as to whether participants contribute to the plan
12. A description of the retirement benefits promised to participants
13. A description of any plan termination terms; and
14. A statement of changes in net assets available for benefits showing the following
 - Employer contributions
 - Employee contributions
 - Investment income such as interest and dividends

- Other income
- Benefits paid or payable (analysed, for example, as retirement death and disability benefits, and lump sum payments).
- Administrative expenses
- Other expenses
- Taxes income
- Profits and losses on disposal of investments and changes in values of investments
- Transfers from and to other plans

IAS 29: FINANCIAL REPORTING IN HYPERINFLATIONARY ECONOMIES

In a hyperinflationary economy, money loses its purchasing power very quickly. Comparisons of transactions at different points in time, even within the same accounting period, are misleading. It is therefore considered inappropriate for entities to prepare financial statement without making adjustments for the fall in the purchasing power of money over time.

IAS 29 financial reporting in hyperinflationary economies applies to the primary financial statements of entities (including consolidated accounts and statements of cash flows) whose functional currency is the currency of a hyperinflationary economy. In this section, we will identify the hyperinflationary currency as \$H.

The standard does not define a hyperinflationary economy in exact terms, although it indicates the characteristics of such an economy, for example, where the cumulative inflation rate over three years approaches or exceeds 100%.

What other factors might indicate a hyperinflationary economy?

These are examples, but the list is not exhaustive.

- a) The population prefers to retain its wealth in non-monetary assets or in a relatively stable foreign currency. Amounts of local currency held are

- b) The population regards monetary amounts not in terms of the local currency but in terms of a relatively stable foreign currency. Prices may be quoted in that currency
- c) Sales/purchases on credit take place at prices that compensate for the expected loss of purchasing power during the credit period, if that period is short.
- d) Interest rates, wages and prices are linked to a price index.

The reported value of non-monetary assets, in terms of current measuring units, increases over time. For example, if a fixed asset is purchased for \$H1,000 when the price index is 100, and the price index subsequently rises to 200, the value of the asset in terms of current measuring units (ignoring accumulated depreciation) will rise to \$H2,000.

In contrast, the value of monetary assets and liabilities, such as a debt for 300 units, is unaffected by changes in the price index, because it is an actual money and the debt is still unpaid when the price index has risen to 150, the debtor still owes just \$H300. The purchasing power of monetary assets, however, will decline over time as the general level of prices goes up.

Requirement to restate financial statement in terms of measuring units current at the year end

In most countries, financial states are produced on the basis of either:

- a) Historical cost, except to the extent that some assets (e.g. property and investments) may be revalued, or
- b) Current cost, which reflects the changes in the values of specific assets held by the entity.

In a hyperinflationary economy, neither of these methods of financial reporting are meaningful unless adjustments are made for the fall in the purchasing power of money. IAS 29 therefore requires that the primary financial statements of entities in a hyperinflationary economy should be produced by restating the figures prepared on current at the year end.

Measuring unit current at the year-end date. This is a unit of local currency with a purchasing power as at the date of the statement of financial position, in terms of general price index.

Financial statements that are not restated (i.e. that are prepared on a historical cost basis of current cost basis without adjustments) may be presented as additional statements by the entity, but this is discouraged. The primary financial statements are those that have been restated.

After the assets, liabilities, equity and statement of profit or loss and other comprehensive income of the entity have been restated, there will be a net gain or loss on monetary assets and liabilities, (the net monetary position') and this should be recognised separately in profit or loss for the period.

Making the adjustments

IAS 29 recognizes that the resulting financial statements, after restating all items in terms of measuring units current at the year end, will lack precise accuracy.

However, it is more important that certain procedures and judgments should be applied consistently from year to year. The implementation guidelines to the standard suggest what these procedures should be.

Statement of financial position: historical cost

Where the entity produces its accounts on a historical cost basis, the following procedures should be applied.

- a) Items that are not already expressed in terms of measuring units current at the yearend should be restated, using a general prices index, so that they are valued in measuring units current at the year end.
- b) Monetary assets and liabilities are not restated, because they are already expressed in terms of measuring units current at the year end.
- c) Assets that are already stated at market value or net realizable value need not be restated, because they too are already valued in measuring units current at the year end.
- d) Any assets or liabilities linked by agreement to changes in the general level of price, such as indexed-linked loans or bonds, should be adjusted in accordance with the terms of the agreements to establish the amount outstanding as at the year end.

- e) All other non-monetary assets, i.e. tangible long-term assets, intangible long-term assets (including accumulated depreciation/amortization) investments and inventories, should be restated in terms of measuring units as at the year end, by applying a general prices index.

The method of restating these assets should normally be to multiply the original cost of the assets by a factor: (prices index at year end/prices index at date of acquisition of the asset). For example, if an item of machinery was purchased for \$H2,000 units when the prices index was 400 and the prices index at the year end is 1,000, the restated value of the long-term asset (before accumulated depreciation) would be:

$$\$H2,000 \times (1,000/400) = \$H5,000$$

If, in the above example, the non current asset has been held for half its useful life and has no residual value, the accumulated depreciation would be restated as \$H2,500. (The depreciation charge for the year should be the amount of depreciation based on historical cost, multiplied by the same factor as above: 1,000/400.)

If an asset has been revalued since it was originally purchased (e.g. property), it should be restated in measuring units at the year-end date by applying a factor: (prices index at year end/prices index at revaluation date) to the revalued amount of the asset.

If the restated amount of a non-monetary asset exceeds its recoverable value (i.e. its net realizable value or market value), its value should be reduced accordingly.

The owners' equity (all components) as at the start of the accounting period should be restated using a general index from the beginning of the period.

Statement of profit or loss: historical cost

In the statement of profit or loss, all amounts of income and expense should be restated in terms of measuring units current at the year end. All amount therefore needs to be restated by a factor that allows for the change in the prices index since the item of income or expense was first recorded.

Gain or loss on net monetary position

In a period of inflation, an entity that holds monetary assets (cash, receivables) will suffer a fall in the purchasing power of these assets. By the same token, in a period of inflation, the value of monetary liabilities, such as a bank overdraft or bank loan, declines in terms of current purchasing power.

- a) If an entity has an excess of monetary assets over monetary liabilities, it will suffer a loss over time on its monetary position, in a period of inflation, in terms of measuring units as at 'today' date'
- b) If an entity has an excess monetary liability over monetary assets, it will make a gain on its net monetary position, in a period of inflation.

Example: hyperinflation accounts

An entity maintains an unchanged position over time. at 1 January, when the general prices index was 100, its statement of financial position was as follows:

| | |
|------------------------|--------------|
| Asset | \$H |
| Non-monetary assets | 2,000 |
| Monetary assets | 2,000 |
| | 4,000 |
| Liabilities and equity | |
| Monetary and equity | 1,000 |
| Equity | <u>3,000</u> |
| | <u>4,000</u> |

Suppose that the general prices index rises to 150 at 31 December.

What are the adjustments required in the statement of financial position?

Prices index is 50 higher gives the following:

| | \$H |
|---------------------------------|-------|
| Assets | |
| Non-monetary assets (x 150/100) | 3,000 |
| Monetary assets | 2,000 |
| | 5,000 |
| Liabilities and equity | |
| Monetary liabilities | 1,000 |
| Equity (x150/100) | 4,500 |
| | 5,500 |

The entity has suffered a loss on its monetary position of \$H500, in terms of measuring units at the current date \$H (5,500 -5,000). This is because it has held net monetary assets of \$H1,000 during the period.

In financial statements of an entity reporting in the currency of a hyperinflationary economy, the gain or loss on the net monetary position:

- a) May be derived as the difference between total assets and total equity and liabilities, after restating the non-monetary assets, owners' equity, profit or loss items and index-linked items
or
- b) May be estimated by applying the change in the general prices index for the period to the weighted average of the net monetary position of the entity in the period.

The gain or loss on the net monetary position should be included in net income and disclosed separately. (Any adjustment that was made to index-linked items can be set off against this net monetary gain or loss).

Current cost accounts: restating the accounts

A similar procedure is required to restate the accounts of an entity that prepares its account using a current cost basis.

- a) Item stated in the statement of financial position at current cost do not need to be restated. Other items should be restated in the same way as for adjusted accounts prepared on a historical cost basis.
- b) In the statement of profit or loss, cost of sales and depreciation are generally reported at current at the time of consumption and sales and other expenses at money amounts at the time they occurred. These items will need to be restated in terms of measuring units as at the year-end by making a prices index adjustment.
- c) There will be a gain or loss on the net monetary position, which will be established in the same way as for accounts based on historical cost.

Economies ceasing to be hyperinflationary economies

When an economy ceases to be a hyperinflationary economy, entities reporting in the currency of the economy are no longer required to produce financial statements in compliance with IAS 29.

Suppose for example that in 20x4 an entity reports in compliance with IAS 29, but in 20x5 it reverts to historical cost accounts reporting, the entity should use the amounts expressed in terms of measuring units as at the end of 20x4 as the basis for its carrying amounts in 20x5 and subsequent years.

Disclosures

IAS 29 calls for the following disclosures.

- The fact that the financial statements have been restated for the changes in general purchasing power.
- Whether the financial statements as shown are based on historical cost or current cost.
- The identity of prices index used to make the restatements, its level at the year end the movement in the index during the current and the previous reporting periods.

In financial statements prepared under IAS 29, corresponding figures for the previous year should be restated using the general prices index.

Hyperinflation and changes in foreign exchange rates

IAS 21 The effects of changes in foreign exchange rates covered earlier. A present may have a foreign operation whose functional currency is the currency of a hyperinflationary economy. When the parent prepares consolidated financial statements, it should:

- a) Restate the financial statements of the foreign operation in accordance with IAS 29; before
- b) Translating all amounts from the foreign operation's functional currency to the presentation currency at the closing rate.

The following example is a simple illustration of the problems that can arise where a foreign subsidiary operates in a hyperinflationary economy.

Example: Disappearing assets'

A company has a subsidiary in a country which suffers from hyperinflation. On 31 December 20x2 the subsidiary acquired freehold land for \$H1,000,000. At that date the exchange rate was \$H10-\$1 and the price index were 300.

At what value will the freehold land be included in the consolidated financial statements of the parent at 31 December 20x3 if the subsidiary's financial statements:

- a) Are not restated to reflect current price levels;
- b) Are restated to reflect current price level?
- a) Without restatement: Assuming that the subsidiary has a different functional currency (\$H) from that of its parent (\$) the statement of financial position is translated at the closing rate.

At 31 December 20x2 (the date of purchase) it was stated at \$250,000 (\$H1,000,000 @ 4). Therefore, there has been an exchange loss of \$150,000 (which may significantly reduce equity) and the land appears to have fallen to only 40% of its original value.

b) With restatement: At 31 December 20x3 the land is included at \$300,000 ($\$1,000,000 \times 300/100 @ 10$).

The value the land is now adjusted so that it reflects the effect of inflation over the year and the disappearing assets' problem is overcome.

Where the financial statement of an entity whose functional currency is that of a hyperinflationary economy are translated into a different presentation currency, comparative amounts should be those that were presented as current year amounts in the relevant prior year financial statements (i.e. not adjusted for subsequent changes in the price level or subsequent changes in exchange rates).

3.05 IAS 32: Financial instruments: presentation

The objective of IAS 32 is:

To enhance financial statement users' understanding of the significance of on- balance sheet and off- balance sheet financial instrument to an entity's financial, position and cash flows.'

IAS 32 should be applied in the presentation of all types of financial instruments, whether recognized or unrecognized

Certain items are excluded.

- * Interests in subsidiaries (IFRS 10)
- * Interest in associates (IAS 20)
- * Interest in joint ventures (IFRS 11)
- * Pensions and other post-retirement benefit (IAS 19)
- * Insurance contracts
- * Contracts for contingent consideration in a business combination
- * Contract that require a payment based on climatic, geological or other physical variables

- * Financial instruments, contracts and obligation under share-based payment transaction (IFRS 2)

Liability and equity

The main thrust of IAS 32 here is that financial instrument should be presented according to their substance, not merely their legal form. In particular, entities which issue financial instrument should classify them (or their component parts) as either financial liabilities, or equity.

The classification of a financial instrument as a liability or as equity depends on the following

- * The substance of the contractual arrangement on initial recognition
- * The identification of a financial liability and an equity instrument

How should a financial liability be distinguished from an equity instrument? The critical feature of a liability is an obligation to transfer economic benefit. Therefore, a financial instrument is a financial liability if there is a critical obligation on the issuer either to deliver cash or another financial asset to the holder or to exchange another financial instrument with the holder under potentially unfavorable condition to the issuer. The financial liability exists regardless of the way in which the contractual obligation will be settled. The issuer's ability to satisfy an obligation may be restricted, e.g. by lack of access to foreign currency, but this is irrelevant as it does not remove the issuer's obligation or the holder's right under the instrument.

Where the above critical feature is not met, then the financial instrument is an equity instrument. IAS 32 explains that although the holder of equity, the issuer does not have a contracted obligation to make such a distribution.

Although substance and legal form are often consistent with each other, this is not always the case. In particular, a financial instrument may have the legal form of equity, but in substance it is in fact a liability. Other instruments may combine features of both equity instruments and financial liabilities.

For example, many entities issue preference shares which must be redeemed by the issuer for a fixed (or determinable) amount at a fixed (or determinable) future date. Alternatively, the holder may have

the right to require the issuer to redeem the shares at or after a certain date for a fixed amount. In such cases, the issuer has an obligation. Therefore, the instrument is a financial liability and should be classified as such.

The classification of the financial instrument is made when it is first recognized and this classification will continue until the financial instrument is removed from the entity statement of financial position.

Contingent settlement provisions

An entity may issue financial instrument where the way in which it is settled depend on:

- (a) The occurrence or non-occurrence of uncertain future events, or
- (b) The outcome of uncertain circumstances,

That are beyond the control of both the holder and the issuer of the instrument for example, an entity might have to deliver cash instead of issuing equity share. In this situation it is not immediately clear weather the entity has equity instrument or financial liability. Such as financial instruction should be classified as financial liabilities unless the possibility of settlement is remote.

Settlement options

When a derivate financial instrument gives one party a choice over how it is settled (e.g. the issuer can choose weather can choose weather settle in cash or by issuing shares) the instrument is a financial liability unless all the alternative choices would result in it being an equity instrument.

Compound financial instruments

Some financial instrument both a liability and an equity element. In such cases, IAS 32 requires the component part of the instrument to be classified separately, according to the substance of the contractual arrangement and the definition of a financial liability and an equity instrument.

One of the most common type of compound instrument is convertible debt. This creates a primary financial liability of issuer and grants and option to the holder f the instrument convert it into an equity instrument (usually ordinary share) of the warrant to acquire share in the future.

Although in theory these are several possible ways of calculating the split, the following method is recommended by IAS 32:

- a) Calculate the value for the liability component.
- b) Deduct this from the instrument as a whole to leave a residual value for equity component

The reason behind this approach is that an entity's equity is its residual interest in its assets amount after deducting all its liabilities.

The sum of the carrying amount assigned to liability equity will always be equal to the carrying amount that would be ascribe to instrument as whole

Example: valuation of compound instruments

Z co issues 2,000 convertible bonds at the start of 20x2. The bonds have a three-year term, and are issued at par with a face value of \$1,000 per bond, giving total proceeds of \$2,000,000. Interest is payable annually in arrears at a nominal annual interest rate of 6%. Each bond is convertible at any time up to maturity into 250 common shares.

When the bonds are issued, the prevailing market interest rate for similar debt without conversion option is 9%. At the issue date, the market price of one common share is \$3. The dividends excepted

over the three-year term of bonds amount to 14c per share at the end of each year. The risk-free annual interest rate for a three-year term is 5%.

What is the value of the equity component in bond?

The liability component is valued first, and the difference between the proceeds of the bond issue and the fair value of the liability is assigned to the equity component. The present value of the liability component is calculated using a discount rate of 9%, the market interest rate for similar bonds having no conversion rights, as

| | \$ |
|---|------------------|
| Present value of the principal: \$2,000,000 payable at the end of three years | |
| (\$2m x 0.772)* | 1,544,000 |
| Present value of the interest: \$120,000 payable annually in arrears for | |
| three years (\$120,000 x 2.531)* | 303,720 |
| Total liability component | <u>1,847,720</u> |
| Equity component (balancing figure) | <u>152,280</u> |
| Proceeds of the bonds issue | <u>2,000,000</u> |

- These figures can be obtained from discount and annuity tables

The split between the liability and equity components remains the same throughout the term of the instrument, even if there are changes in the likelihood of the option being exercised. This is because it is not always possible to predict how a holder will behave. The issuer continues to have an obligation to make future payment until conversion, maturity of the instrument or some other relevant transaction takes place.

Treasury shares

If an entity reacquires its own equity instruments, those instruments ('treasury shares') shall be deducted from equity. No gain or loss shall be recognized on profit or loss on the purchase, sale, issue or cancellation of an entity's own equity instruments. Consideration paid or received shall be recognized in other comprehensive income.

Interest, dividends, losses and gains

As well as looking at statement of financial position presentation, IAS 32 considers how financial instruments affect the profit or loss (and movements in equity). The treatment varies according to whether interest, dividends, losses or gains relate to financial liability or an equity instrument.

- (a) Interest, dividends, losses and gains relating to a financial instrument (or component part) classified as a financial liability should be recognized as income or expense in profit or loss.
- (b) Distributions to holders of a financial instrument classified as an equity instrument should be debited directly to equity by the issuer.
- (c) Transaction costs of an equity transaction shall be accounted for as a deduction from equity (unless they are directly attributable to the acquisition of a business, in which case they are accounted for under IFRS 3).

Offsetting a financial asset and a financial liability

A financial asset and financial liability should only be offset, with the net amount reported in the statement of financial position, when an entity:

- a) Has a legally enforceable right of set off, and
- b) Intends to settle on a net basis, or to realize the asset and settle the liability simultaneously, i.e. at the same moment.

This will reflect the expected future cash flows of the entity in these specific circumstances. In all other cases, financial assets and financial liabilities are presented separately.

Amendment to IAS 32: Puttable financial instruments and obligations arising on liquidation

This amendment was issued in February 2008. The changes deal with puttable financial instrument and the effect obligations that arise on liquidation have on determining whether an instrument is debt or equity.

IAS 32 requires that if the holder of a financial instrument can require the issuer to redeem it for cash it should be classified as a liability. Some ordinary shares and partnership interests allow the holder to 'put' the instrument (that is to require the issuer to redeem it in cash). Such shares might more usually be considered as equity, but application of IAS 32 results in their being classified as liabilities.

The amendment would require entities to classify such instrument as equity, so long as they meet certain conditions. The amendment further requires that instruments imposing an obligation on an entity to deliver to another party a pro rata share of the net assets only liquidation should be classified as equity.

3 Recognition of financial instruments

IFRS 9 applies to all entities and to all types of financial instruments except those specifically excluded, as listed below.

- a) Investments in subsidiaries, associates, and joint ventures that are accounted for under IFRS 10, 11 and 12.
- b) Lease covered in IAS 17
- c) Employee benefit plans covered in IAS 19.
- d) Insurance contracts
- e) Equity instruments issued by the entity e.g. ordinary shares issued, or options and warrants
- f) Financial guarantee contracts
- g) Contracts for contingent consideration in a business combination, covered in IFRS 3
- h) Contract requiring payment based on climatic, geological or other physical variables.

- i) Loan commitment that cannot be settled net in cash or another financial instrument
- j) Financial instruments, contract and obligations under share based payment transactions, covered in IFRS 2

Initial recognition

Financial instruments should be recognised in the statement of financial position when the entity becomes a party to the contractual provisions of the instrument.

Notice that this is different from the recognition criteria in the conceptual framework and in most other standards. Items are normally recognised when there is a probable inflow or outflow of resources and the item has a cost or value that are

Example: initial recognition

An entity has entered into two separated contracts.

- a) A firm commitment (an order) to buy a specific quantity of iron.
- b) A soft ward contract to buy a specific quantity of iron at a specified price on a specified date, provided delivery of the iron is not taken.

Contract (a) is a normal trading contract. The entity does not recognise a liability for the iron until the goods have actually been delivered. (Note that this contract is not financial instrument because it involves a physical asset, rather than a financial asset).

Contract (b) is a financial instrument. Under IFRS 9, the entity recognizes a financial liability (an obligation to deliver cash) on the commitment date, rather than waiting for the closing date on which the exchange takes place.

Note that planned future transactions, no matter how likely, are not assets and liabilities of an entity- the entity has not yet become a party to the contract.

Derecognition

Derecognition is the removal of a previously recognised financial instrument from an entity’s statement of financial position.

An entity should derecognize a financial asset when:

- a) The contractual rights to the cash flows from the financial asset expire, or
- b) The entity transfers substantially all the risks and rewards of ownership of the financial asset to another party.

An entity should derecognize a financial liability when it is extinguished- i.e. when the obligation specified in the contract is discharged or cancelled or expires.

It is possible for only part of a financial asset or liability to be derecognized. This is allowed if the part comprises.

- a) Only specifically identified cash flows; or
- b) Only a fully proportionate (pro rata) share of the total cash flows.

For example, if an entity holds a bond it has the right to two separate sets of cash inflows: those relating to the principal and those relating to the interest. It could sell the right to receive the interest to another party while retaining the right to receive the principal.

On derecognition, the amount to be included in net profit or loss for the period is calculated as follows:

| | | |
|--|----------|-----|
| | \$ | \$ |
| Carrying amount of asset/liability (or the portion of asset/liability) transferred | | X |
| Less: proceeds received/paid | X | |
| Any cumulative gain loss reported in equity | <u>X</u> | |
| | | (x) |

Where only part of a financial asset is derecognized, the carrying amount of the asset should be allocated between the part retained and the part transferred based on their relative fair values on the date of transfer. A gain or loss should be recognised based on the proceeds for the portion transferred.

Classification of financial assets

On recognition, IFRS 9 requires that financial assets are classified as measured at either:

- Amortized cost, or
- Fair value

The IFRS 9 classification is made on the basis of both:

- a) The entity's business model for managing the financial assets, and
- b) The contractual cash flow characteristics of the financial asset.

A financial asset is classified as measured at amortised cost where:

- a) The objective of the business model within which the asset is held is to hold assets in order to collect contractual cash flows and
- b) The contractual terms of financial asset give rise on specific dates to cash flows that are solely payments of principal outstanding.

An application of these rules means that equity investments may not be classified as measured at amortised cost and must be measured at fair value. This is because contractual cash flows on specified dates are not a characteristic of equity instruments. In addition, all derivatives are measured at fair value.

A debt instrument may be classified as measured at either amortised cost or fair value depending on whether it meets the criteria above. Even where the criteria are met at initial recognition, a debt instrument may be classified as measured at fair value through profit or loss if doing so eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as an

‘accounting mismatch’) that would otherwise arise from measuring assets or liabilities or recognizing the gains and losses on them on different bases.

Business model test in more detail

IFRS 9 introduces a business model test that requires an entity to assess **whether its business objective for a debt instrument is to collect the contractual cash flows of the instrument as opposed to realizing its fair value change from sale prior to its contractual maturity**. Note the following key points:

- a) The assessment of a ‘business model’ is not made at an individual financial instrument level
- b) The assessment is based on how key management personnel actually manage the business, rather than management’s intentions for specific financial assets.
- c) An entity may have more than one model for managing its financial assets and the classification need not to be determined at the reporting entity level. For example, it may have one portfolio of investments that is managed with the objective of collecting contractual cash flows and another portfolio of investments held with the objective of trading to realize changes in fair value. It would be appropriate for entities like these to carry out the assessment for classification purposes at portfolio level, rather than at entity level.
- d) Although the objective of an entity’s business model may be to hold financial asset in order to collect contractual cash flows, the entity need not hold all of those assets until maturity. Thus an entity’s business model can be to hold financial assets to collect contractual cash flows even when sales of financial assets occur.

Business model test: examples

The following examples, from the Application Guidance to IFRS 9, are of situations where the objective of an entity’s business model may be to hold financial assets to collect the contractual cash flows.

Example 1

An entity holds investments to collect their contractual cash flows but would sell an investment in particular circumstances, perhaps to fund capital expenditure, or because the credit rating of the instrument falls below that required by the entity's investment policy.

Analysis

Although an entity may consider, among other information, the financial assets' fair values from a liquidity perspective (i.e. the cash amount that would be realized if the entity needs to sell assets), the entity's objective is to hold the financial assets and collect the contractual cash flows. Some sales would not contradict that objective. If sales became frequent, the entity might be required to consider whether the sales were consistent with an objective of collecting contractual cash flows.

Example 2

An entity has a business model with the objective of originating loans to customers and subsequently to sell those loans to a securitization vehicle. The securitization vehicle issues instruments to investors.

The originating entity controls the securitization vehicle and thus consolidates it. The securitization vehicle collects the contractual cash flows from the loans and passes them on to its investors in the vehicle.

It is assumed for the purposes of this example that the loans continue to be recognised in the consolidated statement of financial position because they are not derecognized by the securitization vehicle.

Analysis

The consolidated group originated the loan with the objective of holding them to collect the contractual cash flows.

However, the originating entity has no objective of realizing cash flows on the loan portfolio by selling the loans to the securitization vehicle, so for the purpose of its separate financial statement it would not be considered to be managing this portfolio in order to collect the contractual cash flows.

Example 3

An entity's business model is to purchase portfolios of financial assets, such as loans. Those portfolios may or may not include financial assets with incurred credit losses. If payment on the loans is not made on a timely basis, the entity attempts to extract the contractual cash flows through various means—for example, by contacting the debtor through mail, telephone, etc.

In some cases, the entity enters into interest rate swaps to change the interest rate on particular financial assets in a portfolio from a floating interest rate to a fixed interest rate.

Analysis

The objective of the entity's business model is to hold the financial assets and collect the contractual cash flows. The entity does not purchase the portfolio to make a profit by selling them.

The same analysis would apply even if the entity does not expect to receive all of the contractual cash flows (e.g. some of the financial assets have incurred credit losses).

Moreover, the fact that the entity has entered into derivatives to modify the cash flows of the portfolio does not in itself change the entity's business model. If the portfolio is not managed on a fair value basis, the objective of the business model could be to hold the asset to collect the contractual cash flows.

Contractual cash flow test in more detail

The requirement in IFRS 9 to assess the contractual cash flow characteristics of a financial asset is based on the concept that only instruments with contractual cash flows of principal and interest on principal may qualify for amortised cost measurement.

By interest, IFRS 9 means consideration for the time value of money and the credit risk associated with the principal outstanding during a particular period of time.

Measurement at amortised cost is permitted when the cash flows on a loan are entirely fixed (e.g. a fixed interest rate loan or zero-coupon bond), or where interest is floating (e.g. GBP loan where interest is LIBOR plus a fixed spread).

Examples of instruments that pass the contractual cash flows test

The following instruments satisfy the IFRS 9 criteria

- a) A variable rate instrument with a stated maturity date that permits the borrower to choose to pay three-month LIBOR for a three-month term or one-month LIBOR for a one-month term
- b) A fixed term variable market interest rate bond where the variable interest rate is capped
- c) A fixed term bond where the payments of principal and interest are linked to an unleveraged inflation index of the currency in which the instrument is issued

Example of instruments that do not pass the contractual cash flows test

The following instruments do not satisfy the IFRS 9 criteria

- a) A bond that is convertible into equity instruments of the issuer (see question above)
- b) A loan that pays an inverse floating interest rate (e.g. 8% minus LIBOR)

Note that the IFRS 9 requirement to classify financial assets on recognition as one of two types is a significant simplification of the previous IAS 39 rules. These required financial assets to be classified as one of four types, being:

- At fair value through profit or loss
- Held to maturity
- Available for sale, and
- Loans and receivable

Classification of financial liabilities

On recognition, IFRS 9 requires that financial liabilities are classified as measured at either:

- a) At fair value through profit or loss, or
- b) Financial liabilities at amortised cost

A financial liability is classified at fair value through profit or loss if:

- a) It is held for trading, or
- b) Upon initial recognition it is designated at fair value through profit or loss.

Derivatives are always measured at fair value through profit or loss.

These classification rules are unchanged from those previously contained within IAS 39.

Re-classification of financial assets

Although on initial recognition financial instruments must be classified in accordance with the requirements of IFRS 9, in some cases they may be subsequently reclassified.

IFRS 9 requires that when an entity changes its business model for managing financial assets, it should reclassify all affected financial assets. This reclassification applies only to debt instruments, as equity instruments must be classified as measured at fair value.

The application guidance to IFRS 9 includes examples of circumstances when a reclassification is required or is not permitted.

Examples: Reclassification permitted

Reclassification is permitted in the following circumstances, because a change in the business model has taken place:

- a) An entity has a portfolio of commercial loans that is held to sell in the short term. The entity acquires a company that manages commercial loans and has a business model that holds the loans in order to collect the contractual cash flows. The portfolio of commercial loans is no longer for sale, and the portfolio is now managed together with the acquired commercial loans and all are held to collect the contractual cash flows.
- b) A financial services firm decides to shut down its retail mortgage business. That business no longer accepts new business and the financial services firm is actively marketing its mortgage loan portfolio for sale.

Examples: Reclassification not permitted

Reclassification is not permitted in the following circumstances, because a change in the business model has not taken place.

- a) A change in intention related to particular financial assets (even in circumstances of significant changes in market conditions)
- b) A temporary disappearance of a particular market for financial assets
- c) A transfer of financial assets between parts of the entity with different business models.

Reclassification of financial liabilities is not permitted

4. Measurement of financial instruments

Initial measurement: financial assets

Financial instruments are initially measured at the transaction price, that is the fair value of the consideration given.

An exception is where part of the consideration given is for something other than the financial asset. In this case the financial asset is initially measured at fair value evidence by a quoted price in an active market for an identical asset (i.e. and IFRS 13 level 1 input) or based on a valuation technique that uses only data from observable markets the difference between the fair value at initial recognition and the transaction price is recognised as a gain or loss.

In the case of financial assets classified as measured at amortised cost, transaction costs directly attributable to the acquisition of the financial asset are added to this amount.

Initial measuring: financial liabilities

IFRS 9 requires that financial liabilities are initially measured at transaction price, i.e. the fair value of consideration received except where part of the consideration received is for something other than the financial liability. In this case the financial liability is initially measured at fair value determined as for financial assets (see above). Transaction costs are deducted from this amount for financial liabilities classified as measured at amortised cost.

Subsequent measurement of financial assets

Under IFRS 9, financial assets are measured subsequent to recognition either at:

- At amortized cost, using the effective interest method, or
- At fair value

Financial assets measured at amortised cost

Amortized cost of a financial asset or financial liability is the amount at which the financial asset or liability is measured at initial recognition minus principal repayments, plus or minus the cumulative amortization of any difference between that initial amount and the maturity amount, and minus any write-down (directly or through the use of an allowance account) for impairment or uncollectability.

The effective interest method is a method of calculating the amortised cost of a financial instrument and of allocating the interest income or interest expense over the relevant period.

The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument to the net carrying amount of the financial asset or liability.

Example: financial asset at amortized cost

On 1 January 20x1 Abacus Co purchases a debt instrument for its fair value of \$1,000. The debt instrument is due to mature on 31 December 20x5. The instrument has a principal amount of \$1,250 and the instrument carries fixed interest at 4.72% that is paid annually. (The effective rate is 10%).

How should Abacus Co account for the debt instrument over its five-year term?

Solution

Abacus Co will receive interest of \$59 ($1,250 \times 4.72\%$) each year and \$1,250 when the instrument matures.

Abacus must allocate the discount of \$250 and the interest receivable over the five-year term at a consistent rate on the carrying amount of the debt. To do this, it must apply the effective interest rate of 10%.

The following table shows the allocation over years:

| Year | Amortized cost at beginning of year | Profit or loss: interest income for year @ 10% | Interest received during year (cash inflow) | Amortized cost at end of year |
|------|-------------------------------------|--|---|-------------------------------|
| | N | N | N | N |
| 20x1 | 1,000 | 100 | (59) | 1,041 |
| 20x2 | 1,041 | 104 | (59) | 1,086 |
| 20x3 | 1,086 | 109 | (59) | 1,136 |
| 20x4 | 1,136 | 113 | (59) | 1,190 |
| 20x5 | 1,190 | 119 | (1,250 +59) | 1,190 |

Each year the carrying amount of the financial asset is increased by the interest income for the year and reduced by the interest actually received during the year.

Investments whose fair value cannot be reliably measured should be measured at cost.

Financial assets measured at fair value

Where a financial asset is classified as measured at fair value, fair value is established at each period end in accordance with IFRS 13 fair value measurement. That standard requires that a fair value hierarchy is applied with three levels of input:

Level 1 input: Unadjusted quoted prices in active market for identical assets or liabilities that the entity can access at the measurement date.

Level 2 inputs: Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly or indirectly. These may include quoted prices for similar assets or liabilities in active markets or quoted price for identical or similar assets and liabilities in markets that are not active.

Level 3 inputs: Unobservable inputs for the asset or liability.

Any changes in fair value are normally recognised in profit or loss.

There are two exceptions to this rule:

- a) The asset is part of a hedging relationship (see section 6)
- b) The financial asset is an investment in an equity instrument not held for trading. In this case the entity can make an irrevocable election to recognise changes in the fair value in other comprehensive income.

Example: Asset measurement

On 8 February 20x8 Orange Co acquires a quoted investment in the shares of Lemon Co with the intention of holding it in the long term. The investment cost \$850,000. At Orange Co's year end of 31 March 20x8, the market price of an identical investment is \$900,000. How is the asset initially and subsequently measured?

Orange Co has elected to recognise changes in the fair value of the equity investment in other comprehensive income.

Solution

- The asset is initially recognised at the fair value of the consideration, being \$850,000
- At the period end it is remeasured to \$900,000
- This results in the recognition of \$50,000 in other comprehensive income

Subsequent measurement of financial liabilities

After initial recognition, all financial liabilities should be measured at amortized cost, with the exception of financial liabilities at fair value through profit or loss (including most derivatives). These should be measured at fair value, but where the fair value is not capable of reliable measurement, they should be measured at cost.

Financial liabilities measured at amortized cost

The definitions of amortized cost, effective interest method and effective interest rate that are used for measurement of financial assets are also used for financial liabilities.

Example: financial liability at amortized cost

B Co issues a bond for \$503,778 on 1 January 20x2. No interest is payable on the bond, but it will be redeemed on 31 December 20x4 for \$600,000. The effective interest rate of the bond is 6%.

Required

Calculate the charge to profit or loss of B Co for the year ended 31 December 20x2 and the balance outstanding at 31 December 20x2.

Solution

The bond is a deep discount' bond and is a financial liability of B Co. it is measured at amortized cost. Although there is no interest as such, the difference between the initial cost of the bond and the price at which it will be redeemed is a finance cost. This must be allocated over the term of the bond at a constant rate on the carrying amount.

The effective interest is 6%

The change to profit or loss for the year is \$30,226 ($503,778 \times 6\%$)

The balance outstanding at 31 December 20x2 is \$534,004 ($503,778 + 30,226$).

Financial liabilities at fair value through profit or loss

Financial liabilities which are held for trading are remeasured to fair value each year in accordance with IFRS 13 Fair value measurement with any gain or loss recognised in profit or loss.

Exceptions

The exceptions to the above treatment of financial liabilities are:

- a) It is part of a hedging arrangement (see section 6)
- b) It is a financial liability designated as at fair value through profit or loss and the entity is required to present the effects of changes in the liability's credit risk in other comprehensive income.

Credit risk

IFRS 9 requires that financial liabilities which are designated as measured at fair value through profit or loss are treated differently. In this case the gain or loss in a period must be classified into:

- Gain or loss resulting from credit risk, and
- Other gain or loss.

This change to IFRS 9 was made in 2010 in response to an anomaly regarding changes in the credit risk of a financial liability.

Changes in a financial liability's credit risk affect the fair value of that financial liability. This means that when an entity's creditworthiness deteriorates, the fair value of its issued debt will decrease (and vice versa). For financial liabilities measured using the fair value option, this causes a gain (or loss) to be recognised in profit or loss for the year. For example:

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME (EXTRACT)

Profit or loss for the year:

N'000

Liabilities at fair value (except derivatives and liabilities held for trading):

| | |
|----------------------------|------------|
| Change in fair value | 100 |
| Profit (loss) for the year | <u>100</u> |

Many users of financial statement found this result to be counter-intuitive and confusing. Accordingly, IFRS 9 requires the gain or loss as a result of credit risk to be recognised in other comprehensive income, unless it creates or enlarges an accounting mismatch (see below), in which case it is recognised in profit or loss. The other gain or loss (not the result of credit risk) is recognised in profit or loss.

On derecognition any gains or losses recognised in other comprehensive income are not transferred to profit or loss, although the cumulative gain or loss may be transferred with equity.

Example of IFRS 9 presentation

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME (EXTRACT)

| | N'000 |
|--|--------------|
| Profit or loss for year: | |
| Liabilities at fair value (except derivatives and liabilities held for trading): | |
| Change in fair value from own credit | 90 |
| Profit (loss) for the year | 90 |

Accounting mismatch

The new guidance allows the recognition of the full amount of change in the fair value in the profit or loss only if the recognition of changes in the liability's credit risk in other comprehensive income would create or enlarge an accounting mismatch in profit or loss. That determination is made at initial recognition and is not reassessed

3.06 IAS 36: Impairment of assets

There is an established principle that assets should not be carried at more than their recoverable amount. An entity should write down the carrying value of an asset to its recoverable amount if the carrying value of an asset is not recoverable in full. IAS 36 Financial instruments: Presentation. This is because those IASs already have rules for recognizing and measuring impairment. Note also that IAS 36 does not apply to non-current assets held for sale, which are dealt with under IFRS 5 non-current assets held for sale and discontinued operations.

Impairment: a fall in the value of an asset, so that its 'recoverable amount' is now less than its carrying amount in the statement of financial position.

Carrying amount: is the net value at which the asset is included in the statement of financial position (i.e. after deducting accumulated depreciation and any impairment losses).

The basic principle underlying IAS 36 is relatively straightforward. If an asset's value in the accounts is higher than its realistic value, measured as its 'recoverable amount', the asset is judged to have suffered an impairment loss. It should therefore be reduced in value, by the amount of the impairment loss. The amount of the impairment loss should be written off against profit immediately.

The main accounting issues to consider are therefore as follows:

- a) How is it possible to identify when an impairment loss may have occurred?
- b) How should the recoverable amount of the asset be measured?

- c) How should an 'impairment loss' be reported in the accounts?

Identifying a potentially impaired asset

An entity should assess at each year end whether there are any indications of impairment to any assets. The concept of materiality applies, and only material impairment needs to be identified.

If there are indications of possible impairment, the entity is required to make a formal estimate of the recoverable amount of the assets concerned.

IAS 36 suggests how indications of a possible impairment of assets might be recognised. The suggestions are based largely on common sense.

- a) External source of information
- i. A fall in the asset's market value that is more significant than would normally be expected from passage of time over normal use.
 - ii. A significant change in the technological, market, legal or economic environment of the business in which the assets are employed.
 - iii. An increase in market interest rates or market rate of return on investments likely to affect the discount rate used in calculating value in use.
 - iv. The carrying amount of the entity's net assets being more than its market capitalization.
- b) Internal sources of information: evidence of obsolescence of physical damage, adverse changes in the use to which the asset is put, or the asset's economic performance.

Even if there are no indications of impairment, the following assets must always be tested for impairment annually.

- a) An intangible asset with an indefinite useful life
- b) Goodwill acquired in a business combination

Measuring the recoverable amount of the asset

What is an asset's recoverable amount?

The recoverable amount of an asset should be measured as the higher value of:

- a) The asset's fair value less costs of disposal; and
- b) Its value in use.

An asset's fair value less costs to sell is the amount net of selling costs that could be obtained from the sale of the asset. Selling costs include sales transaction costs, such as legal expenses.

- a) If there is an active market in the asset, the net selling price should be based on the market value, or on the price of recent transactions in similar assets.
- b) If there is no active market in the assets it might be possible to estimate a net selling price using best estimates of what 'market participants might pay in an orderly transaction.

Net selling price cannot be reduced, however, by including within selling costs any restructuring or reorganization expenses, or any costs that have already been the concept of 'value in use' is very important.

The value in use of an asset is measured as the present value of estimated future cash flows (inflows minus outflows) generated by the generated by the asset, including its estimated net disposal value (if any) at the end of its expected useful life.

The cash flows used in the calculation should be pre-tax cash flows and a pre-tax discount rate should be applied to calculate the present value.

The calculation of value in use must reflect the following:

- a) An estimate of the future cash flows the entity expects to derive from the asset.
- b) Expectations about possible variations in the amount and timing of future cash flows
- c) The time value of money
- d) The price for bearing the uncertainty inherent in the asset, and
- e) Other factors that would be reflected in pricing future cash flows from the asset.

Calculating a value in use therefore calls for estimates of future cash flows, and the possibility exists that an entity might come up with over-optimistic estimates of cash flows. The IAS therefore states the following.

- a) Cash flow projections should be based on 'reasonable and supportable assumptions.
- b) Projections of cash flows, normally up to a maximum period of five years, should be based on the most recent budgets or financial forecasts.
- c) Cash flow projections beyond this period should be obtained by extrapolating short-term projections, using either a steady or declining growth rate for each subsequent year (unless a rising growth rate can be justified). The long-term growth rate applied should not exceed the average long-term growth rate for the product, market, industry or country, unless a higher growth rate can be justified.

Composition of estimates of future cash flows

These should include the following:

- a) Projections of cash inflows from continuing use of the asset
- b) Projections of cash outflows necessarily incurred to generate the cash inflows from continuing use of the asset
- c) Net cash flows received/paid on disposal of the asset at the end of its useful life.

There is an underlying principle that future cash flows should be estimated for the asset in its current condition. Future cash flows relating to restructurings to which the entity is not yet committed, or to future costs to add to, replace part of, or service the asset are excluded.

Estimates of future cash flows should exclude the following:

- a) Cash inflows/outflows from financing activities
- b) Income tax receipts/payments

The amount of net cash inflow/outflow on disposal of an asset should assume an orderly transaction.

Foreign currency future cash flows: should be forecast in the currency in which they will arise and will be discounted using a rate appropriate for the currency. The resulting figure should then be translated into the reporting currency at the spot rate at the end of the reporting period.

The discount rate should be a current pre-tax rate (or rates) that reflect the current assessment of the time value of money and the risks specific to the asset. The discount rate should not include a risk weighting if the underlying cash flows have already been adjusted for risk.

Recognition and measurement of an impairment loss

The rule for assets at historical cost is:

If the recoverable amount of an asset is lower than the carrying amount, the carrying amount should be reduced by the difference (i.e. the impairment loss) which should be charged as an expense in profit loss.

The rule for assets held at a revalued amount (such as property revalued under IAS 16) is:

The impairment loss is to be treated as a revaluation decrease under the relevant IAS.

In practice this means:

- To the extent that there is a revaluation surplus held in respect of the asset, the impairment loss should be charged to revaluation surplus.
- Any excess should be charged to profit or loss.

If it is not possible to calculate the recoverable amount for an individual asset, the recoverable amount of the asset's cash generating unit should be measured instead.

A cash generating unit is the smallest identifiable group of assets for which independent cash flows can be identified and measured.

How would a cash generating unit be identified?

Here are two possibilities.

- a) A mining company owns a private railway that it uses to transport output from one of its mines. The railway now has no market value other than as scrap, and it is impossible to identify any separate cash inflows with the use of the railway itself. Consequently, if the mining company

suspects an impairment in the value of the railway, it should treat the mine as a whole as a cash generating unit, and measure the recoverable amount of the mine as a whole.

- b) A bus company an agreement with a town's authorities to run a bus service on four routes in the town. Separately identifiable assets are allocated to each of the bus routes, and cash inflow and outflow can be attributing to each individual route. Three routes are running at a profit and one is running at a loss. The bus company suspects that there is an impairment asset on the loss-making route, because it is under an obligation to operate all four routes, as part of its contract with the local authorities. Consequently, the company should treat all four routes together as cash generating unit, and calculate the recoverable amount for the unit as a whole.

If an active market exists for the output produced by the asset or a group of assets, this asset or group should identify as a cash generating unit, even if some or all of the output is used internally.

Cash generating units should be identified consistently from period to period for the same type of asset unless a change is justified.

The group of net assets less liabilities that are considered for impairment should be the same as those considered in the calculation of the recoverable amount.

Goodwill and the impairment of assets

Goodwill acquired in a business combination does not generate cash flows independently of other assets. It must be **allocated** to each of the acquirer's **cash generating units** (or group of cash-generating units) that are excepted to benefit from the synergies of the combination. Each unit to which the goodwill is so allocated should:

- (a) Represent the lowest level within the entity at which the goodwill is monitored for internal management purposes
- (b) Not be larger than a reporting segment determined in accordance with IFRS 8 operating segment It may be impractical to complete the allocation of goodwill before the first reporting date after a business combination, particularly if the acquirer is accounting for the combination for the first

time using provisional values. The initial allocation of goodwill must be completed before the end of the first reporting period after the acquisition date.

There are two situations to consider.

- (a) Where goodwill has been allocated to a cash-generating unit
- (b) Where it has not been possible to allocate goodwill to a specific cash-generating unit, but only to a group of units

A cash-generating unit to which goodwill has been allocated is tested for impairment annually. The carrying amount of unit, including goodwill, is compared with the recoverable amount. The entity must recognise an impairment loss.

Where goodwill relates to a cash-generating unit but has not been allocated to that unit, the unit is tested for impairment by comparing its carrying amount (excluding goodwill) with its recoverable amount. The entity must recognise an impairment loss if the carrying amount exceeds the recoverable amount.

The annual impairment test may be performed at any time during an accounting period, but must be performed at the same time every year.

Corporate assets

Corporate assets are group or divisional assets such as head office building, computer equipment or a research centre. Essentially, corporate assets that do not generate cash inflows independently from other assets, hence their carrying amount cannot be fully attributed to a cash-generating unit under review.

In testing a cash generating unit for impairment, an entity should identify all the corporate assets that relate to the cash generating unit.

- (a) If a portion of the carrying amount of a corporate asset can be allocated to the unit on a reasonable and consistent basis, the entity compares the carrying amount of the unit (including the portion of the asset) with its recoverable amount.

- (b) If a portion of the carrying of a corporate asset cannot be allocated to the unit on a reasonable and consistent basis, the entity:
- i) Compares the carrying amount unit (excluding the asset) with its recoverable amount and recognizes any impairment loss
 - ii) Identifies the smallest group of cash-generating units that includes the cash-generating unit to which the asset belongs and to which a portion of the carrying amount of the asset can be allocated on a reasonable and consistent basis.
 - iii) Compare the carrying amount of that group of cash-generating units (including the portion of the asset allocated to the group of units) with impairment loss

Accounting treatment of an impairment loss

If, and only if, the recoverable amount of an asset is less than its carrying amount in the statement of financial position, an impairment loss has occurred. This loss should be recognised immediately.

- a) The assets carrying amount should be reduced to its recoverable amount in the statement of financial position.
- b) The impairment loss should be recognised immediately in profit or loss (unless the asset has been revalued in which case the loss is treated as a revaluation decreased).

After reducing an asset to its recoverable amount, the depreciation charge on the asset should then be based on its new carrying amount, its estimated residual value (if any) and its estimated remaining useful life.

An impairment loss should be recognised for a cash generating unit if (and only if) the recoverable amount for the cash generating unit is less than carrying amount in the statement of financial position for all the assets in the unit. When an impairment loss is recognised for a cash generating unit, the loss should be allocated between the assets in the unit in the following order.

- a) First, to the goodwill allocated to the cash generating unit
- b) Then to all other assets in the cash-generating unit, on a pro rata basis

In allocating an impairment loss, the carrying amount of an asset should not be reduced below the highest of:

- a) Its fair value costs to sell
- b) Its value in use (if determinable)
- c) Zero

Any remaining amount of an impairment loss should be recognised as a liability if required by other IFRSs.

Example 1: impairment loss

A company that extracts natural gas and oil has a drilling platform in the Caspian Sea. It is required by legislation of the country concerned to remove and dismantle the platform at the end of its useful life. Accordingly, the company has included an amount in its accounts for removal and dismantling costs, and is depreciating this amount over the platform's expected life.

The company is carrying out an exercise to establish whether there has been an impairment of the platform.

- a) Its carrying amount in the statement of financial position is \$3m.
- b) The company has received an offer of \$2.8m for the platform from another oil company. the bidder would take over the responsibility (and costs) for dismantling and removing the platform at the end of its life.
- c) The present value of the estimated cash flows from the platform's continued use is \$3.3m.
- d) The carrying amount in the statement of financial position for the provision for dismantling and removal is currently \$0.6m.

What should be the value of the drilling platform in the statement of financial position, and what, if anything, is the impairment loss?

Fair value less costs of

Disposal = \$2.8m

| | | |
|--------------------|---|---|
| Value in use | = | PV of cash flows from use less the carrying amount of the provision/liability |
| | = | \$3.3m-\$0.6m |
| | = | \$2.7m |
| Recoverable amount | = | Higher of these two amounts, i.e. \$2.8m |
| Carrying amount | = | \$3m |
| Impairment loss | = | \$0.2m |

The carrying amount should be reduced to \$2.8m.

Example 2: impairment loss

A company has acquired another business for \$4.5m: tangible assets are valued at \$4.0m and goodwill at \$0.5m.

An asset with a carrying amount of \$1m is destroyed in a terrorist attack. The asset was not insured. The loss of the asset, without insurance, has prompted the company to assess whether there has been an impairment of assets in the acquired business and what the amount of any such loss is.

The recoverable amount of the business (a single cash generating unit) is measured as \$3.1m.

There has been an impairment loss of \$1.4m (\$4.5m-\$3.1m).

The impairment loss will be recognised in profit or loss. The loss will be allocated between the assets in the cash generating unit as follows.

- a) A loss of \$1m can be attributed directly to the uninsured asset that has been destroyed.
- b) The remaining loss of \$0.4m should be allocated to goodwill.

The carrying amount of the assets will now be \$3m for tangible assets and \$0.1m for goodwill.

Reversal of an impairment loss

The annual assessment to determine whether there may have been some impairment should be applied to all assets, including assets that have already been impaired in the past.

In some cases, the recoverable amount of an asset that has previously been impaired might turn out to be higher than the asset's current carrying value. In other words, there might have been a reversal of some of the previous impairment loss.

- a) The reversal of the impairment loss should be recognised immediately as income in profit or loss.
- b) The carrying amount of the asset should be increased to its new recoverable amount.

An impairment loss recognised for an asset in prior years should be reversed if; and only if, there has been a change in the estimates used to determine the asset recoverable amount since the last impairment loss was recognised.

The asset cannot be revalued to a carrying amount that is higher than its value would have been if the asset had not been impaired originally, i.e its depreciated carrying value had the impairment not taken place. Depreciation of the asset should now be based on its new revalued amount, its estimated residual value (if any) and its estimated remaining useful life.

An exception to this rule is for goodwill. An impairment loss for goodwill should be reversed in a subsequent period.

Disclosure

IAS 36 calls for substantial disclosure about impairment of assets. The information to be disclosed includes the following:

- a) For each class of assets, the amount of impairment losses recognised and the amount of any impairment losses recovered (i.e. reversals of impairment losses)
- b) For each individual asset or cash generating unit that has suffered a significant impairment loss, details of the nature of the asset, the amount the loss, the events that led to recognition of the loss, whether the recoverable amount is fair value less costs to sell or value in use, and if the

recoverable amount is value in use, the basis on which this value was estimated (e.g. the discount rate applied)

An entity may receive monetary or non-monetary compensation from third parties the impairment or loss of items of property, plant and equipment. The companies may be used to restore the asset.

Example includes:

- Reimbursement by insurance companies after an impairment of items of plant and equipment
- Physical replacement of an impaired or lost asset.

The accounting treatment is as follows:

- a) Impairments of items of property, plant and equipment should be recognised under IAS 36, disposals should be recognised under IAS 16.
- b) Monetary or non-monetary compensation from third parties for items of property etc that were impaired, lost or given up, should be included in profit or loss.
- c) The cost of assets restored, purchased, constructed as replacement or received as compensation should be determined and presented under IAS 16.

3.07 IAS 39: FINANCIAL INSTRUMENTS: RECOGNITION AND MEASUREMENT

Leases

IAS 39 applies to lease receivables and payables only in limited respects: [IAS 39.2(b)] IAS 39 applies to lease receivables with respect to the derecognition and impairment provisions. IAS 39 applies to lease payables with respect to the derecognition positions. IAS 39 applies to derivatives embedded in leases.

Loan commitments

Loan commitments are outside the scope of IAS 39 if they cannot settle net in cash or another financial instrument, they are not designated as financial liabilities at fair value through profit or loss, and the entity does not have a past practice of selling the loans that resulted from the commitment shortly after origination. An issuer of a commitment to provide a loan at a below-market interest rate is

required initially to recognize the commitment at its fair value; subsequently, the issuer will remeasure it at the higher of (a) the amount recognized under IAS 37 and (b) the amount initially recognized less, where appropriate, cumulative amortization recognized in accordance with IAS 18. An issuer of loan commitments must apply IAS 37 to other loan commitments that are not within the scope of IAS 39 (that is, those made at market or above.) loan commitments are subject to the derecognition provisions of IAS 39. [IAS 39.4]

Contracts to buy or sell financial items

Contracts to buy or sell financial items are always within the scope of IAS 39.

Contracts to buy or sell non-financial items contracts to buy or sell non-financial items are within the scope of IAS 39 if they can be settled net in cash or another financial asset and are not entered into and held for the purpose of the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale, or usage requirements. Contracts to buy or sell non-financial items are inside the scope if net settlement occurs. The following situations constitute net settlement: [IAS 39.5] the terms of the contract permit either counterparty to settle net; there is a past practice of net settling similar contracts; there is a past practice, for similar contracts, of taking delivery of the underlying and selling it within a short period after delivery to generate a profit from short-term fluctuations in price, or from a dealer's margin; or the non-financial item is readily convertible to cash.

Weather derivatives

Although contracts requiring payment based on climatic; geological or other physical variable were generally excluded from the original version of IAS 39, they were added to the scope of the revised IAS 39 in December 2003. [IAS 39.AG1]

Common Examples of Financial instruments within the scope of IAS 39

Cash

Demand and time deposits

Commercial paper

Accounts, notes and loans receivable and payable

Debt and equity securities. These are financial instruments from the perspectives of both the holder and the issuer. This category includes investments in subsidiaries, associates, and joint ventures

Asset backed securities such as collateralized mortgage obligation, repurchase agreements, and securitized packages of receivables

Derivatives, including options, rights, warrants, futures contracts, forward contracts, and swaps.

A derivative is a financial instrument: whose value changes in response to the change in an underlying variable such as an interest rate, commodity or security price, or index; that requires no initial investment, or one that is smaller than would be required for a contract with similar response to changes in market factors; and that is settled at a future date.

Examples of Derivatives

Forwards: contracts to purchase or sell a specific quantity of a financial instrument, a commodity, or a foreign currency at a specified price determined at the outset, with delivery or settlement at a specified future date. Settlement is at maturity by actual delivery of the item specified in the contract, or by a net cash settlement.

Interest rate swaps and forward rate agreements: contracts to exchange cash flows as of a specified date or a series of specified dates based on a notional amount and fixed and floating rates.

Futures: contracts similar to forwards but with the following differences: futures are generic exchange-traded, whereas forwards are individually tailored. Futures are generally settled through an offsetting (reversing) trade, whereas forward are generally settled by delivery of the underlying item or cash settlement.

Options: contracts that give the purchaser the right, but not the obligation, to buy (call option) or sell (put option) a specified quantity of a particular financial instrument, commodity, or foreign currency, at a specified price (strike price), during or at a specified period of time. These can be individually written or exchange-traded. The purchaser of the option pays the seller (writer) of the option a fee (premium) to compensate the seller for the risk of payments under the option.

Caps and floors: these are contracts sometimes referred to as interest rate options. An interest rate cap will compensate the purchaser of the cap if interest rates rise above a predetermined rate (strike rate) while an interest rate floor will compensate the purchaser if rates fall below a predetermined rate.

Embedded Derivatives

Some contracts that themselves are not financial instruments may nonetheless have financial instruments embedded in them. For example, a contract to purchase a commodity at a fixed price for delivery at a future date has embedded in it a derivative that is indexed to the price of the commodity.

An embedded derivative is a feature within a contract, such that the cash flows associated with that feature behave in a similar fashion to stand-alone derivative. In the same way that derivatives must be accounted for at fair value on the balance sheet with changes recognised in the income statement, so must some embedded derivatives. IAS 39 requires that an embedded derivative be separated from its host contract and accounted for as a derivative when: [IAS 39.11] the economic risks and characteristics of the embedded derivative are closely related to those of the host contract; a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and the entire instrument is not measured at fair value with changes in fair value recognized in the income statement.

If an embedded derivative is separated, the host contract is accounted for under the appropriate standard (for instance, under IAS 39 if the host is a financial instrument). Appendix A to IAS 39 provides examples of embedded derivatives that are closely related to their hosts, and of those that are not.

Examples of embedded derivatives that are not closely related to their hosts (and therefore must be separately accounted for) include: the equity conversion option in debt convertible to ordinary shares (from the perspective of the holder only); commodity indexed interest or principal payments in host debt contracts; cap and floor options in host debt contracts that are in-the-money when the instrument was issued; leveraged inflation adjustments to lease payments; currency derivatives in purchase or sale contracts for non-financial items where the foreign currency is not that of either counterparty to the contract, is not the currency in which the related good or service is routinely denominated in commercial transactions around the world, and is not the currency that is commonly used in such contracts in the economic environment in which the transaction takes place.

If IAS 39 requires that an embedded derivative be separated from its host contract, but the entity is unable to measure the embedded derivative separately, the entire combined contract must be treated as a financial asset or financial liability that is held for trading (and, therefore, remeasured to fair value at each reporting date, with changes in profit or loss). [IAS 39.12]

Classification as Liability or Equity

Since IAS 39 does not address accounting for equity instrument issued by the reporting enterprise but it does deal with accounting for financial liabilities, classification of an instrument as liability or as equity is critical. **IAS 32 Financial instruments: presentation** addresses the classification question.

Classification of Financial Assets

IAS 39 requires financial assets to be classified in one of the following categories: [IAS 39.45] Financial assets at fair value through profit or loss. Available-for –sale financial assets. Loans and receivables. Held-to-maturity investments.

Those categories are used to determine how a particular financial asset is recognized measured in the financial statements.

Financial assets at fair value through profit or loss. This category has two subcategories:

- . Designated. The first includes any financial asset that is designated on initial recognition as one to be measured at fair value with value changes in profit or loss.

. Held for trading. The second category includes financial assets that are held for trading. All derivatives (except those designated hedging instruments) and financial assets acquired or held for the purpose of selling in the short term or for which there is a recent pattern of short-term profit taking are held for trading.

Available-for-sale financial assets (AFS) are any non-derivative financial assets designated on initial recognition as available for sale. AFS assets are measured at fair value in the balance sheet. Fair value changes on AFS assets are recognized directly in equity, through the statement of changes in equity, except for interest on AFS assets (which is recognized in income on an effective yield basis), impairment losses. The cumulative gain or loss that was recognized in equity is recognized in profit or loss when an available-for-sale financial asset is derecognised.

Loans and receivables are non-derivative financial assets with fixed or determinable payments, originated or acquired, that are not quoted in an active market, not held for trading, and not designated on initial recognition as asset at fair value through profit or loss or as available-for-sale. Loans and receivables, for which the holder may not recover substantially all of its initial investment, other than because of credit deterioration, should be classified as available-for-sale. Loans and receivables are measured at amortised cost. [IAS 39.46(a)]

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments that an entity intends and is able to hold to maturity and that do not meet the definition of loans and receivables and are not designated on initial recognition as assets at fair value through profit and loss or as available for sale. Held-to-maturity investments are measured at amortised cost. If an entity sells a held-to-maturity investment other than in insignificant amounts or as a consequence of a non-recurring, isolated event beyond its control or in insignificant amounts or as a consequence of a non-recurring, isolated event beyond its control that could not be reasonably anticipated, all of its other held-to-maturity investments must be reclassified as available-for-sale for the current and next two financial reporting years. (IAS 39.46 (b))

Classification of Financial Liabilities

IAS 39 recognises two classes of financial liabilities: (IAS 39.47) Financial liabilities at fair value through profit or loss. Other financial liabilities measured at amortised cost using the effective interest method.

The category of financial liability at fair value through profit or loss has two subcategories:

Designated: A financial liability that is designated by the entity as a liability at fair value through profit or loss upon initial recognition.

Held for trading: A financial liability classified as held for trading, such as an obligation for securities borrowed in a short sale, which have to be returned in the future.

Initial Recognition

IAS 39 requires recognition of a financial asset or a financial liability when, and only the entity becomes a party to the contractual provisions of the instrument, subject to the following provision in respect of regular way purchases. (IAS 39.14)

Regular way purchases or sales of a financial asset: A regular way purchase or sale of financial

Assets is recognised and derecognized using either trade date or settlement date accounting. The method used is to be applied consistently for all purchases and sales of financial assets that belong to the same category of financial asset as defined in IAS 39 (note that for this purpose assets held for trading form a different category from assets designated at fair value through profit or loss). The choice of method is an accounting policy. (IAS 39.38)

IAS 39 requires that all financial assets and all financial liabilities be recognised on the balance sheet. That includes all derivatives. Historically, in many parts of the world, derivatives have not been recognised on company balance sheets. The argument has been that at the time the derivative contract was entered into, there was no amount of cash or other assets paid. Zero cost justified non-recognition, notwithstanding that as time passes and the value of the underlying variable (rate, price, or index) changes, the derivative has a positive (asset) or negative (liability) value.

Initial Measurement

Initially, financial assets and liabilities should be measured at fair value (including transaction costs for assets and liabilities not measured at fair value through profit or loss).

Measurement Subsequent to Initial Recognition

Subsequently, financial assets and liabilities (including derivatives) should be measured at fair value, with the following exceptions: (IAS 39.46)

Loans and receivables. Held-to-maturity investments, and non-derivatives financial liabilities should be measured at amortised cost using the effective interest method. Investments in equity instruments with no reliable fair value measurement (and derivatives indexed to such equity instruments) should be measured at cost. financial assets and liabilities that are designated as a hedged item or hedging instrument are subject to measurement under the hedge accounting requirements of the IAS 39. Financial liabilities that arise when a transfer of a financial asset does not qualify for derecognition, or that are accounted for the continuing-involvement method, are subject to particular measurement requirements.

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. IAS 39 provides a hierarchy to be used in determining the fair value for a financial instrument: (IAS 39 Appendix A, paragraphs AG 69-82)

Quoted market prices in an active market, an entity establishes fair value by using a valuation technique that makes maximum use of market inputs and includes recent arm's length market transactions, reference to the current fair value of another instrument that is substantially the same, discounted cash flow analysis, and option pricing models. An acceptable valuation technique incorporates all factors that market participants would consider in setting a price and is consistent with accepted economic methodologies for pricing financial instruments.

If there is no active market for an equity instrument and the range of reasonable fair values is significant and these estimates cannot be made reliably, then an entity must measure the equity instrument at cost less impairment.

Amortized cost is calculated using the effective interest method. The effective interest is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument to the net carrying amount of the financial asset or liability. Financial assets that are not carried at fair value through profit and loss is subject to impairment test. If expected life cannot be determined reliably, then the contractual life is used.

IAS 39 Fair Value Option

IAS 39 permits entities to designate, at the time of acquisition or issuance, any financial asset or financial liability to be measured at fair value, with value changes recognised in profit or loss. The option is available even if the financial asset or financial asset or financial would ordinarily, by its nature, be measured at amortised cost- but only if fair value can be reliably measured. Once an instrument is put in the fair-value-through-profit-and-loss category, it cannot be reclassified out.

IAS 39 Available for Sale Option for Loans Receivables

IAS 39 permits entities to designate, at the time of acquisition, any loan or receivable as available for sale, in which case it is measure at fair value with changes in fair value recognised in equity.

Impairment

A financial asset or group of assets is impaired, and impairment losses are recognised, only if there is objective evidence as a result of one or more events that occurred after the initial recognition of the asset. An entity is required to assess at each balance sheet date whether there is any objective evidence of impairment. If any such evidence exists, the entity is required to do a detailed impairment calculation to determine whether an impairment loss should be recognised. (IAS 39.58).

The amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated cash flows discounted at the financial asset's original effective interest rate. (IAS 39.63)

Assets that are individually assessed and for which no impairment exists are grouped with financial assets with similar credit risk statistics and collectively assessed for impairment. (IAS 39.64).

If, in a subsequent period, the amount of the impairment loss relating to a financial assets carried at amortized cost or a debt instrument carried as available-for-sale decreases due to an event occurring after the impairment was originally recognised, the previously recognised impairment loss is reversed through profit and loss. Impairments relating to investments in available-for-sale equity instruments are not reversed. (IAS 39. 65)

Derecognition of a Financial Asset

The basic premise for the derecognition model in IAS 39 is to determine whether the asset under consideration for derecognition is: (IAS 39. 16) an asset in its entirety; or specifically identified cash flows from an asset; or a fully proportionate share of the cash flows from an asset; or a fully proportionate share of specifically identified cash flows from a financial asset.

Once the asset under consideration for derecognition has been determined, an assessment is made as to whether the asset has been transferred, and if so, whether the transfer of that asset is subsequently eligible for derecognition.

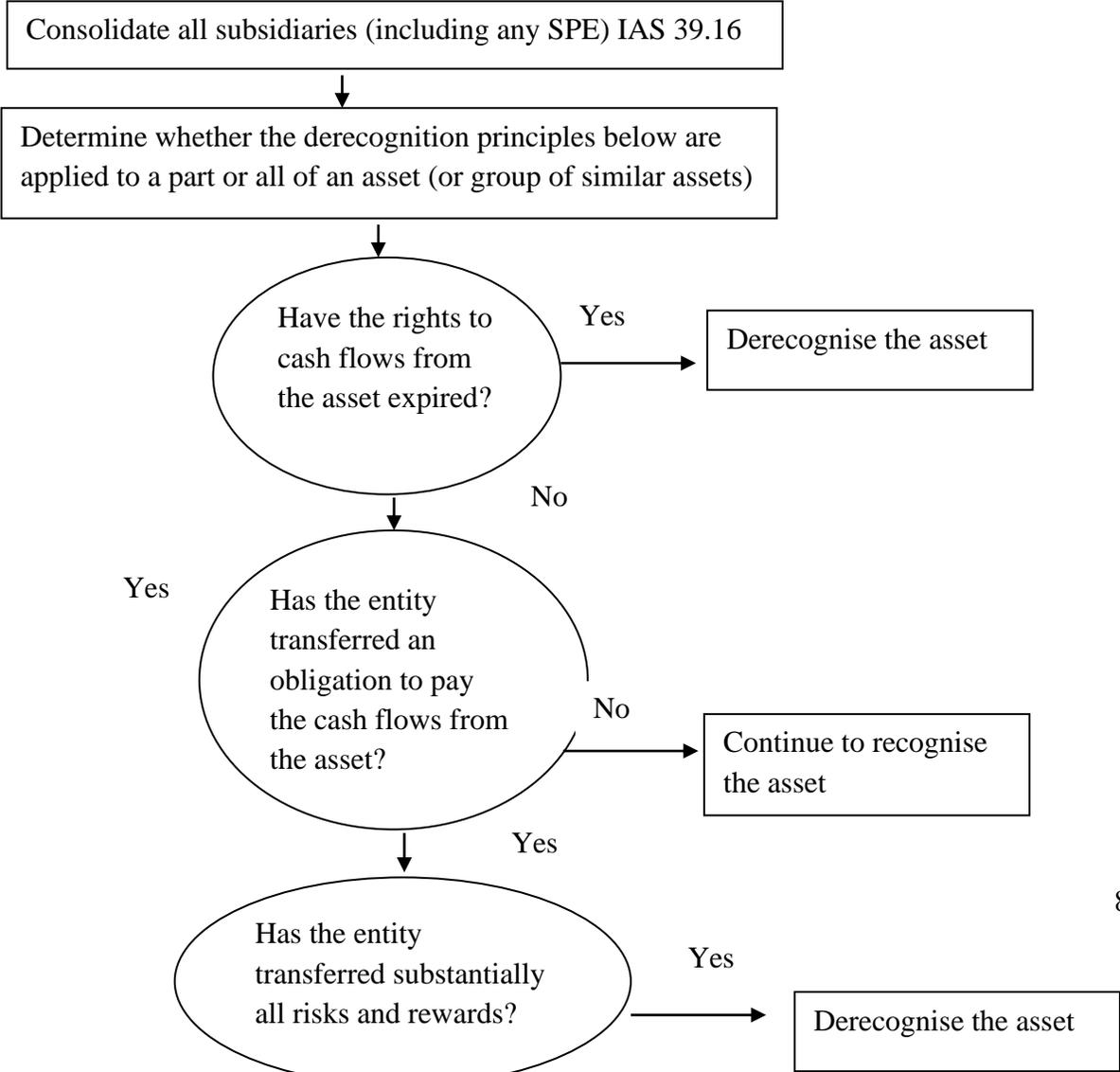
An asset is transferred if either the entity has transferred the contractual rights to receive the cash flows, or the entity has retained the contractual rights to receive the cash flows from the asset, but has assumed a contractual obligation to pass those cash flows on under an arrangement that meets the following three conditions: (IAS 39. 17-19) the entity has no obligation to pay amounts to the eventual receipt unless it collects equivalent amounts on the original asset, the entity is prohibited from selling or pledging the original asset (other than as security to the eventual recipient), and the entity has an obligation to remit those cash flows without material delay.

Once an entity has determined that the asset has been transferred, it then determines whether or not it has transferred substantially all of the risks and rewards of ownership of the asset. If substantially all the risks and rewards have been transferred, the asset is derecognised. If substantially all the risks and rewards have been retained, derecognition of the asset is precluded. (IAS 39.20)

If the entity has neither retained nor transferred substantially all of the risks and rewards of the asset, then the entity must assess then derecognition is appropriate; however, if the entity has retained

control of the asset, then the entity continues to recognise the asset to the extent to which it has a continuing involvement in the asset. (IAS 39.30)

These various derecognition steps are summarized below in a decision tree.



Derecognition of a Financial Liability

A financial liability should be removed from the balance sheet when, and only when, it is extinguished, that is, when the obligation specified in the contract is either discharged, cancelled, or expired. Where there has been an exchange between an existing borrower and lender of debt instruments with substantially different terms, or there has been a substantial modification of the terms of an existing financial liability, this transaction is accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability. A gain or loss from extinguishment of the original financial liability is recognised in the income statement. (IAS 39.39).

Hedge Accounting

IAS 39 permits hedge accounting under certain circumstances provided that the hedging relationship is: (IAS 39.88) formally designated and documented, including the entity's risk management objective and strategy for undertaking the hedge, identification of the hedging instrument, the hedged item, the nature of the risk being hedged, and how the entity will assess the hedging instrument's effectiveness; and expected to be highly effective in achieving offsetting change in fair value or cash flows attributable to the hedged risk as designated and documented, and effectiveness can be reliably measured.

Hedging Instruments

All derivative contracts with an external counterparty may be designated as hedging instruments except for some written options. (IAS 39.72-72).

An external non-derivative financial asset or liability may not be designated as a hedging instrument except as a hedge of foreign currency risk. (IAS 39.72)

A proportion of the derivative may be designated as the hedging instrument. Generally, specific cash flows inherent in a derivative cannot be designated in a hedge relationship while other cash flows are excluded. However, the intrinsic value and the time value of an option contract may be separated, with only the intrinsic value being designated. Similarly, the interest element and the spot price of a forward can also be separated, with the spot price being the designated risk. (IAS 39.75)

Hedged item

A hedged item can be: (IAS 39.78) a single recognised asset or liability, firm commitment, highly probable transaction, or a net investment in a foreign operation, a group of assets, liabilities, firm commitments, highly probable forecast transactions, or net investments in foreign operations with similar risk characteristics; a held-to-maturity investment for foreign currency or credit risk (but not for interest risk or prepayment risk); a portion of the cash flows or fair value of a financial asset or financial liability; or a non-financial item for foreign currency risk only or the risk of changes in fair value of the entire item. In a portfolio hedge of interest rate risk of changes in fair value of the entire item. In a portfolio hedge of interest rate risk (Macro Hedge) only, a portion of the portfolio of financial assets or financial liabilities that share the risk being hedged.

Effectiveness

IAS 39 requires hedge effectiveness to be assessed both prospectively and retrospectively. To qualify for hedge accounting at the inception of a hedge and, at a minimum, at each reporting date, the changes in the fair value or cash flows of the hedged item attributable to the hedged risk must be expected to be highly effective in offsetting the changes in the fair value or cash flows of the hedging

instrument on a prospective basis, and on a retrospective basis where actual results are within a range 80% to 125%.

All hedge ineffectiveness is recognised immediately in the income statement (including ineffectiveness within the 80% to 125% window).

Categories of hedges:

A fair value hedge is a hedge of the exposure to changes in fair value of a recognised asset or liability or a previously unrecognized firm commitment to buy or sell an asset at a fixed price or an identified portion of such an asset, liability or firm commitment, that is attributable to a particular risk and could affect profit or loss. The gain or loss. At the same time the carrying amount of the hedged item is adjusted for the corresponding gain or loss with respect to the hedged risk, which is also recognised immediately in net profit or loss.

A cash flow hedge is a hedge of the exposure to variability in cash flows that (i) is attributable to a particular risk associated with a recognised asset or liability (such as all or some future interest payments on variable rate debt) or a highly probable forecast transaction and (ii) could affect profit or loss. (IAS 39.86)

The portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognised directly in equity and recycled to the income statement when the hedged cash transaction affects profit or loss. (IAS 39.95).

If a hedge of a forecast transaction subsequently results in the recognition of a financial asset or a financial liability, any gain or loss on the hedging instrument that was previously recognised directly in equity is 'recycled' into profit or loss in the same period(s) in which the financial asset or liability affects profit or loss. (IAS 39.97).

If a hedge of a forecast transaction subsequently results in the recognition of a non-financial asset or non-financial liability, then the entity has an accounting policy option that must be applied to all such hedges of forecast transactions: (IAS 39.98)

Same accounting as for recognition of a financial asset or financial liability-any gain or loss on the hedging instrument that was previously recognised directly in equity is 'recycled' into profit or loss in the same period(s) in which the non-financial asset or liability affects profit or loss.

'Basis adjustment' of the acquired non-financial asset or liability-the gain or loss on the hedging instrument that was previously recognised directly in equity is removed from equity and is included in the initial cost or other carrying amount of the acquired non-financial asset or liability.

A hedge of a net investment in a foreign operation as defined in IAS 21 is accounted for similarly to a cash flow hedge. (IAS 39.86)

A hedge of the foreign currency risk of a firm commitment may be accounted for as a fair value hedge or as a cash flow hedge.

Fair value hedge accounting for a portfolio Hedge of Interest Rate Risk (Macro Hedging)

IAS 39 allows fair value hedge accounting to be used for a portfolio hedge of interest rate risk (macro hedging) as follows:

1. The entity identifies a portfolio of items whose interest rate risk it wishes to hedge. The portfolio may include both assets and liabilities.
2. The entity analyses the portfolio into time periods based on expected, rather than contractual, repricing dates.
3. The entity designates the hedged item as a percentage of the amount of assets (or liabilities) in each time period from step 2. All of the assets from which the hedged amount is drawn must be items (a) whose fair value changes in response to the risk being hedged and (b) that could have qualified for fair value hedge accounting under IAS 39 had they been hedged individually. The time periods must be sufficiently narrow to ensure that all assets (or liabilities) in a time period are homogeneous with respect to the hedged risk-that is, the fair value of each item moves proportionately to, and in the same direction as, changes in the hedged interest rate risk.

4. The entity designates what interest rate risk it is hedging. This risk could be a portion of the interest rate risk in each of the items in the portfolio, such as a benchmark interest rate like LIBOR.
5. The entity designates a hedging instrument for each time period. The hedging instrument may be a portfolio of derivatives (for instances, interest rate swaps) containing offsetting risk positions.
6. The entity measures the change in the fair value of the hedged item (from step 3) that is attributable to the hedged risk (from step 4). The result is recognised in profit or loss and one of two separate line items in the balance sheet. The balance sheet line item depends on whether the hedged item is an asset (in which case the change in fair value is reported in a separated line item within assets) or is a liability (in which case the value change is reported in a separate line item within liabilities). This separate balance sheet line item is presented on the face of the balance sheet adjacent to the related asset(s) or liability(ies)-but it cannot be allocated to individual assets or liabilities, or to separate classes of assets or liabilities (that is, no “basis adjustment”).
7. The entity measures the change in the fair value of the hedging instrument and recognises this as a gain or loss in profit or loss. It recognizes the fair value of the hedging instrument as an asset or liability in the balance sheet.
8. Ineffectiveness is the difference in profit or loss between the amounts determined in step 6 and step 7.

A change (up or down) in the amounts that are expected to be repaid or mature in a time period will result in ineffectiveness. That ineffectiveness is the difference between (a) the initial hedge ratio applied to the initial estimated amount in a time period and (b) that same ratio applied to the revised estimate of the amount.

demand deposits and similar items with a demand feature (such as a bank’s core deposits’) cannot be designated as the hedged item in a fair value hedge for any period beyond the shortest period in which

the counterparty can demand repayment. Thus deposits payable immediately on demand are not eligible for hedge accounting.

Discontinuation of Hedge Accounting

hedge accounting must be discontinued prospectively if: [IAS 39.91 and 39.101] the hedging instrument expires or is sold, terminated, or exercised; the hedge no longer meets the hedge accounting criteria- for example it is no longer effective; for cash flow hedges the forecast transaction is no longer expected to occur; or the entity revokes the hedge designation.

If hedge accounting ceases for a cash flow hedge relationship because the forecast transaction is no longer expected to occur, gains and losses deferred in equity must be taken to the income statement immediately. If the transaction is still expected to occur and the hedge relationship ceases, the amounts accumulated in equity will be retained in equity until the hedged item affects profit or loss. [IAS 39.101(c)]

If a hedge financial instrument that is measured at amortised cost has been adjusted for the gain or loss attributable to the hedged risk in a fair value hedge, this adjustment is amortised to profit or loss based on a recalculated effective interest rate on this date such that the adjustment is fully amortised by the maturity of the instrument. amortised may begin as soon as an adjustment exists and must begin no later than when the hedged item ceases to be adjusted for changes in its fair value attributable to the risks being hedged.

Transition and effective date [IAS 39.103-108]

Comparative statements

in 2005 financial statements only, an entity may elect for the prior-year comparative information to still be prepared under their existing GAAP. If this election is taken the entity must: disclose this fact together with the basis used to prepare this information; and disclose the nature of the main adjustments that would make the information comply with IAS 32 and IAS 39. The entity need not quantify those adjustments. However, the entity must treat any adjustment between the balance

sheet at the comparative period's reporting date and balance sheet at the start of the first IFRS reporting period as arising from a change in accounting policy.

Effective date

IAS 39 must be applied for annual periods beginning on or after 1 January 2005. Earlier application is permitted only if the entity also early applies IAS 32. If the entity early adopts the two standards that facts should be disclosed.

Transition

on initial adoption, subject to the guidance below, IAS 29 should be applied retrospectively, with the opening balance of retained earnings for the earliest period presented and all other comparative amounts adjusted as if the standard had always been in use, except where restating the information would be impracticable, in which case the entity must disclose that fact and indicate the extent to which the information was restated.

Derecognition

with respect to derecognition the entity may either apply the IAS 39 requirements prospectively for financial years beginning on or after 1 January 2004, or apply the IAS 39 requirements retrospectively from a date of the entity's choosing, provided that the information needed to apply IAS 39 to assets and liabilities derecognized as a result of transactions was obtained at the time initially accounting for those transactions.

Designation upon transition

On initial adoption of the standard an entity may designate a previously recognized financial asset or financial liability as a financial asset or financial liability at fair value through profit or loss or as available for sale.

Hedging

If, before the date of transition to IFRSs, an entity had designated a transaction as a hedge, but the hedge does not meet the conditions for hedge accounting in IAS 39, the entity must apply the rules on discontinuation of hedge accounting. Transactions entered into before the date of transition to IFRS may not be retrospectively designated as hedges.

The designation and documentation of a hedge relationship must be completed on or before the date of transition of IFRSs if the hedge relationship is to qualify for hedge accounting from that date.

Fair value Hedges

With respect to fair value hedges, if under previous GAAP the hedged item was not adjusted, the entity should adjust the carrying amount of the hedged item on transition with the adjustment amounting to the lower of: a that portion of the cumulative change in the fair value of the hedged item that reflects the designated hedged risk and that was not recognised under previous GAAP; and b. that portion of the cumulative change in the fair value of the hedging instrument that reflects the designated hedged risk.

Cash Flow Hedges

Under its previous GAAP, an entity may have deferred gains and losses on a cash flow hedge of a forecast transaction. If, at the date of transition to IFRSs, the hedged forecast transaction is not highly probable, but is expected to occur, the entire deferred gain or loss is recognised in equity. Any net cumulative gain or loss that is reclassified to equity on initial application to IAS 39 remains in equity until (a) the forecast transaction subsequently results in the recognition of a non-financial asset or non-financial liability, (b) the forecast transaction affects profit or loss, or (c) circumstances subsequently change and the forecast transaction is no longer expected to occur, in which case any related net cumulative gain or loss that had been recognised directly in equity is recognised in profit or

loss. If the hedging instrument is still held, but the hedge does not qualify as a cash flow hedge under IAS 39, hedge accounting is no longer appropriate starting from the date of transition to IFRSs.

An entity may not adjust the carrying amount of non-financial asset and non-financial liabilities to exclude gains and losses related to cash flow hedges that were included in the carrying amount before the beginning of the financial year in which IAS 39 is first applied.

Disclosure

When IAS 32 and IAS 39 were revised in 2003, all of the disclosures about financial instruments that had been in old IAS 39 were moved to IAS 32, so IAS 32 financial instruments: Presentation and Disclosure requirements. In 2005, the IASB issued IFRS 7 Financial Instruments: Disclosures to replace the disclosure portions of IAS 32 effective 1 January 2007, with earlier application encouraged. IFRS 7 also supersedes IAS 30 Presentation of Financial Statements of Banks and Similar Financial Institutions.

MODULE 4

4.00

MISCELLANEOUS ACCOUNTS

4.01 Learning Outcomes

On successful completion of this Module, Students should be able to:

- vii. Elucidate the nature, economic substance, and advantages of lease transactions;
- viii. Contrast the operating and capitalization methods of recording leases;
- ix. Recognize special features of lease arrangements that cause unique accounting problems;
- x. Prepare accounts on inflation under historical cost accounts and methods of current purchasing power and current cost accounts;
- xi. Prepare inflation accounts with its adjustments;

- xii. Describe the types of specialized accounts;
- xiii. Design the account formats of all the specialized organizations;
- xiv. Prepare the accounts of specialized organizations.

4.02 Accounting for Lease/Contracts/Hire Purchase/Price Level Changes

4.2.1 ACCOUNTING FOR LEASE

A lease is an agreement between two parties the lessor and the lessee. It is a contract of bailment with the lessee rarely becoming the owner in practice.

Lessor

A Lessor is someone who owns a capital asset, but gains the lessee use of it.

Lessee

A Lessee is someone who does not own the asset but uses it, and in return makes payments under the lease to the lessor, for a specified period of time at the onset or in instalments, subject to the agreement between the parties.

Types of Leases

There are two (2) basic types of lease:

1. Operating Lease
2. Capital / Finance / Financial Lease

Operating Lease (Wet lease in the airline industry)

These are rental agreements between a lessor and a lessee whereby the lessor is responsible for the upkeep, maintenance, servicing and insurance of the leased asset i.e. all risks and rewards incident the ownership remains with the lessor.

Capital / Finance / Financial Lease (Dry lease in the airline industry)

These are lease agreements between the user of the leased asset (i.e. the lessee) and a provider of finance (i.e. the lessor). The lessee is responsible for the upkeep, maintenance, servicing and insurance of the leased asset. The lessor is not involved in this at all.

Consequently, all risks and rewards incident to ownership are substantially transferred to the lessee. Title may or may not eventually be transferred at the end of the lease agreement.

The accounting steps to record lease transaction is as follows:

Accounting Steps:

- 1) Determine the total lease payments:
=Instalment payment x number of instalment

- 2) Determine the cash / fair value of the leased property
- * It may be given in the information
 - * If it is not given, calculate it as follows:

a. Instalments in arrears (i.e. at the end of the year)

$$= \text{Instalment } \frac{[1 - (1 + r)^{-n}]}{r}$$

Where r is the lease rental rate, n is the duration of the lease.

- b. Instalments in advance (i.e. at the beginning of the year)

$$= \frac{[1 - (1+r)^{-t} + 1]}{r}$$

Where: $t = n - 1$

n = the duration of the lease

- 3) Calculate the depreciation on the cash price/fair value of the leased asset.
 4) Determine the total interest on the lease/finance charges:

| | |
|--|------|
| Total lease payment | xx |
| Cash / Fair value | (xx) |
| Total lease interest / finance charges | xxx |

Treatment of Finance Charges

The finance charges may be spread over the period of the lease using:

- i. Straight Line Method
- ii. Sum of the Year Digit Method
- iii. Actuarial Method.

Straight Line Method

Under this method, finance charges are distributed evenly over the period of the lease and will be written off into the profit and loss account accordingly.

I.e. Finance charges

Sum of the Year Digit Method

Under this method, the finance charges will be written off into the profit and loss account on the basis of the sum of the year digits. Let us consider the lease asset with 4 years life span, the finance charge will be distributed into each year' P & L A/c as follows:

| Year (1) | Digit (2) | Proportion (3) | Finance Charges |
|----------|-----------|----------------|-----------------|
| | | | N |
| 1 | 4 | 4/10 | xxx 1 |
| 2 | 3 | 3/10 | xxx 2 |
| 3 | 2 | 2/10 | xxx 3 |
| 4 | <u>1</u> | 1/10 | xxx 4 |
| | <u>10</u> | | |

Actuarial Method

Under this method, the interest in each of the periods will be calculated on the balance after deducting the instalment payments and adding the interest due on the cash price.

| Consider the following: | N | Interest |
|--|-------------|----------|
| Cash Price | xxx | |
| Instalment payment 1* | <u>(xx)</u> | |
| Outstanding balance 1 | xxx | |
| Interest: x% of outstanding balance 1 | <u>xx</u> | xxx |
| | xxx | |
| Instalment payment 2 | <u>(xx)</u> | |
| Outstanding balance 2 | xxx | |
| Interest: x% of outstanding 2 | <u>xx</u> | xxx |
| | xxx | |
| Instalment payment 3 | <u>(xx)</u> | |
| Outstanding balance 3 | xxx | |
| Interest: x % of outstanding balance 3 | <u>xx</u> | xxx |
| | xxx | |
| Final instalments | <u>(xx)</u> | |
| Outstanding balance 4 | xxx | |
| Interest: x% of outstanding balance 4 | <u>xx</u> | xxx |
| Outstanding balance | <u>NIL</u> | |

Accounts Required

Interest Payable Method:

- Leased asset a/c

- Provision of depreciation a/c
- Lessor's a/c
- Finance charges a/c
- P & L a/c

Interest Suspense Method:

- Leased asset a/c
- Provision for depreciation a/c
- Lessor's a/c
- Finance charges suspense a/c
- P & L a/c
- Finance charges a/c

Accounting Procedures

Interest Payable Method:

1. Dr Leased asset a/c
Cr Lessor's a/c (with the cash price / fair value of the leased asset)
- 2, Dr Finance charge a/c
Cr Lessor's a/c (with the interest for each of the periods)
3. Dr Lessor's a/c
Cr Bank a/c (with the instalmental payments)
4. Dr P & L a/c
Cr Financed charge a/c (with the interest due for each period)
5. Dr P & L a/c
Cr Provision for depreciation a/c (with the depreciation for each period).

Interest Suspense Method:

1. Dr Leased asset a/c
Cr Lessor's a/c (with the cash price / fair value of the leased asset)
- 2, Dr Interest Suspense a/c
Cr Lessor's a/c (with the total lease interest)
3. Dr Finance Charge a/c
Cr Interest Suspense a/c (with the interest for each of the periods)
4. Dr P & L a/c
Cr Financed charge a/c (with the interest due for each period)
5. Dr Lessor's a/c
Cr Bank a/c (with the Instalment payments)
6. Dr P & L a/c

Cr Provision for depreciation a/c (with the depreciation for each period).

Illustration

AKOGU Nigeria Limited has two options to choose from; it could either buy or lease an asset at a cost of N18,000. The terms of the lease are as follows:

- 1) The primary period of the lease is for 4 years from 1st January 1999 with a rental repayment of N6,000 P.A. payable on 31st December each year.
- 2) The lessee has the right to continue to lease the asset after the end of the primary period for an indefinite period subject to only nominal rent.
- 3) The lessee is required to pay for repairs, maintenance and insurance cost as they arise.
- 4) The interest rate implicit in the lease is 15%.
- 5) The lessee estimated that the useful economic life of the asset is 6 years and that depreciation for three years should be calculated on straight line.

Required:

- (a) Show calculation of finance charge to be recognized on the leased asset under the different methods of spreading finance charges:
- (b) Show details accounting entries in respect of one of the method identified in (a) above.

Solution

AKOGU NIGERIA LIMITED

Step 1: Total lease payment:

$$\text{Total instalment (N6,000 x 4 years)} = \text{N24,000}$$

Step 2: The fair value of the leased asset:

The payment is in arrears:

$$\begin{aligned} &= \text{Instalment } \frac{[1 - (1 + r)^{-n}]}{r} \\ &= \text{N6,000} \times \frac{[1 - (1.15)^{-4}]}{0.15} \\ &= \text{N6,000} \times \text{N2.8550} \\ &= \text{N17,130} \end{aligned}$$

Step 3: The depreciation:

$$\begin{aligned} \text{Depreciation} &= \frac{17,130}{5 \text{ years}} \\ &= \text{N2,141} \end{aligned}$$

Step 4: Calculation of Interest:

| | |
|------------------------------------|---------------|
| | N |
| Total Instalment (6,000 x 4 years) | 24,000 |
| Cash price / Fair value | <u>17,130</u> |
| Total Interest / Finance charge | <u>6,870</u> |

Interest per Period Using:

a) Straight Line Method

$$\frac{6,870}{4} = \underline{\underline{N1,718}}$$

b) Sum of the Years Digit Method

| Years | Digit | Allocation | Finance Charges |
|-------|-----------|-------------|-----------------|
| | | | N |
| 1 | 4 | 4/10 x 6870 | 2,748 |
| 2 | 3 | 3/10 x 6870 | 2,061 |
| 3 | 2 | 2/10 x 6870 | <u>1,374</u> |
| 4 | <u>1</u> | 1/10 x 6870 | 6,870 |
| Total | <u>10</u> | | |

c) Actuarial Method

| | N | Interest |
|---------------------------------|--------------|--------------|
| Fair value | 17,130 | |
| Add interest 15% x 17,130 | <u>2,570</u> | 2,570 |
| | 19,700 | |
| Less 1 st Instalment | <u>6,000</u> | |
| Outstanding balance | 13,700 | |
| Interest added 15% x 13,700 | <u>2,055</u> | 2,055 |
| | 15,755 | |
| Less 2 nd Instalment | <u>6,000</u> | |
| Outstanding balance | 9,755 | |
| Add interest 15% x 9,755 | <u>1,463</u> | 1,463 |
| | 11,218 | |
| Less 3 rd Instalment | <u>6,000</u> | |
| Outstanding balance | 5,218 | |
| Add interest 15% x 5,218 | <u>782</u> | 782 |
| | 6,000 | |
| Less 4 th Instalment | <u>6,000</u> | <u>6,870</u> |

NIL

Accounting Entries

Under Interest Payable Method

Leased Assets

| | | N | | | N |
|----------|----------------|---------------|----------|----------|---------------|
| 1/1/1990 | Lessor Account | <u>17,130</u> | 13/12/90 | Bal. c/d | <u>17,130</u> |
| 1/1/1991 | Bal. b/d | <u>17,130</u> | 13/12/91 | Bal. c/d | <u>17,130</u> |
| 1/1/1992 | Bal. b/d | <u>17,130</u> | 13/12/92 | Bal. c/d | <u>17,130</u> |
| 1/1/1993 | Bal. b/d | <u>17,130</u> | 13/12/93 | Bal. c/d | <u>17,130</u> |

Provision for Depreciation Account

| | | N | | | N |
|------------|----------|--------------|----------|----------|--------------|
| 31/12/1990 | Bal. c/d | <u>2,141</u> | 1/1/1990 | P & L | <u>2,141</u> |
| 31/12/1991 | Bal. c/d | <u>4,282</u> | 1/1/1991 | Bal. b/d | <u>2,141</u> |
| | | | | P & L | <u>2,141</u> |
| | | <u>4,282</u> | | | <u>4,282</u> |
| 31/12/1992 | Bal. c/d | 6,423 | 1/1/1992 | Bal. b/d | 4,282 |
| | | | | P & L | <u>2,141</u> |
| | | <u>6,423</u> | | | <u>6,423</u> |
| 31/12/1993 | Bal. c/d | <u>8,564</u> | 1/1/1993 | Bal. b/d | 6,423 |
| | | | | P & L | <u>2,141</u> |
| | | <u>8,564</u> | | | <u>8,564</u> |

Lessor's Account

| | | N | | | N |
|------------|---------------------------------|---------------|----------|-----------------|---------------|
| 31/12/1990 | Bank 1 st Instalment | <u>6,000</u> | 1/1/1990 | Lease Assets | 17,130 |
| 31/12/1990 | Bank 2 nd Instalment | <u>13,700</u> | 1/1/1991 | Finance charges | <u>1,570</u> |
| | | <u>19,700</u> | | | <u>19,700</u> |
| 31/12/1991 | Bank 2 nd Instalment | 6,000 | 1/12/91 | Bal. b/d | 13,700 |
| 31/12/1991 | | <u>9,755</u> | 1/12/91 | Finance charges | <u>2,055</u> |
| | | <u>15,755</u> | | | <u>15,755</u> |
| 31/12/1992 | Bank 3 rd Instalment | 6,000 | 1/12/92 | Bal. b/d | 9,755 |
| 31/12/1992 | Bal. c/d | <u>5,218</u> | 31/12/92 | Finance charges | <u>1,463</u> |
| | | <u>11,218</u> | | | <u>11,218</u> |
| 31/12/1993 | Bank 4 th Instalment | 6,000 | 1/12/93 | Bal. b/c | 5,218 |
| | | | 31/12/93 | Finance charges | <u>782</u> |

| | | <u>6,000</u> | | | <u>6,000</u> |
|--------------------------------|----------------|--------------|------------|-------|--------------|
| Finance Charges Account | | | | | |
| N | | | N | | |
| 31/12/1990 | Lessor Account | <u>2,570</u> | 31/12/1990 | P & L | <u>2,570</u> |
| 1/12/1991 | Lessor Account | <u>2,055</u> | 31/12/1991 | P & L | <u>2,055</u> |
| 31/12/1992 | Lessor Account | <u>1,463</u> | 31/12/1992 | P & L | <u>1,463</u> |
| 31/12/1993 | Lessor Account | <u>782</u> | 31/12/1993 | P & L | <u>782</u> |

| Under Interest Suspense Account Method Leased Assets | | | | | |
|---|----------------|---------------|------------|----------|---------------|
| N | | | N | | |
| 1/1/1990 | Lessor Account | <u>17,130</u> | 31/12/1990 | Bal. c/d | <u>17,130</u> |
| 1/1/1991 | Bal. b/d | <u>17,130</u> | 31/12/1991 | Bal. c/d | <u>17,130</u> |
| 1/1/1992 | Bal. b/d | <u>17,130</u> | 31/12/1992 | Bal. c/d | <u>17,130</u> |
| 1/1/1993 | Bal. b/d | <u>17,130</u> | 31/12/1993 | Bal. c/d | <u>17,130</u> |
| 1/1/1994 | Bal. b/d | <u>17,130</u> | 31/12/1994 | Bal. c/d | <u>17,130</u> |

| Provision for Depreciation Account | | | | | |
|---|----------|--------------|----------|----------|--------------|
| N | | | N | | |
| 31/12/1990 | Bal. c/d | <u>2,141</u> | 1/1/1990 | P & L | <u>2,141</u> |
| 1/1/1991 | Bal. b/d | 2,141 | 1/1/1991 | P & L | <u>2,141</u> |
| 31/12/1991 | Bal. c/d | <u>4,282</u> | | | <u>4,282</u> |
| | | <u>4,282</u> | 1/1/1992 | Bal. b/d | 4,282 |
| 31/12/1992 | Bal. c/d | <u>6,423</u> | 1/1/1992 | P & L | <u>2,141</u> |
| | | <u>6,423</u> | | | <u>6,423</u> |
| 31/12/1993 | Bal. c/d | <u>8,564</u> | 1/1/1993 | Bal. b/d | 6,423 |
| | | <u>8,564</u> | 1/1/1993 | P & L | <u>2,141</u> |
| | | | | | <u>8,564</u> |

| Finance Charges Suspense Account | | | | | |
|---|----------------|--------------|----------|-----------------|--------------|
| N | | | N | | |
| 31/12/1990 | Lessor Account | 6,870 | 31/12/90 | Finance Charges | 2,750 |
| | | — | | Bal. c/d | <u>4,300</u> |
| | | <u>6,870</u> | | | <u>6,870</u> |
| 31/12/1991 | BAL b/d | 4,300 | 31/12/91 | Finance Charges | 2,055 |
| | | — | | Bal. c/d | <u>2,245</u> |
| | | <u>4,300</u> | | | <u>4,300</u> |
| 31/12/1992 | Bal. b/d | 2,245 | 31/12/92 | Finance Charges | 1,463 |
| | | — | | Bal. c/d | <u>782</u> |
| | | <u>2,245</u> | | | <u>2,245</u> |
| 31/12/1993 | Bal. b/d | <u>782</u> | 31/12/93 | Finance Charges | <u>782</u> |

| Finance Charges Account | | | | | |
|--------------------------------|--|--|---|--|--|
| N | | | N | | |
| | | | | | |

| | | | | | |
|----------|--------------------------|--------------|----------|-------|--------------|
| 31/12/90 | Finance Charges Suspense | <u>2,570</u> | 31/12/90 | P & L | <u>2,570</u> |
| 31/12/91 | Finance Charges Suspense | <u>2,055</u> | 31/12/91 | P & L | <u>2,055</u> |
| 31/12/92 | Finance Charges Suspense | <u>1,463</u> | 31/12/92 | P & L | <u>1,463</u> |
| 31/12/93 | Finance Charges Suspense | <u>782</u> | 31/12/93 | P & L | <u>782</u> |

Lessor's Account

| | | N | N | |
|----------|----------|---------------|-------------------------|---------------|
| 31/12/90 | Bank | 6,000 | 1/1/90 Leased Assets | 17,130 |
| 31/12/90 | Bal. C/D | <u>18,000</u> | 31/12/90 Finance Charge | <u>6,870</u> |
| | | <u>24,000</u> | Suspense | <u>24,000</u> |
| 31/12/91 | Bank | 6,000 | 1/1/92 Bal. b/d | 18,000 |
| 31/12/91 | Bal. c/d | <u>12,000</u> | | <u>18,000</u> |
| | | <u>18,000</u> | | <u>18,000</u> |
| 31/12/92 | Bank | 6,000 | 1/1/92 Bal. b/d | 12,000 |
| | Bal. c/d | <u>6,000</u> | | ----- |
| | | <u>12,000</u> | | <u>12,000</u> |
| 31/12/93 | Bank | <u>6,000</u> | 1/1/93 Bal. b/d | <u>6,000</u> |

4.2.2 CONTRACT ACCOUNTS

The main accounting problems associated with construction contracts is the timing, measurement and recognition of revenue and the assets created during construction. The value assigned to work-in-progress has an effect on the Profit and Loss Account and the value reported as current asset on the Balance Sheet It also ensures the proper matching of costs with revenue.

In practice, two (2) Methods are generally used for Accounting for Construction Contracts, namely:

- (a) The Completed Contract Method; and
- (b) The Percentage of Completion Method.

Both methods are used, depending on the circumstances of each contract.

The Completed Contract Method

Under the completed contract method, revenue is recognized when the contract is completed. No interim charges and credits are made to profit and loss account.

Sometimes, there are costs to be incurred at the end of the contract, which may not be material to warrant regarding the contract as uncompleted. Such costs are provided for and the contract is treated as completed. In the construction industry, this is referred to as practical completion stage.

Usually, the completed contract method for long-term contracts is used by enterprises in a situation where there are no dependable estimates or where there are inherent uncertainties, which make forecasts unreliable. Until the point at which contract is identified to be completed revenue is not recognized.

The completed contract method has an appeal to many enterprises because the income that is reported in the accounts is the final result of the contract rather than an estimate of the result to date. The revenue at this point is terminal.

The major drawback of the completed contract method when applied to long-term contracts is that periodic revenue is subject to distortion. Revenue prior to completion is not reflected in the accounts of the reporting enterprises even if operations on the contract are uniform over the construction period.

Under the completed-contract method, although profit is not recognized prior to the completion of the contract, foreseeable losses on the contract are often charged in the accounts in the period they are identified.

The Percentage of Completion Method

Under the percentage-of-completion method, costs that are incurred on a contract are accumulated in an asset account. The proportion of revenue in relation to the work done may be ascertained by one of the following two methods.

- (a) The percentage of estimated total revenue that the incurred costs to date bears to the estimated total costs.
- (b) The percentage of total contract value that the engineering and architectural work done to date bears to the engineering and architectural estimate of the whole contract.

Where the percentage-of-completion method is used, it is usual to establish that the revenue is not overstated by computing the estimated total costs to completion and comparing it with the total estimated revenue.

The percentage of completion method is used when:-

- a) There is a contract in which the following terms are included:-
 - i. The goods or services to be provided and received;
 - ii. The frequency of inspection of work-in-progress and the certification procedures for billing purposes;
 - iii. The manner of billing for work done and the term of payment.

- b) The contractor has an adequate estimating process and the ability to estimate reliably both the cost to completion and the percentage of contract executed.

- c) The contractor has a cost accounting system, which adequately accumulates and allocates costs to final work in a manner consistent with his estimating process.

The percentage-of-completion method is considered to give a fair measure of activities performed in each accounting period and the resultant revenue. Thus revenue is adequately matched with cost in the accounting period.

Illustration

Bayero Construction Limited started on 3 July 2000, the construction of a dam awarded to them for N9 million by Kano State Government. The contract was expected to be completed by June 30 2003. As at 30 June 2002, the company's financial year ended, the following information in respect of the contract was available.

| | | |
|--|----------------|-----------------|
| Cost incurred during the year to 30/6/2002 | N | |
| Materials purchased | 447,000 | |
| Wages and salaries | 873,000 | |
| Payment to sub-contractors | 165,000 | |
| Hire of plant | 45,000 | |
| Contract overheads | 210,000 | |
| Other relevant information is as follows: | | |
| | As at 1/7/2001 | As at 30/6/2002 |
| Book value of plant purchased for the contract | 1,200,000 | 975,000 |
| Stock of unusual materials | 81,000 | 165,000 |
| Cost of work certified | 6,000 | 4,500 |
| Value of work certified | 5,400,000 | 7,500,000 |
| Progress payments received to date | 3,600,000 | 4,500,000 |
| Progress payments receivable | 450,000 | 1,380,000 |
| Retentions | 405,000 | 675,000 |
| Profit recognized to date | 385,000 | |

The total cost incurred from the commencement of the contracts to 30 June, 2002 amounted to N6,840,000. On 30 June 2002, it was estimated that additional N1,440,000 would still be incurred to complete the Dam.

You are required to:

- (a) Prepare the Contract Account for the year ended 30 June 2002.
- (b) Show the Kano State Government Account and the Retention Account.
- (c) Show the relevant entries estimated in the balance sheet of Bayero Construction Limited as at June, 2002.

Solution

(a) Bayero Construction Limited

| | | N | | | N |
|-----------------------------|--|-------------------------|------------------------|--|-------------------------|
| Materials | | 447,000 | Work certified | | 2,100,000 |
| Wages and salaries | | 873,000 | Unused Materials c/f | | 165,000 |
| Payments to sub-contractors | | 165,000 | Work not certified c/f | | 4,500 |
| Hire plant | | 45,000 | Plant c/f | | 975,000 |
| Contract overheads | | 210,000 | | | |
| Unused materials | | 81,000 | | | |
| Cost of work not certified | | 6,000 | | | |
| Cost of plant | | 1,200,000 | | | |
| Profit | | 209,783 | | | |
| Reserve | | <u>7,717</u> | | | |
| | | <u>3,244,500</u> | | | <u>3,244,500</u> |

(b)

Kano State Government Account

| | | N | | | N |
|---|--|------------------|--|--|-------------------------|
| 1/7/02 Bal. b/f (progress payment received) | | 450,000 | 30/6/02 Bank | | 90,000 |
| 30/6/02 Contract A/c value of Certified | | 2,100,000 | Retention | | 270,000 |
| | | <u>2,550,000</u> | Bal. c/f (Progress payment receivable) | | <u>1,380,000</u> |
| | | | | | <u>2,550,000</u> |

Retention Account

| | | | | | |
|-----------------|--|---------|------------------|--|---------|
| 1/7/01 Bal. b/f | | 405,000 | 30/6/02 Bal. c/f | | 675,000 |
|-----------------|--|---------|------------------|--|---------|

| | | | |
|---------|------------------|----------------|----------------|
| 30/6/02 | Kano State Govt. | <u>270,000</u> | |
| | | <u>675,000</u> | <u>675,000</u> |

(c) **Bayero Construction Limited**
Balance Sheet (extract) as at 30th June, 2002

| N | | N |
|--------------------------------------|--|-----------|
| Reserve | Fixed Assets | |
| Profit in suspense on contract 7,717 | Plant on construction site | 975,000 |
| | Current Assets | |
| | Stock of unused materials on Construction site | 165,000 |
| | Construction work in Progress | 879,783 |
| | Debtors: Progress Payment rec. | 1,380,000 |
| | Retention money | 675,000 |

Working Notes:

| | | | |
|----|--|------------------|-----------------------|
| 1. | Profit Recognized | N | N |
| | Contract price | | 9,000,000 |
| | Less cost to date | 6,840,000 | |
| | Estimate future cost | <u>1,440,000</u> | <u>8,280,000</u> |
| | Profit to recognize from inception to year ended | | <u>720,000</u> |

30/6/2002

$$\frac{N6,840,000}{8,280,000} \times \frac{N720,000}{1} = N594,783$$

| | |
|--|----------------|
| Less Profit recognized to 30/6/2001 | <u>385,000</u> |
| Profit to recognize in 2001 / 2002 Accounting Year | <u>209,783</u> |

| | | | |
|----|--|----------------|-----------------------|
| 2. | Work In Progress as at 30/6/2002 | | |
| | Cost to date | 6,840,000 | |
| | Add Profit recognized to date | <u>594,783</u> | |
| | | | 7,434,783 |
| | Less Progress Payment receivable to date | 4,500,000 | |
| | Progress Payment receivable on 30/6/2002 | 1,380,000 | |
| | Retention as at 30/6/2002 | 675,000 | <u>6,555,000</u> |
| | Work In Progress as at 30/6/2002 | | <u>879,783</u> |

4.2.3 HIRE PURCHASE ACCOUNTS

A Hire Purchase transaction is one in which the seller of an item parts with possession and transfers same to a buyer who, in return pays to the seller an amount known as a hire purchase price by way of an initial deposit plus periodic instalments over the period. The hire purchase price will normally be higher than the normal selling price of the item, the difference being hire purchase interest.

Accounting Procedures in H.P Buyer's Books (Using H.P. Interest Account Method)

1. Asset Acquired on H.P Terms
DR H.P Fixed Assets A/c With the cash price
CR H.P Creditors A/c

2. Deposit / Instalment Paid
DR H.P Creditor's A/c With the amount paid
CR H.P Bank A/c

3. Recognition of H.P Interest included in Instalment Paid.
DR H.P Interest A/c with H.P interest attributable to the
CR H.P Creditors A/c instalment period

4. At the Accounting Year-end.
(a) DR Profit and Loss A/c with H.P interest written off during
CR H.P Interest A/c the year
(b) DR Profit and Loss Account Depreciation on the Hire Purchase
Provision for Depreciation A/c

N.B: The closing balance the H.P Creditors Account is the outstanding portion of the cash price

Accounting Procedures in H.P Buyer's Book using H.P Interest Suspense Account Method

1. Asset Acquire on H.P Terms
DR H.P Fixed Asset A/c With cash price
DR H.P Interest Suspense A/c With full H.P interest
CR H.P Creditors A/c With H.P price

2. Deposit /Instalment Paid.
DR H.P Creditor's A/c

- | | | | |
|-----|----|--|---------------------------------------|
| | CR | Bank A/c | With the amount |
| 3. | | Recognition of H.P Interest included in Instalment Paid. | |
| | DR | H.P Interest A/c | With H.P interest attributable to the |
| | CR | H.P Suspense A/c | instalment period |
| 4. | | At the Accounting Year – end. | |
| (a) | DR | Profit and Loss A/c | With depreciation on the H.P asset |
| | CR | H.P Interest A/c | |
| (b) | DR | Profit and Loss Account | With depreciation on the H.P asset |
| | CR | Provision for Depreciation A/c | |

N.B: The closing balance on H.P Creditors Account is the outstanding portion of the cash price plus unamortized portion of H.P interest. The creditors account balance is therefore, disclosed in the balance sheet less the balance on the H.P interest suspense account.

REPOSSESSION

Repossession occurs when the H.P seller takes back possession of goods sold on hire purchase items from the hire purchase buyer.

A common reason for the action is default on the part of H.P buyer in paying instalment(s) due. Repossession has the effect of bringing transactions to a close before the agreed terminal date. After goods are repossessed, they may be reconditioned before being sold or take to stock.

Repossession may take place before the end of the accounting year in which the goods were sold or after. Since repossession effectively brings the transaction to an end, all outstanding balances in respect of the repossessed goods are, at the date of repossession, transferred to repossession account.

Repossession of goods before the end of the accounting year in which the goods were sold
When repossession occurs before the end of the accounting year in which the goods were sold, the following entries shall be passed.

1. Transfer of outstanding balances in respect of repossessed goods to repossession account
 - (a)

| | | |
|----|------------------|---|
| DR | Repossession A/c | With the outstanding H.P debtors' balance |
| CR | H.P Debtors A/c | In respect of the goods repossessed |
 - (b)

| | | |
|----|---------------------------|--|
| DR | H.P Interest Suspense A/c | With the suspended H.P Interest, if |
| CR | Repossession A/c | any, in respect of the repossessed goods |

(c) DR H.P Interest Received A/c With the total H.P Interest already
 CR Repossession A/c credited to H.P interest received A/c.

(d) DR H.P Sales A/c With the cash price (or H.P price, in the case
 CR Repossession A/c of small items) already credited to the H.P
 Sales Account.

NB: Entries (1 (b) and (c) apply you to repossession of large items.

2. Transfer of cost repossessed goods to repossession goods

DR Repossession A/c With the cost repossessed goods
 CR Purchases A/c

3. Cost of reconditioning the repossessed goods

DR Repossession A/c With the cost reconditioning the
 CR Bank A/c goods

4. Repossession goods taken into stock

DR Stock A/c With the valuation of the repossessed
 CR Repossession A/c goods

5. DR Bank A/c With the sales proceeds

CR Repossession A/c

6. The balance on the repossession account is the profit or loss on repossession and should be written off to the profit and loss account.

Repossession of goods after the end of the accounting year in which the goods were sold

Where repossession takes place after end of the accounting year in which the goods were sold, the following accounting entries shall be passed.

1. Transfer of outstanding balances in respect of the repossessed goods to Repossession Account

(a) DR Repossession A/c With outstanding balance on the H.P
 Debtors
 CR H.P Debtors A/c account in respect of repossessed goods

(b) DR H.P Interest Suspense A/c With suspended interest, if any on
 CR Repossession A/c the repossessed goods

(c) DR H.P Interest Received A/c With the total H.P Interest already

- (d) Show an extract from Chimamanda Ltd.'s balance sheet relevant to the contract as at 31st December, 2001 and using facts in (c), the depreciation on crane is at 25% per annum straight line on cost.
- (e) Show an extract from Big-Lift Ltd.'s balance sheet relevant to the contract as at 31st December, 2001. The company includes in its instalments receivable interest at 20% per annum on the outstanding balance. The manufacturing cost of the hydraulic crane was N9,000,000.

Solution

- (a) Calculation of Hire Purchase Price and Interest

| | N |
|--------------------------------|-------------------|
| Initial deposit paid on 1/1/01 | 4,000,000 |
| Instalments = N3,797,800 x 3 = | <u>11,393,400</u> |
| Hire purchase price | 15,393,400 |
| Less: Cash price | <u>12,000,000</u> |
| Hire purchase interest | <u>3,393,400</u> |

| (b) | Year | Digit allocated | Workings | H.P. Interest |
|-----|------|-----------------|--------------------------------|-------------------------|
| | | | | N |
| | 1 | 3 | $\frac{3}{6} \times 3,393,400$ | 1,696,700 |
| | 2 | 2 | $\frac{2}{6} \times 3,393,400$ | 1,131,133 |
| | 3 | $\frac{1}{6}$ | $\frac{1}{6} \times 3,393,400$ | <u>565,567</u> |
| | | | | <u>3,393,400</u> |

- (c) Workings

| | N | H.P Interest (N) |
|--------------------------------------|--------------------|------------------|
| 1/1/01 Cash price | 12,000,000 | |
| 1/1/01 Deposit | <u>(4,000,000)</u> | |
| | 8,000,000 | |
| 31/12/01 Interest (N8,000,000 x 20%) | <u>1,600,000</u> | 1,600,000 |
| | 9,600,000 | |
| 31/12/01 1 st Instalment | <u>(3,797,800)</u> | |
| | 5,802,200 | |
| 31/12/02 Interest (N5,802,200 x 20%) | <u>1,160,440</u> | 1,160,440 |
| | 6,962,640 | |
| 31/12/02 2 nd Instalment | <u>(3,797,800)</u> | |
| | 3,164,840 | |
| 31/12/03 Interest (N3,164,840 x 20%) | <u>632,960</u> | 632,960 |
| | 3,797,800 | _____ |

$$\begin{aligned}
2). \quad \text{Unrealized Profit} &= \frac{\text{H.P Debtor Balance Outstanding}}{\text{H.P Price}} \times \frac{\text{H.P Price} - \text{cost}}{1} \\
&= \frac{7,595,600}{15,393,400} \times 15,393,400 - 9,000,000 \\
&= \frac{7,595,600}{15,393,400} \times 6,393,400 \\
&= \text{N3,154,710}
\end{aligned}$$

4.2.4 Accounting for Price Level Changes

Definition of Inflation

Inflation is a general rise in the prices of goods and services. It is a fall in the purchasing value of money.

High inflation affects the economy and businesses in the following ways:

- i. Profits are generally overstated.
- ii. There is increasing pressure on the cash flow position of the company.
- iii. Procurement costs tend to continue to rise.
- iv. Interests rates tend to rise, making it more difficult for a company to borrow and also more costly.
- v. Wage agreements tend to be negotiated more often, thereby making costing forecasts less accurate.
- vi. Assets such as plant and machinery require to be replaced at a higher cost than provided for in the accounts where the cost price of the original assets is the basis of the provision.

Methods of Accounting for Inflation

i). Current Purchasing Power (CPP)

This method of accounting for inflation is designed to show the equity shareholder whether or not shareholding is maintaining its purchasing power value relative to when he originally acquired it. This is termed the maintenance of capital concept.

ii). Current Cost Account (CCA)

A current cost is stated in terms of its current price rather than in terms of its acquisition cost. Thus, operating profit is computed taking into account the value of the assets used in earning that profit at their current value to the business.

Accounting Relating to Current Cost Account

Four adjustments to be made to historic cost profit before tax under the current cost account are:

- i. Cost of sale adjustment (COSA)
- ii. Depreciation adjustment (DA).
- iii. Monetary Working capital adjustment (MWCA).
- iv. Gearing adjustment (GA).

Format of Current Cost Profit and Loss Account

| | N | N |
|--|------------|--------------|
| Historical cost profit before tax | | xxx |
| Cost of sales adjustment | xxx | |
| Depreciation adjustment | xxx | |
| Monetary working capital adjustment | <u>xxx</u> | <u>(xxx)</u> |
| Entity current cost operating profit | | xxx |
| Interest | | <u>(xx)</u> |
| | | xxx |
| Gearing adjustment | <u>xx</u> | |
| | | <u>xxx</u> |
| Proprietary current cost profit before tax | | <u>xxx</u> |

COST OF SALE ADJUSTMENT

Cost of sale adjustment is arrived at as follows:

COSA = Historic cost less current cost

$$\text{Current Cost} = \text{Historic Cost} \times \frac{\text{Average index}}{\text{Index at valuation}}$$

Index at valuation implies: Opening index for opening stock
Closing index for closing stock

DEPRECIATION ADJUSTMENT

This is the difference between historic cost depreciation charge and the current cost depreciation charge in the profit and loss account.

$$\text{CURRENT COST DEPRECIATION} = \text{HISTORIC COST} \times \frac{\text{Average Index}}{\text{Index at acquisition}}$$

However, in the balance sheet, the current Cost Net Book Value is calculated as follows:

$$\text{HISTORIC COST} \times \text{Index at balance sheet date}$$

Index at acquisition

MONETARY WORKING CAPITAL ADJUSTMENT

Monetary working capital is the excess of trade debtors over the trade creditors. In broad term, monetary working capital is the total of the following items:

- i. Trade debtors, prepayment and bills receivable.
- ii. Certain special categories of stock where a cost of sales adjustment is regarded as inappropriate.
- iii. Trade creditors, accruals and bill payables.

$$\text{Current cost MWC} = \text{HC MWC} \times \frac{\text{Average index}}{\text{Index at opening/closing}}$$

GEARING ADJUSTMENT

This adjustment partly reflects the effect of external source of finance. The adjustment is an addition to profits, if there is excess of monetary liabilities, and a deduction, if there is an excess of monetary assets.

Gearing adjustment is calculated as follows:

$$\frac{\text{Average net borrowing}}{\text{Average net operating assets} + \text{Average net borrowing}} \times \text{Current cost adjustments} \quad 1$$

Current cost adjustments include:

- i. Cost of sales adjustment
- ii. Depreciation adjustment
- iii. Monetary capital adjustment

STEPS IN CALCULATING GEARING ADJUSTMENT

STEP I:

Determine the average net borrowing based on opening and closing balance sheet date. I.e.

$$\frac{\text{Opening net borrowing} + \text{Closing net borrowing}}{2}$$

| | |
|------------------------|----|
| NET BORROWING: | N |
| Debtenture | xx |
| Convertible loan stock | xx |
| Long term loan | xx |

| | |
|--------------------|------------|
| Deferred tax | xx |
| Company tax | xx |
| Overdraft | <u>xx</u> |
| | xx |
| Cash/ bank balance | <u>(x)</u> |
| | <u>(x)</u> |

STEP II:

Determine the average net operating assets based on opening and closing balance sheet date

i.e. Opening net operating asset + Closing net operating asset

2

| | |
|----------------------|-----------|
| NET OPERATING ASSET: | N |
| Share Capital | xx |
| Reserves | xx |
| Proposed Dividends | <u>xx</u> |
| | <u>xx</u> |

STEP III:

Calculate the gearing adjustment.

Illustration 1

The financial statement of Paul Ltd as at 31/12/07 are stated below (Historical cost basis)

Profit and Loss for the year ended 31st December 2007

| | |
|---------------------------------|--------------------|
| | N |
| Turnover | 20,000,000 |
| Cost of goods sold (COGS) | <u>(8,000,000)</u> |
| Gross profit | 12,000,000 |
| Administrative expenses | (1,200,000) |
| Selling & Distribution expenses | <u>(900,000)</u> |
| Operating Profit | 9,900,000 |
| Other incomes | <u>300,000</u> |
| Profit before tax | 10,200,000 |

| | | | |
|-----------------|------------------|---|------------------|
| Taxation | (3,060,000) | “ | (3,199,090) |
| | 7,140,000 | “ | 7,464,547 |
| Dividend | (2,000,000) | “ | (2,090,909) |
| Retained profit | <u>5,140,000</u> | | <u>5,373,638</u> |

Balance sheet based on Current Purchasing Power (CPP)

| | Historical Cost basis N'000 | Conversion Factor | CPP N'000 | <u>Fixed asset:</u> Historical Cost basis N'000 | Conversion Factor | CPP N'000 |
|----------------------------|-----------------------------------|----------------------|-------------------------|--|----------------------|-------------------------|
| Ordinary share | 15,000 | - | 15,000 | L & B | 16,000 115/105 | 17,523.81 |
| 8% Pref. share | 6,000 | - | 6,000 | M/Vehicle | 4,000 115/105 | 4,380.97 |
| 9% debenture | 4,000 | - | 4,000 | Furniture | 3,000 115/105 | 3,285.70 |
| <u>Reserves</u> | | | | <u>Current Assets</u> | | |
| General reserve | 3,000 | - | 3,000 | Stock | 3,200 115/105 | 3,504.76 |
| Share premium | 1,000 | - | 1,000 | Debtors | 1,800 | 1,800.00 |
| Capital reserve | | | 2,295.24 | Bank | 1,400 | 1,400.00 |
| | | | | Cash | 600 | 600.00 |
| <u>Current Liabilities</u> | | | | | | |
| Creditors | 1,000 | - | <u>1,000</u> | | | |
| | | | <u>32,295.24</u> | | | <u>32,295.24</u> |

Illustration 2

The cost of sales of New Enterprises Ltd. has been computed as follows, in accurate with historical cost accounting:

| | |
|----------------------------------|-----------------------|
| | N |
| Opening stock | 210,000 |
| Purchases | <u>929,000</u> |
| Cost of goods available for sale | 1,139,000 |
| Less closing stock | <u>246,000</u> |
| | <u>893,000</u> |

You are informed that the opening stock was acquired when the index for stock stood at 110 and closing stock when the index was 130. The average index during the year was 120.

Required: Compute the cost of sales adjustment.

Solution

| | | |
|-------------------------|----------------------|-------------|
| Historical Cost N | Adjustment Factor | (COSA) N |
|-------------------------|----------------------|-------------|

| | | | |
|---------------|------------------|---------|------------------|
| Opening stock | 210,000 | 120/110 | 229,091 |
| Purchases | <u>929,000</u> | | <u>929,000</u> |
| | 1,139,000 | | 1,158,091 |
| Closing stock | <u>(246,000)</u> | 120/130 | <u>(227,077)</u> |
| Cost of sales | <u>893,000</u> | | <u>931,014</u> |

Cost of sales adjustment (COSA) = 931,014 – 893,000 = N38,014

Illustration 3

The following data was extracted from the accounts of Joel Ltd for the Current financial year ended 30th June 2009:

| | |
|---------------|------------|
| Opening Stock | N 100,000 |
| Closing stock | N140,800 |
| Purchases | N800,000 |
| Sales | N1,600,000 |

The balance sheet also revealed the following information in respect of motor vehicles

| | |
|--------------------------|------------------|
| | N |
| Cost | 416,000 |
| Accumulated Depreciation | <u>(272,000)</u> |
| Net book value | <u>144,000</u> |

The motor vehicles were acquired at a cost of N240,000 during the year ended June 2005. The accumulated depreciation to 30th June 2009, was N192,000. Another was acquired during the year ended June 2008 at a cost of N176,000. The accumulated depreciation to 31st June 2009 was N80,000.

In the Current year's Profit and Loss the amount charged as depreciation on Motor Vehicles was N112,000 (N72,000 on 2005 Purchases and N40,000 on 2008 purchases).

The following specific price indices were extracted in respect of stock and Motor Vehicles:

| | Stock | Plant and Machinery |
|-----------------------------|-------|---------------------|
| June 2005 | - | 160 |
| June 2008 | - | 210 |
| 1 st July, 2008 | 110 | - |
| 30 th June, 2009 | 120 | 235 |
| Average during 2008/2009 | 115 | 230 |

Required:

- Prepare the trading account using Historical Cost and the Current Cost basis.

- b) Calculate cost of sales adjustment and depreciation adjustment.
- c) Show the balance sheet extract (for Motor Vehicles) under the Current Cost basis.
- d) What are the accounting entries required to record the adjustments in fixed assets in the current cost balance sheet?

Solution

a)

| JOEL Ltd. | | | | | |
|--|-----------------|------------------|---------------------------------|------------------|------------------|
| <u>Trading Account for the Year ended 30th June 2009</u> | | | | | |
| | Historical Cost | | Index | Current Cost | |
| | N | N | | N | N |
| Sales | | 1,600,000 | | | 1,600,000 |
| Opening stock | 100,000 | | ¹¹⁵ / ₁₁₀ | 104,545 | |
| Purchases | <u>800,000</u> | | | <u>800,000</u> | |
| | | | | 904,545 | |
| Closing stock | (140,800) | <u>(759,200)</u> | ¹¹⁵ / ₁₂₀ | <u>(134,933)</u> | <u>(769,612)</u> |
| Gross profit | <u>840,800</u> | | | | <u>830,388</u> |

b)

Cost of Sales Adjustment:

| | |
|--------------------------|------------------|
| | N |
| Current Cost of sales | 769,612 |
| Historical cost of sales | <u>(759,200)</u> |
| COSA | <u>10,412</u> |

Depreciation Adjustment:

| | HC Dep. | Index | CC Dep |
|------|---------------|---------------------------------|----------------|
| | N | | N |
| 2005 | 72,000 | ²³⁰ / ₁₆₀ | 103,500 |
| 2008 | <u>40,000</u> | ²³⁰ / ₂₁₀ | <u>43,810</u> |
| | 112,000 | | <u>147,310</u> |

Depreciation Adjustment = N147,310 - N112,000
 = N35,310

c)

| HC NBV | Index | CC NBV |
|--------|-------|--------|
|--------|-------|--------|

| | | | |
|------|----------------|---------------------------------|----------------|
| | N | | N |
| 2005 | 48,000 | ²³⁵ / ₁₆₀ | 70,500 |
| 2008 | <u>96,000</u> | ²³⁵ / ₂₁₀ | <u>107,429</u> |
| | <u>144,000</u> | | <u>177,929</u> |

Depreciation Adjustment in fixed asset (Motor Vehicle a/c)

$$= \text{N}177,929 - \text{N}144,000$$

$$= \underline{\underline{\text{N}33,929}}$$

Illustration 4

Below are the opening and closing debtors and creditors of OYIN Ltd for the year ended 30th September 2009:

| | | |
|-----------|-----------|-----------|
| | 2009 | 2008 |
| | N | N |
| Debtors | 1,160,000 | 1,080,000 |
| Creditors | (820,000) | (720,000) |

Relevant indices are:

| | | |
|-----------|------|-----|
| September | 2008 | 148 |
| September | 2009 | 154 |
| Average | | 150 |

Calculate the monetary working capital adjustment.

Solution

| | | | |
|-----------------------------|-----------------|---------------------------------|-----------------|
| | HC | Index | CC |
| Opening MWC | 360,000 | ¹⁵⁰ / ₁₄₂ | 380,282 |
| Closing MWC | <u>340,000</u> | ¹⁵⁰ / ₁₅₄ | <u>331,169</u> |
| Increase/ (Decrease) in MWC | <u>(20,000)</u> | | <u>(49,113)</u> |

$$\text{Monetary Working Capital Adjustment} = (20,000) - (49,113)$$

$$= \underline{\underline{\text{N}29,113}}$$

Illustration 5

Below are the historical balance sheets extract of White Knight Ltd as well as the Profit and Loss account.

| | | |
|---|------------|------------|
| <u>Current Cost balance sheet at</u> | 31/02/2007 | 31/02/2006 |
| | N | N |
| Fixed Assets | 870,000 | 945,000 |

| | | |
|---------------------------------|----------------|----------------|
| Less: Related government grants | <u>174,000</u> | <u>189,000</u> |
|---------------------------------|----------------|----------------|

CURRENT ASSETS:

| | | |
|------------------------------|------------------|------------------|
| Stock | 1,087,000 | 612,000 |
| Debtors | 484,000 | 372,000 |
| Cash | <u>35,000</u> | <u>382,000</u> |
| | <u>2,650,000</u> | <u>2,500,000</u> |
| Ordinary Share Capital | 350,000 | 350,000 |
| Share premium | 32,500 | 32,500 |
| Current cost revenue reserve | 596,000 | 940,000 |
| Convertible Loan stock | 500,000 | 500,000 |
| Deferred taxation | 275,000 | 250,000 |

CURRENT LIABILITIES:

| | | |
|-------------------|------------------|------------------|
| Creditors | 444,000 | 250,000 |
| Taxation | 75,000 | 60,000 |
| Bank overdraft | 252,500 | 17,500 |
| Proposed Dividend | <u>250,000</u> | <u>200,000</u> |
| | <u>2,650,000</u> | <u>2,500,000</u> |

Historical Cost P or L account for the year ended 31/02/2007

| | |
|--------------------------------|------------------|
| | N |
| Profit before interest and tax | 520,500 |
| Interest payable | <u>(97,500)</u> |
| Profit before tax | 423,000 |
| Taxation | <u>(100,000)</u> |
| Profit after tax | 323,000 |
| Dividends | <u>(187,500)</u> |
| Retained profit for the year | <u>135,500</u> |

The following current cost adjustment have been compiled

| | |
|-------------------------------------|--------|
| Depreciation adjustment | 45,000 |
| Cost of sale adjustment | 84,500 |
| Monetary Working Capital Adjustment | 70,000 |

Required:

Calculate the Gearing Adjustment and present the Current Profit or Loss account for the year ended 31st December 2007.

Solution

| White Knight Ltd. | | |
|--------------------------|------------------|------------------|
| | 2006 | 2007 |
| | N | N |
| Average net borrowing | 500,000 | 500,000 |
| Convertible loan stock | 250,000 | 275,000 |
| Deferred tax | 60,000 | 75,000 |
| Tax | <u>17,500</u> | <u>252,500</u> |
| Bank overdraft | 827,500 | 1,102,500 |
| Cash | <u>(382,000)</u> | <u>(35,000)</u> |
| | <u>445,500</u> | <u>1,067,500</u> |

$$\begin{aligned} \text{Average Net Borrowing} &= \frac{445,000 + 1,067,500}{2} \\ &= \underline{\underline{756,250}} \end{aligned}$$

Average shareholders' interest (Net Operating Asset):

| | 2006 | 2007 |
|------------------------------|------------------|------------------|
| | N | N |
| Ordinary Share capital | 350,000 | 350,000 |
| Share premium | 32,500 | 32,500 |
| Current cost revenue reserve | <u>940,000</u> | <u>596,000</u> |
| | 1,322,500 | 978,500 |
| Proposed dividend | <u>100,000</u> | <u>125,000</u> |
| | <u>1,422,500</u> | <u>1,103,500</u> |

$$\begin{aligned} \text{Average Net Operating Asset} &= \frac{1,422,500 + 1,103,500}{2} \\ &= \underline{\underline{1,263,000}} \end{aligned}$$

$$\begin{aligned} \text{Gearing proportion} &= \frac{756,250}{756,250 + 1,263,000} \\ &= \underline{\underline{756,250}} \end{aligned}$$

$$2,019,500 = 0.37$$

$$\begin{aligned} \text{Gearing Adjustment} &= 0.37 (45,000 + 84,500 + 70,000) \\ &= 0.37 (197,500) \\ &= \underline{73,075} \end{aligned}$$

Current Cost Profit and Loss Account for the Year ended 31st December 2007

| | N | N |
|--------------------------------|---------------|------------------|
| Profit before Interest and Tax | | 520,500 |
| Interest payable | | <u>(97,500)</u> |
| | | 423,000 |
| Depreciation Adjustment | 45,000 | |
| COS Adjustment | (84,500) | |
| MWC Adjustment | <u>70,000</u> | <u>(30,500)</u> |
| Profit before tax | | 392,500 |
| Tax | | <u>(100,000)</u> |
| Profit after tax | 292,500 | |
| Dividend | | <u>(187,500)</u> |
| | | 105,000 |
| Gearing Adjustment | | <u>73,815</u> |
| Current retained | | <u>178,815</u> |

4.03 Specialized Accounts

4.3.1 ACCOUNTING FOR INSURANCE CLAIMS

Accounting Entries

1. Estimated value of stock at Date of Fire:

| | | |
|-----------------|---|--------------------------|
| DR: Stock a/c | } | with the amount computed |
| CR: Trading a/c | } | |

2. The amount of the agreed claim:

| | | |
|-------------------------|---|--------------------------|
| DR: Insurance claim a/c | } | with the amount of claim |
| CR: Stock a/c | } | |

3. Value of stock lost on which claim is not payable by the insurance company

| | | |
|-------------------------|---|--|
| DR: Profit and loss a/c | } | with the cost of stock less the amount |
|-------------------------|---|--|

CR: Stock a/c

NB: At this point, the balance on the stock account represents the value of the salvage stock. If there is no salvaged stock, the balance on the stock account will be nil.

4. Claim received from insurance company:

| | | |
|------------------------|---|--------------------------|
| DR: Cash book | } | with the amount received |
| CR Insurance claim a/c | | |

Illustration 1

Where written down stock items are not involved

On May 31st 19x6, a fire occurred on the premises of Ogbologbo Ltd. The most important books were not destroyed from where it was possible to assert the following particulars:

| | N |
|---|---------|
| Sales from 1 st January to 31 st May 19x6 | 256,000 |
| Purchases during the same period | 168,000 |
| Stock on hand on 1 st January 19x6 | 47,200 |

The gross profit for the past five years had averaged 35% on sales. The value of the salvaged stock was N6,000.

You are required to draft a statement of insurance claim in respect of the lost stock.

Solution

Statement of Insurance Claim

| | N | N |
|-------------------------------------|---------|----------------|
| Stock at 1/1/x6 | | 47,200 |
| Purchases: 1/1/x6-31/5/x6 | | <u>168,000</u> |
| Goods available for sale | | 215,200 |
| Less: cost of goods sold: | | |
| Sales: - 1/1/x6 – 31/5/x6 | 256,000 | |
| Less: Gross profit at 35% | 89,600 | |
| Cost of goods sold | | <u>166,400</u> |
| Estimated value of stock at 31/5/x6 | | 48,800 |
| Less: salvaged stock | | <u>6,000</u> |
| Stock lost (i.e. claim) | | <u>42,800</u> |

Illustration 2

Where written down stock items are involved

On August 31, 19x6 the following items of Inferno Ltd were destroyed by fire. The business books and records were saved from where the following data were taken:

| | N |
|--|--------|
| Stock at 31 st March 19x5 | 9,100 |
| Stock at 31 st March 19x6 | 7,510 |
| Purchases (year to 31 st March 10x6) | 20,770 |
| Sales (year to 31 st March 19x6) | 30,930 |
| Purchases from 1 st April to 31 st August 19x6 | 7,470 |
| Sales from 1 st April to 31 st August 19x6 | 11,800 |

In valuing stock at 31st March 19x5, N400 has been written off a particular line of goods which originally cost N640. The written down stock was sold in May 19x5 for N430.

In valuing stock at 31st March 19x6, another line of goods costing N30 was written down to N200. In June 19x6, this item of stock was sold for N350.

Except as regards the goods indicated above, the gross profit percentage had remained unchanged throughout.

You are required to calculate amount of claim due from the insurers in respect of stock lost.

Solution

Statement of Insurance Claim

| | Normal Stock | | Abnormal Stock | | Total | |
|-----------------------------------|--------------|--------|----------------|-----|---------|--------|
| | N | N | N | N | N | N |
| Stock @ 1/4/x6 | | 7,310 | | 200 | 7,510 | |
| Purchases 1/4/x6-31/8/06 | 7,470 | | - | | 7,470 | |
| Goods available for sale | | 14,780 | | 200 | | 14,980 |
| Less Cost of goods sold: | | | | | | |
| Sales: 1/4/x6 – 31/8/x6 | | 11,450 | | | 350 | 11,800 |
| Gross profit at 28% | (3,206) | | - | | (3,206) | |
| Profit on abnormal stock | - | | (150) | | (150) | |
| Cost of goods sold | | 8,244 | | 200 | | 8,444 |
| Estimated value of stock @31/8/x6 | | 6,536 | | - | | 6,536 |
| Salvaged stock | | | | | (1,020) | |

| | |
|-------------------------|--------------|
| Stock lost (i.e. Claim) | <u>5,516</u> |
|-------------------------|--------------|

Workings

(W.1) Calculations of Gross Profit % for the Year Ended 31st March 19x6

| | | N |
|-------------------------------------|----------------|-----------------|
| Sales | | 30,930 |
| Less: sales of written stock | | <u>430</u> |
| | | 30,500 |
| Less: Cost of goods sold | | |
| Opening stock | 9,100 | |
| Less: written down stock | <u>240</u> | |
| | 8,860 | |
| Purchases | <u>20,770</u> | |
| | 29,630 | |
| Closing stock | 7,510 | |
| Add: stock written off | <u>160</u> | |
| | <u>(7,670)</u> | |
| Cost of goods sold (@ normal value) | | <u>(21,960)</u> |
| Normal gross profit | | 8,540 |

$$\text{Normal gross profit \%} = \frac{8,540}{30,500} \times 100 = 28\%$$

- It is necessary to deduct the written – down stock from the opening stock and the amount for which the written – down stock was sold (i.e.N430) from the sales so that both the opening stock and sales figures shall be free of all abnormal values (see page 239).

- It is necessary to add back the written-off value to the closing stock to ensure that the closing stock is deducted at its full normal cost {see page 240}

(W.2) Gross Profit on Abnormal Stock Sold in June 19x6

| | | N |
|--------------------------|--|------------|
| Stock value | | 350 |
| Less: written down value | | <u>200</u> |
| Gross profit thereon | | <u>150</u> |

4.3.2 FINANCIAL STATEMENTS OF INSURANCE COMPANIES

Legal/Regulatory Framework

The relevant regulatory requirements in preparing the accounts of insurance companies include:

1. Insurance Act 1997, as amended 2003 and 2007
2. Companies and Allied Matters Act (CAMA)1990
3. National Insurance Commission Act 1997
4. Statement of Accounting Standards SAS 16

Types of Insurance Business

There are two types of insurance business according to the provision of section 2 of Insurance Act 1997:

1. Life Insurance Business
2. General Insurance Business

Life Insurance Business

This comprises of:

1. Individual Life Insurance Business
2. Group Life Insurance Business

Minimum paid up Share Capital

The minimum paid up capital according to section 10 of Insurance Act 1997 is as follows:

1. For Life Insurance business: Not less than N20 Million
2. For General Insurance business: Not less than N20 Million
3. Where General Insurance business include any of the following:
 - a. Oil and Gas Insurance
 - b. Credit Insurance business, bond and sureteeship
 - c. Contracts "all risks" and engineering risk Insurance business
 - d. Marine and Aviation Insurance;
 - e. Paid up Capital of not less than N70Million
4. For Reinsurance business: Not less than N150Million.

According to the main provision of Insurance Act 2003, the minimum paid up capital is as follows:

1. Life Insurance business – not less than N150million
2. General Insurance business- not less than N200million
3. Composite Insurance business, not less than N350million
4. Insurance Brokerage and loss adjusters, not less than N5million
5. Re – insurance business, not less than N350million

The current provision in respect of minimum paid up capital is as follows:

1. Life Insurance business – N2billion
2. General Insurance business- N3billion
3. Composite Insurance business – N5billion
4. Re-insurance business – N10billion

Reserve Requirements

Every insurer shall maintain technical reserves based on the type of business being carried out by the company.

General Insurance

An insurer shall in respect of its general business maintain three types of reserves:

1. Reserves for Unexpired Risks- This shall be credited with 45% of net premium of other non – life business and 25% of net premium of marine cargo insurance.
2. Reserves For Outstanding Claims - This shall be credited with an amount equal to a total estimated outstanding claims plus a further provision of 10% of estimated figure of outstanding claims incurred but not reported at the end of the year under review.
3. Contingency reserves – This reserve is provided to cover fluctuations in securities and variations in statistical estimates. This shall be 3% of net premium or 20% of net profits whichever is higher. The reserve is to be accumulated until it reaches the amount of minimum paid up capital or 50% of net premium whichever is higher.

Life Insurance business

An insurer in life business should keep two types of reserves:

1. General reserve – An insurance company in life business shall maintain a general reserve equal to the net liabilities on all the policies in force as determined by and at the time of an actuarial valuation.
2. Contingency reserve – This shall be credited with 1% of premium or 10% of profits whichever is greater and this shall accumulate up to the minimum paid up capital.

Re-insurance

A reinsurer shall maintain a general reserve to be credited with not less than 50% of gross profit where reserve is less than paid up capital or 25% of gross profit where reserve is equal to or greater than paid up capital.

Solvency Margin

An insurer other than the life business shall maintain at all times a margin of solvency, being the excess of the value of its admissible assets in Nigeria over its liabilities in Nigeria, consisting of:-

- (a) reserves for unexpired risks
- (b) reserves for outstanding claims
- (c) reserves for claims but not yet reported
- (d) funds to meet other liabilities.

The Margin shall not be less than 15% of the gross premium income less re- insurance premium paid out during the year review or the minimum paid up capital whichever is greater.

FORMAT FOR LIFE BUSINESS

Profit and Loss Account for the year ended 30th Dec. XX

| | Notes | N |
|------------------------------|------------|------------|
| Life Fund buff | | x |
| Add Incomes: | | |
| - Underwriting income | | x |
| - Commission | | x |
| - Investment income | | x |
| - Other income | | <u>x</u> |
| | | <u>xx</u> |
| Expenses: | | |
| Underwriting expenses | (x) | |
| Commission expenses | (x) | |
| Investment expenses | (x) | |
| Management expenses | <u>(x)</u> | <u>(x)</u> |
| | | xx |
| Life Fund c/f | | <u>(x)</u> |
| Profit / (Loss) before tax | | xx |
| Tax | | <u>(x)</u> |
| Profit after tax | | xx |
| Appropriations | | <u>(x)</u> |
| Retained Profit for the year | | <u>x</u> |

NON-LIFE INSURANCE BUSINESS

Profit and Loss account for the year ended 30th Dec. XX

| | Fire | | Marine | | Burglary | | Total | |
|----------------------|------|------------|--------|------------|----------|------------|-------|------------|
| | N | N | N | N | N | N | N | N |
| Gross Premium Income | | xx | | xx | | xx | | xx |
| Less reinsurance | | | | | | | | |
| Premium paid | | <u>(x)</u> | | <u>(x)</u> | | <u>(x)</u> | | <u>(x)</u> |

| | | | | | | | |
|----------------------|------------|-------------|------------|-------------|------------|-------------|-------------|
| | xx | | xx | | xx | | xx |
| Commission Income | <u>x</u> | | <u>x</u> | | <u>x</u> | | <u>x</u> |
| | xx | | xx | | xx | | xx |
| Expenses: | | | | | | | |
| Claims | (x) | | (x) | | (x) | | (x) |
| Commission expenses | <u>(x)</u> | <u>(xx)</u> | <u>(x)</u> | <u>(xx)</u> | <u>(x)</u> | <u>(xx)</u> | <u>(xx)</u> |
| Underwriting profit | | <u>xxx</u> | | <u>xxx</u> | | <u>xxx</u> | xxx |
| Investment Income | | | | | | | xx |
| Other Income | | | | | | | xx |
| Expenses: | | | | | | | |
| Management expenses | | | | | | | (x) |
| Investment expenses | | | | | <u>(x)</u> | <u>(xx)</u> | |
| Profit before tax | | | | | | | xx |
| Tax | | | | | | | <u>(x)</u> |
| Profit after tax | | | | | | | xx |
| Appropriations: | | | | | | | |
| Dividend | | | | | | (x) | |
| Transfer to reserves | | | | | | <u>(x)</u> | <u>(xx)</u> |
| | | | | | | | <u>xxx</u> |

Statement of Financial Position as at 31/12/XX

| | | | |
|--------------------------|-------|------------|------------|
| Assets Employed: | Notes | N | N |
| Cash & Short-term Funds | | | x |
| Agent & Company balances | | | x |
| Investments | | | x |
| Other Assets | | | x |
| Noncurrent Assets | | | <u>x</u> |
| | | | xx |
| Liabilities: | | | |
| Insurance Fund | | (x) | |
| Other Liabilities | | <u>(x)</u> | <u>(x)</u> |
| Net Assets | | | <u>xx</u> |
| Financed by: | | | N |
| Share Capital | | | x |

Reserves

x

xx

Illustration 1

Ambali Plc. an Insurance Company into non-life business; incorporated with an authorized share capital of N5billion. The following balances were extracted from the books as at 31st December, 2007.

| | Dr N'000 | Cr N'000 |
|--|-------------------|-----------------------------|
| Ordinary Share Capital | | 3,000,000 |
| Premium | | 5,000,000 |
| Re-insurance premium | 500,000 | |
| Commission received | | 2,000,000 |
| Investment income | | 1,000,000 |
| Claims | 1,500,000 | |
| Re-insurance claims | | 800,000 |
| Agents and company balance | | 2,000,000 |
| Provision for bad debt on agents & company balance | | 580,000 |
| Cash at bank | 800,000 | |
| Treasury Bills and Certificates | 200,000 | |
| Statutory Deposits | 1,100,000 | |
| Commission expenses | | 900,000 |
| Contingency reserve | | 700,000 |
| Reserve for unexpired risk | | 520,000 |
| Reserve for outstanding claims | | 300,000 |
| Agency fees | 50,000 | |
| Auditors fees | 30,000 | |
| Actuarial valuation fees | 32,000 | |
| Management expenses | 100,000 | |
| Directors emoluments | 120,000 | |
| Electricity | 70,000 | |
| Stationary | 40,000 | |
| Investment | 150,000 | |
| Priming | 82,000 | |
| Depreciation on plants | 90,000 | |
| Sundry income | | 120,000 |
| Loan on policy | 115,000 | |
| Interest on loan | | 78,000 |
| Land and building | <u>6,219,000</u> | <u> </u> |
| | <u>14,098,000</u> | <u>14,098,000</u> |

Additional Information

- i. Taxation for the year ended should be taken at 10% of the profit before tax.
- ii. The following analysis has been made:

| | Fire N'000 | Marine N'000 | Burglary N'000 | Total N'000 |
|---------------------|---------------|-----------------|-------------------|----------------|
| Premium | 2,000,000 | 1500,000 | 1,500,000 | 5,000,000 |
| Re-insurance | 140,000 | 260,000 | 100,000 | 500,000 |
| Claims | 600,000 | 700,000 | 200,000 | 1,500,000 |
| Re-insurance claims | 200,000 | 500,000 | 100,000 | 800,000 |
| Commission received | 1,000,000 | 600,000 | 400,000 | 2,000,000 |
| Commission expenses | 450,000 | 300,000 | 150,000 | 900,000 |

Reserves: (31/12/06)

| | | | | |
|---------------------------------|---------|---------|---------|---------|
| Contingency reserve | 200,000 | 250,000 | 250,000 | 700,000 |
| Expired risk | 220,000 | 180,000 | 120,000 | 520,000 |
| Reserves for outstanding claims | 130,000 | 70,000 | 100,000 | 300,000 |

- iii. The provision on agents and company balances should be increased by 10%.

- iv. The following transfer should be made during the year:

| | Fire | Marine | Burglary | Total |
|-------------------------------------|--------|--------|----------|---------|
| Contingency reserves (N) | 30,000 | 20,000 | 15,000 | 65,000 |
| Reserves for unexpected risk | 10% | 8% | 12% | 30% |
| Reserves for outstanding claims (N) | 80,000 | 75,000 | 50,000 | 205,000 |

- v. The sum of N3billion has been included in the value of the land and building during the year. This sum represents the value for plant. You are required to make provision for depreciation on plants at the rate of 2% in addition to the one charged during the year.
- vi. Ordinary dividend of 10% on the total value of shares is to be paid.

Required:

Prepare the Profit or Loss A/c and a Statement of Financial Position as at 31st December, 2007.

Solution

AMBALI PLC

Profit and Loss Account for the Year ended 31st December 2007

| | | N'000 | Total N'000 |
|--|-------|----------------|-------------------------|
| Income: | Notes | | |
| Premium | (1) | 4,196,000 | |
| Commission | (2) | 2,000,000 | |
| Investment | (3) | 1,000,000 | |
| Other income | (4) | <u>198,000</u> | <u>7,394,000</u> |
| <u>Expenses:</u> | | | |
| Commission Expenses (5) | | 900,000 | |
| Management Expenses | (6) | 874,000 | |
| Claims | (7) | <u>905,000</u> | <u>(2,679,000)</u> |
| Profit before Tax | | | 4,715,500 |
| Taxation @ 10% | | | <u>(471,500)</u> |
| Profit after Tax | | | 4,243,500 |
| <u>Appropriation:</u> | | | |
| Ordinary dividend [10% of 3,000,000] (8) | | 300,000 | |
| Transfer to contingency reserve (9) | | <u>65,000</u> | <u>(365,000)</u> |
| Retained profit for the year | | | <u>3,878,500</u> |

AMBALI PLC

Statement of Financial Position as at 31st December 2007

| Assets: | Notes | N'000 | N'000 |
|---------------------------------|-------|------------------|------------------|
| Cash & short term funds: | | | |
| Treasury Bills and Cash at Bank | (10) | 1,000,000 | |
| Investment | | 150,000 | |
| Agents & Company balance | (11) | 1,220,000 | |
| Other assets (Loan on policy) | | 115,000 | |
| Statutory deposits | | 1,100,000 | |
| Noncurrent assets | (12) | <u>6,159,000</u> | <u>9,744,000</u> |
| Liabilities: | | | |
| Insurance Fund | (13) | 1,329,000 | |
| Taxation | | 471,500 | |

| | | |
|----------------------------|----------------|-------------------------|
| Proposed ordinary dividend | <u>300,000</u> | <u>(2,100,500)</u> |
| | | <u>7,643,500</u> |

Financed by:

| | | |
|------------------------|------|-------------------------|
| Ordinary share capital | | 3,000,000 |
| Retained profit | | 3,878,500 |
| Contingency reserve | (14) | <u>765,000</u> |
| | | <u>7,643,500</u> |

Notes:

| | Fire N'000 | Marine N'000 | Burglary N'000 | Total N'000 |
|--------------------------------|-------------------------|-------------------------|-------------------------|-------------------------|
| (1) Premium | 2,000,000 | 1,500,000 | 1,500,000 | 5,000,000 |
| Re-insurance prem. | (140,000) | (260,000) | (100,000) | (500,000) |
| Transfer to unexpired risk | <u>(120,000)</u> | <u>(64,000)</u> | <u>(120,000)</u> | <u>(304,000)</u> |
| | <u>1,740,000</u> | <u>1,176,000</u> | <u>1,280,000</u> | <u>4,196,000</u> |
| (2) Commission fee | 1,000,000 | 600,000 | 400,000 | <u>2,000,000</u> |
| (3) Investment income | | | | <u>1,000,000</u> |
| (4) Sundry income | | | 120,000 | |
| Interest on loan | | | <u>78,000</u> | <u>198,000</u> |
| (5) Commission expenses | <u>450,000</u> | <u>300,000</u> | <u>150,000</u> | <u>900,000</u> |
| (6) Management expenses | | N'000 | | |
| Management expenses | | 100,000 | | |
| Directors emolument | | 120,000 | | |
| Electricity | | 70,000 | | |
| Stationery | | 40,000 | | |
| Printing | | 82,000 | | |
| Depreciation | | 90,000 | | |
| Dep. Prov. (2% of N3m) | | 60,000 | | |
| Increase in Prov. for bad debt | | 200,000 | | |
| Agency fees | | 50,000 | | |
| Auditors fees | | 30,000 | | |
| Actuarial valuate fees | | <u>32,000</u> | | |
| | | <u>874,000</u> | | |
| (7) | Fire N'000 | Marine N'000 | Burglary N'000 | Total N'000 |

| | | | | |
|---|----------------|------------------|------------------|--------------------|
| Claims | 600,000 | 700,000 | 200,000 | 1,400,000 |
| Re-insurance claims | (200,000) | (500,000) | (100,000) | (800,000) |
| Transfer to Oust. Claims | <u>80,000</u> | <u>75,000</u> | <u>50,000</u> | <u>205,000</u> |
| | <u>480,000</u> | <u>275,000</u> | <u>150,000</u> | <u>905,000</u> |
| (8) Ordinary dividend 10% of 3,000,000 | | = | | <u>300,000</u> |
| (9) Transfer | <u>30,000</u> | <u>20,000</u> | <u>15,000</u> | <u>65,000</u> |
| (10) Treasury Bills and Cash at bank: - 800,000 + 200,000 | | | | = <u>1,000,000</u> |
| (11) Agents and company balance | | 2,000,000 | | |
| Less: Provision (580,000+200,000) | | | <u>780,000</u> | <u>1,220,000</u> |
| (12) Land & Building | | 6,219,000 | | |
| Less: Provision (2% of N3m) | | | <u>(60,000)</u> | |
| | | | <u>6,159,000</u> | |
| (13) Unexpired risk | 220,000 | 180,000 | 120,000 | 520,000 |
| Transfer | <u>120,000</u> | <u>64,000</u> | <u>120,000</u> | <u>304,000</u> |
| | <u>340,000</u> | <u>244,000</u> | <u>240,000</u> | <u>824,000</u> |
| Outstanding claims | 130,000 | 70,000 | 100,000 | 300,000 |
| Transfers | <u>80,000</u> | <u>75,000</u> | <u>50,000</u> | <u>205,000</u> |
| | <u>210,000</u> | <u>145,000</u> | <u>150,000</u> | <u>505,000</u> |
| | | <u>1,329,000</u> | | |
| (14) Balance | 200,000 | 250,000 | 250,000 | 700,000 |
| | <u>30,000</u> | <u>20,000</u> | <u>15,000</u> | <u>65,000</u> |
| | <u>230,000</u> | <u>270,000</u> | <u>265,000</u> | <u>765,000</u> |

Illustration 2

The following have been extracted from the Ledgers of ABC Assurance Company as at 31/12/07:

| | | |
|----------------------------|--------|-----------|
| | Dr | Cr |
| | N'000 | N'000 |
| Ordinary shares of N2 each | | 2,000,000 |
| Claims | 90,000 | |

| | | |
|-----------------------------|-------------------------|-------------------------|
| Re-insurance claims | | 40,000 |
| Premium | | 150,000 |
| Re-insurance premium | 30,000 | |
| Agent & company balance | 200,000 | |
| Cash & short-term funds | 80,000 | |
| Commission income | | 95,000 |
| Commission expenses | 6,000 | |
| Investment income | | 80,000 |
| Underwriting income | | 70,000 |
| Underwriting Expenses | 15,000 | |
| Investment Expenses | 8,000 | |
| General Reserves | | 1,000,000 |
| Life funds (31/12/06) | | 700,000 |
| Agency fees | 30,000 | |
| Auditors remuneration | 25,000 | |
| Management Expenses | 18,000 | |
| Commission due but not paid | | 16,000 |
| Endowment policy matured | 7,000 | |
| Investment | 10,000 | |
| Statutory deposit | 5,000 | |
| Fixed Assets | <u>3,627,000</u> | |
| | <u>4,151,000</u> | <u>4,151,000</u> |

Additional Information

1. During the year the value of claims on life policies (life fund) was estimated at N300,000,000.
2. Provision is to be made on agent and company balance at the rate of 5%.
3. 10k is payable on ordinary shares as dividend.
4. Company taxation is taken at N2,000,000.
5. All un-appropriated profits are to be transferred to general reserves.
6. Depreciation is to be charged at 2%.

Required:

Prepare the Profit or Loss Account and extract a Statement of Financial Position at that date.

Solution

WKC ASSURANCE COMPANY
Profit and Loss Account for the Year ended 31/12/07

| | | | |
|---|-----------------|----------------|------------------|
| Income: | | N'000 | N'000 |
| Life fund b/f | | | 700,000 |
| Underwriting income | | 70,000 | |
| Investment income | | 80,000 | |
| Commission income | | 95,000 | |
| Premium | 150,000 | | |
| Re-insurance | <u>(30,000)</u> | <u>120,000</u> | <u>365,000</u> |
| | | | 1,065,000 |
| Expenses: | | | |
| Claims | 90,000 | | |
| Re-insurance claims | <u>(40,000)</u> | 50,000 | |
| Underwriting expenses | | 15,000 | |
| Investment expenses | | 8,000 | |
| Agency fees | | 30,000 | |
| Commission expenses | 6,000 | | |
| Auditors remuneration | | 25,000 | |
| Management expenses | | 18,000 | |
| Depreciation (2% of N3,627,000) | | 72,540 | |
| Provision on agency & company bal. (5% of N200,000) | | 10,000 | |
| Endowment policy matured | | <u>7,000</u> | <u>(241,540)</u> |
| | | | 823,460 |
| Life Fund c/f (additional info.1) | | | <u>(300,000)</u> |
| Profit before Tax | | | 523,460 |
| Taxation | | | <u>(2,000)</u> |
| Profit after Tax | | | 521,460 |
| Appropriation: | | | |
| Ordinary share dividend | | | (100,000) |
| General reserve | | | <u>(421,460)</u> |
| | | | <u>--</u> |

WKC ASSURANCE COMPANY
Statement of Financial Position as at 31/12/2007

| Assets: | N'000 | N'000 |
|---------------------------|-----------------|------------------|
| Cash and short term funds | | 80,000 |
| Investment | | 10,000 |
| Agents & company balance | 200,000 | |
| Provision | <u>(10,000)</u> | 190,000 |
| Statutory deposits | | 5,000 |
| Fixed assets | 3,627,000 | |
| Depreciation | <u>(72,540)</u> | <u>3,554,460</u> |

| | | |
|---------------------|----------------|-------------------------|
| | | 3,839,460 |
| Liabilities: | | |
| Commission due | 16,000 | |
| Proposed dividend | 100,000 | |
| Taxation | 2,000 | |
| Life fund | <u>300,000</u> | <u>(418,000)</u> |
| Net assets | | <u>3,421,460</u> |

| | | |
|----------------------------|----------------|-------------------------|
| Financed by: | | |
| Ordinary shares of N2 each | | 2,000,000 |
| General reserves | 1,000,000 | |
| Transfer | <u>421,000</u> | <u>1,421,460</u> |
| Net assets | | <u>3,421,460</u> |

Illustration 3

Below is the Statement of Financial Position of Keffi Insurance as at 31st December 2004:

| | 2004 | 2003 |
|-------------------------|-----------------------|-----------------------|
| | N | N |
| Cash and Bank | 19,854 | 30,006 |
| Debtors and prepayments | 349,750 | 294,905 |
| Investments | 261,800 | 218,808 |
| Statutory Deposit | 10,386 | 10,386 |
| Assets on Lease | 11,829 | - |
| Fixed Assets | 233,562 | 211,245 |
| Creditors and Accruals | <u>(62,175)</u> | <u>(93,185)</u> |
| | <u>825,006</u> | <u>672,165</u> |

Presented by:

| | | |
|--------------------------|-----------------------|-----------------------|
| Called up shares capital | 218,076 | 218,076 |
| Insurance funds | 385,419 | 302,748 |
| Share premium | 15,120 | 108,582 |
| Contingency Reserves | 74,985 | 20,334 |
| Bonus Issue provision | 93,462 | - |
| Retained Earnings | <u>37,944</u> | <u>22,425</u> |
| | <u>825,006</u> | <u>672,165</u> |

Additional Information:

- (a) The Insurance Company is into general insurance business.
- (b) The Financial statements include investments assets of N9,221,538 with associated company based in Canada in 2004.
- (c) The gross premium income was N923,067,690 and N777,836,769 for 2004 and 2003 respectively.
- (d) Debtors include outstanding premium with the insurance brokers and agents of N67,238,307 and N116,939,076 for 2004 and 2003 respectively.

Required:

Compute the Company's Solvency Margin for 2004 financial year. Comment on your results.

Solution

Computation of the Company's Solvency Margin for 2004

| | |
|--|---------------------|
| Admissible Assets | N |
| Net Assets | 825,006,000 |
| Add: Creditors and Accruals | <u>62,175,000</u> |
| Total Assets | 887,181,000 |
| Less: | |
| Investment in Canada | (9,221,538) |
| Outstanding premium | <u>(67,238,307)</u> |
| Total Admissible Assets in Nigeria (A) | <u>810,721,155</u> |

| | |
|---|--------------------|
| Admissible Liabilities | |
| Creditors & Accruals | 62,175,000 |
| Insurance Funds | <u>385,419,000</u> |
| Total Admissible liabilities in Nigeria (B) | <u>447,594,000</u> |

Therefore, A – B = N363,127,155

BENCHMARK:

Higher of

| | |
|-----------------------------|----------------------|
| (a) Minimum paid up capital | N <u>200,000,000</u> |
| (b) Gross Premium | N923,067,690 |
| Less:- Re Insurance premium | <u>N 6,023,076</u> |
| | <u>N917,044,614</u> |

15% there off: N137,556,692

Comment

From the computation of the Solvency margin, the company is solvent.

4.3.4 FINANCIAL STATEMENTS OF BANKS**Main Provision of the Banks and other Financial Institutions Act****Minimum Paid-up Capital:**

N25 billion effective from December, 2005

Reserve Requirements

Every bank shall maintain a reserve fund and shall out of its net profit for each year (after due provision made for taxation) and before any dividend is declared, where the amount of the reserve fund is:

- (a) Less than the paid up share capital transfer to the reserve fund, a sum equal to not less than thirty percent of the net profit or
- (b) Equal to or in excess of the paid up share capital transfer to the reserve fund a sum equal to not less than fifteen percent of the net profits.

Returns to CBN

Every bank shall submit to the CBN and NDIC mid-month, monthly and quarterly returns not later than 5 days after 15th of every month for mid-month returns, 10 days after the last of each month for monthly returns and not later than 14 days after the end of each quarter or such other interval as the CBN may specify. A statement showing: mid monthly returns, monthly returns, quarterly returns and semi-annual returns.

Publication of Financial Statement

Subject to prior approval in writing of the CBN, a bank shall not later than 4 months after the end of its financial year:

- a. Caused to be published in daily newspaper printed in and circulating in Nigeria and approved by the CBN
- b. Exhibit in a conspicuous position in each of its offices and branches in Nigeria forward to the CBN copies of the bank's balance sheet and profit and loss account duly signed containing the full and correct names of the directors of the bank.

NDIC Premium

Every bank shall insure its qualifying deposit with the Nigeria Deposit Insurance Corporation and a premium of 1% of $\frac{15}{16}$ of such deposit is payable to the corporation as at 31st December each year. Insider deposits such as directors, staff and deposit specifically to collateralize credit facilities are excluded for the purpose of the premium calculation. The NDIC as the insurer of deposits guarantees full payment of all depositors of amount up to N50, 000 in case of banks liquidation. Further liquidation dividends are payable to depositors who had more than N50, 000 as at the time of liquidation when the assets of the banks are realized, if any.

Analysis of Loans and Advances

All license banks are required to analyse credit facilities in line with the provisions of the prudential guidelines issued to all licensed banks as amended.

Credit facility which includes term loan, overdraft, commercial papers, bankers acceptance, guarantee bonds etc. are to be classified under two headings:

i. Performing and Non-performing

A credit facility is classified as performing if interest and or principal is paid as at when due in accordance with the terms of the facility – the account is current and the company has no symptoms of going concern problem. Also, the facility is adequately secured and security is perfected. Action – a minimum general provision of 1% is required.

ii. Non – performing credit

A credit facility is classified as non-performing if interest and / or principal is due for at least 90 days and unpaid or interest payment equals to 90 days or more have been capitalized or rolled over into a new loan. Non-performing credit can further be classified into three, i.e.

- **Sub-standard** - Interest and / or principal is due and unpaid for 90 days or more but less than 180 days

Action:

Suspend interest and treat on cash basis henceforth

Make a full provision for interest and for principal due and unpaid

I.R.O principal not due to a provision of 10% on total amount not due is required.

- **Doubtful:** A credit facility is classified doubtful if interest and / or principal are due and unpaid for 180 days but less than 360 days

Action:

IRO principal not due to a provision of 50% of the outstanding principal is required.

- **Lost Credit:** A credit facility is classified lost if interest and/ or principal are due and unpaid for 350 days or more.

Action:

IRO principal not due a 100% provision is required.

FORMAT OF THE REVENUE ACCOUNT

| | | |
|-------------------------------|---|--------------|
| | N | N |
| Interest Income (note 1) | | xxx |
| Interest Expenses (note 2) | | <u>(xx)</u> |
| | | xxx |
| Other Income (note 3) | | <u>xxx</u> |
| | | xxx |
| Management Expense (note 4) | | <u>(xxx)</u> |
| | | xxx |
| Taxation | | <u>(xxx)</u> |
| Profit after Tax | | xxx |
| Transfer to Statutory Reserve | | <u>(xx)</u> |
| | | xxx |
| Other Appropriation | | <u>(xx)</u> |
| Retained Profit for the Year | | xxx |
| Retained Profit b/d | | <u>xxx</u> |
| Retained Profit c/d | | <u>xxx</u> |

FORMAT FOR STATEMENT OF FINANCIAL POSITION

| | | |
|------------------------------------|------------|-------------|
| Assets Employed: | N | N |
| Cash & Short – Term Funds (note 5) | | x |
| Bills Discounted | | x |
| Loans (note 6) | | x |
| Investments (note 7) | | x |
| Other Assets (note 8) | | x |
| Fixed Assets (note 9) | | <u>x</u> |
| | | xx |
| Deposits & Other Liabilities: | | |
| Deposit Liabilities (10) | (x) | |
| Other Liabilities (11) | <u>(x)</u> | |
| Net Assets | | <u>(x)</u> |
| | | <u>(xx)</u> |
| Financed by: | | |
| Share Capital | | x |

Reserves

X

XX

NOTES TO THE ACCOUNTS

| | | |
|----|---------------------------------------|-------------|
| 1) | Interest Income | N |
| | Transfer to interest suspense account | xxx |
| | Interest on treasury bills | xxx |
| | Interest on call money | xxx |
| | Interest on discounted bills | <u>xxx</u> |
| | Interest on advance and overdraft | <u>xxx</u> |
| 2) | Interest Expense | N |
| | Interest paid on call money | xxx |
| | Interest paid on staff current a/c | xxx |
| | Interest on short – term deposit | xxx |
| | Interest savings a/c | <u>xxx</u> |
| | Interest on sundry operation | <u>xxx</u> |
| 3) | Other Incomes | N |
| | Commission on discounted bills | xxx |
| | Commission for collection | xxx |
| | Commission on turnover | xxx |
| | Commission in guaranteed bonds | xxx |
| | Commission on NITEL for received | xxx |
| | AFEM proceeds | xxx |
| | Other sundry income | <u>xxxx</u> |
| | Bad debts recovered | <u>xxxx</u> |
| 4) | Management Expenses | N |
| | Legal fees | xxx |
| | Audit fees | xxx |
| | Depreciation | xxx |
| | Deferred tax | xxx |
| | Bad debts | xxx |
| | Salaries and allowance | xxx |
| | General stationary expenses | xxx |
| | Computer stationery expenses | xxx |
| | Printing of cheques booklets | xxx |
| | Travelling and transport expenses | xxx |

| | | | |
|----|--|------------|--------------|
| | Advert and public relations | | xxx |
| | Deposit insurance | | xxx |
| | Property insurance | | <u>xxxx</u> |
| | Social insurance charges | | <u>xxxx</u> |
| 5) | Cash and Short-term Funds | N | |
| | Cash in hand | | xxx |
| | CBN Current Account | | xxx |
| | Cash reserve at CBN | | xxx |
| | Foreign bank current account | | xxx |
| | Call money with local bank | | xxx |
| | Treasury bills | | <u>xxx</u> |
| | CBN stabilization securities | | <u>xxx</u> |
| 6) | Loan and Advances | N | N |
| | Loans secured against real estate | | xxx |
| | Otherwise secured | | xxx |
| | Unsecured | | <u>xxx</u> |
| | | | xxx |
| | Less provision for bad debts | | |
| | New Provision: | | |
| | Performing 1% x 70.5% x 456879 | | xxx |
| | Sub-standing 10% x 21% x 456879 | xxx | |
| | Doubtful 50% x 9% x 456879 | | xxx |
| | Lost 100% x 0.5% x 456879 | <u>xxx</u> | <u>(xxx)</u> |
| | | | xxx |
| | Less Old Provision | | <u>xxx</u> |
| | | | <u>xxx</u> |
| 7) | Investment | | N |
| | Investment in debenture | | xxx |
| | Investment in commercial paper | | xxx |
| | Investment in associate coy | | <u>xxx</u> |
| | | | <u>xxx</u> |
| 8) | Fixed Assets Schedule | | |
| | See the format for general fixed assets schedule | | |
| 9) | Deposit Liabilities | | N |

| | | |
|-----|----------------------------|------------|
| | Savings Account | xxx |
| | Current Account | xxx |
| | Deposit Account | xxx |
| | Call money from local Bank | xxx |
| | Domiciliary Account | <u>xxx</u> |
| | | <u>Xxx</u> |
| 10) | Other Liabilities | N |
| | Proposed Dividend | xxx |
| | Legal fees | xxx |
| | Audit fees | xxx |
| | Corporate tax (provision) | xxx |
| | Deferred tax (2000 + 200) | xxx |
| | Sundry balances | <u>xxx</u> |
| | | <u>Xxx</u> |
| 11) | Reserve | N |
| | Statutory reserve | xxx |
| | Retained profit c/f | <u>xxx</u> |
| | | <u>xxx</u> |

Illustration

The following balances were extracted from the books of WKC International Bank as at 21st Dec. 2007.

| | | |
|--|-----------------------------------|------------|
| | | N |
| | Land & Building | 3,000,000 |
| | Furniture & Fitting | 1,400,000 |
| | Motor Vehicles | 2,300,000 |
| | Provision for Depreciation: | |
| | Furniture & Fittings | 320,000 |
| | Motor Vehicles | 180,000 |
| | Statutory Reserve | 14,000,000 |
| | Ordinary Share Capital of N1 each | 15,000,000 |
| | Legal Expenses | 80,000 |
| | Audit Fees | 170,000 |
| | Directors' Emolument | 450,000 |
| | Electricity | 900,000 |

| | |
|--|------------|
| Rent & Rates | 220,000 |
| Loans & Advances (debtors) | 7,000,000 |
| Provision for Bad Debt (loans & advance) | 180,000 |
| Investment in Debentures | 750,000 |
| Investment in Associate Company | 530,000 |
| Investment in Preference Shares | 290,000 |
| Interest Income: | |
| Savings Account | 5,000,000 |
| Current Account | 16,000,000 |
| Call Account | 8,000,000 |
| Fixed Deposit | 18,000,000 |
| Interest Expenses: | |
| Savings Account | 65,000 |
| Current Account of Staff | 89,000 |
| Call Account | 120,000 |
| Fixed Deposit | 186,000 |
| Commission on Turnover (COT) | 1,000,000 |
| Commission on Cheque Books | 800,000 |
| Commission on Vat Received | 320,000 |
| Commission on NITEL, PHCN | 1,380,000 |
| Deposit Liabilities | 7,000,000 |
| Other Deposit Liabilities | 2,800,000 |
| Cash Reserve with CBN / Cash Deposit | 8,200,000 |
| Cash Balance | 2,100,000 |
| Bills Discounted | 8,000,000 |
| Commission on Bills Discounted | 1,020,000 |

Additional Information

- (1) Taxation is to be taken at 30%
- (2) A dividend of 2k is proposed
- (3) Accrued rent & rate N 40,000, prepaid electricity N120,000
- (4) Audit fees and directors' emolument outstanding N230,000 & N40,000
- (5) The analysis of loans & advances received the following:
 - 4% performing
 - 16% sub-standard
 - 40% doubtful and the balance bad
- (6) Make the required transfer to statutory reserve

- (7) Depreciation is to be provided on Furniture & Fittings and motor vehicles at the rate of 5% & 10% respectively on cost.

Required:

- 1) Extract a trial balance for the banks as at 31st December 2007, the balancing figure (if any) represent sundry asset or sundry liabilities as the case may be.
- 2) Prepare the revenue account of the bank and prepare the balance sheet as at 31st December 2007.

Solution

Trial Balance as at 31st December 2007

| | Dr | Cr |
|-----------------------------------|-----------|------------|
| | N | N |
| Land & Building | 3,000,000 | |
| Furniture & Fittings | 1,400,000 | |
| Motor & Vehicle | 2,300,000 | |
| Provision for Depreciation: | | |
| Furniture & Fitting | | 320,000 |
| Motor Vehicles | | 180,000 |
| Statutory Reserve | | 14,000,000 |
| Ordinary Share Capital at N1 each | | 15,000,000 |
| Legal Expenses | 80,000 | |
| Audit Fees | 170,000 | |
| Directors' Emolument | 450,000 | |
| Electricity | 900,000 | |
| Rent & Rates | 220,000 | |
| Loans & Advance (debtors) | 7,000,000 | |
| Provision for Bad Debts | | 180,000 |
| Investment in Debt | 750,000 | |
| Investment in Ass. Coy | 530,000 | |
| Investment in Pref. Shares | 290,000 | |
| Interest Income: | | |
| Savings Account | | 5,000,000 |
| Current Account | | 16,000,000 |
| Call Account | | 8,000,000 |
| Fixed Deposit | | 18,000,000 |
| Interest Expenses | | |
| Savings Account | 65,000 | |
| Current Account of Staff | 89,000 | |
| Call Account | 120,000 | |
| Fixed Deposit | 186,000 | |
| Commission on Turnover | | 1,000,000 |

| | | |
|-------------------------------|-------------------|-------------------|
| Commission on Cheque Books | | 800,000 |
| Commission on Vat Received | | 320,000 |
| Commission of Nitel, PHCN | | 1,380,000 |
| Deposit Liabilities | | 7,000,000 |
| Other Deposit Liabilities | | 2,800,000 |
| Cash Deposit Reserve with CBN | 8,200,000 | |
| Cash Balance | 2,100,000 | |
| Bills Discounted | 8,000,000 | |
| Commission on Bill Discounted | | 1,020,000 |
| Sundry Assets | <u>55,150,000</u> | |
| | <u>91,000,000</u> | <u>91,000,000</u> |

WKC International Bank
Revenue Account as at 31st December, 2007

| | Note | N |
|-------------------------------|------|---------------------|
| Interest Income | (1) | 47,000,000 |
| Interest Expenses | (2) | <u>(460,000)</u> |
| | | 46,540,000 |
| Other Income | (3) | <u>4,520,000</u> |
| | | 51,060,000 |
| Management Expenses | (4) | <u>(6,544,800)</u> |
| Profit before Tax | | 44,515,200 |
| Tax @ 30% x 44,515,200 | | <u>(13,354,560)</u> |
| Profit after Tax | | 31,160,640 |
| Transfer to Statutory Reserve | (5) | <u>(9,348,192)</u> |
| | | 21,812,448 |
| Other Appropriation | (6) | <u>(300,000)</u> |
| Retained Profit | | <u>21,512,448</u> |

White Knight Consulting (WKC) International Bank
Statement of Financial Position as at 31st December 2007

| | Note | N |
|-------------------------|------|-------------------|
| Cash & short term funds | (7) | 10,300,000 |
| Bills Discounted | | 8,000,000 |
| Investment | (8) | 1,570,000 |
| Loans & Advances | (9) | 2,685,200 |
| Sundry & other Assets | (10) | 55,270,000 |
| Noncurrent Assets | (11) | <u>5,900,000</u> |
| | | <u>83,725,200</u> |

| | | |
|------------------------|------|-------------------|
| Financed by: | | |
| Ordinary Share Capital | | 15,000,000 |
| <u>Liabilities</u> | | |
| Deposit Liabilities | | 7,000,000 |
| Other Liabilities | (12) | 16,864,560 |
| <u>Reserves</u> | | |
| Statutory Reserves | (13) | 23,348,192 |
| Retained Profit | | <u>21,512,448</u> |
| | | <u>83,725,200</u> |

Workings:

Note (1)

Interest Income

| | | |
|---------------------------|---|-------------------|
| | | N |
| Interest on Savings A/c | = | 5,000,000 |
| Interest on Current A/c | = | 16,000,000 |
| Interest on Call Deposit | = | 8,000,000 |
| Interest on Fixed Deposit | = | <u>18,000,000</u> |
| | | <u>47,000,000</u> |

Note (2)

Interest Expenses:

| | | |
|------------------------------|---|----------------|
| Interest paid on savings A/c | = | 65,000 |
| Interest paid current A/c | = | 89,000 |
| Interest paid call A/c | = | 120,000 |
| Interest paid fixed deposit | = | <u>186,000</u> |
| | | <u>460,000</u> |

Note (3)

Other Income:

| | | |
|--------------------------------|---|------------------|
| Commission on Turnover | = | 1,000,000 |
| Commission on Cheques | = | 800,000 |
| Commission on vat | = | 320,000 |
| Commission on NITEL, PHCN | = | 1,380,000 |
| Commission on Bills Discounted | = | <u>1,020,000</u> |
| | | <u>4,520,000</u> |

Note (4)

Management Expenses

| | | |
|----------------|---------|--------|
| Legal Expenses | | 80,000 |
| Audit Fees | 170,000 | |

| | | |
|-------------------------------------|----------------|------------------|
| Add arrears | <u>230,000</u> | 400,000 |
| Directions Emolument | 450,000 | |
| Add Outstanding | <u>140,000</u> | 590,000 |
| Electricity | 900,000 | |
| Less Prepaid | <u>120,000</u> | 780,000 |
| Rent & Rates | 220,000 | |
| Add Accrued | <u>40,000</u> | 260,000 |
| Depreciation: | | |
| Furniture & Fittings 5% x 1,400,000 | | 70,000 |
| Motor Vehicle 10% x 2,300,000 | | 230,000 |
| Provision on Loans & advances | | <u>4,134,800</u> |
| | | <u>6,544,800</u> |

$$\text{Performing} \quad 7,000,000 \times \frac{4}{100} \times \frac{1}{100} = \quad 2,800$$

$$\text{Sub-standard} \quad 7,000,000 \times \frac{16}{100} \times \frac{10}{100} = \quad 112,000$$

$$\text{Doubtful} \quad 7,000,000 \times \frac{40}{100} \times \frac{50}{100} = \quad 1,400,000$$

$$\text{Lost} \quad 7,000,000 \times \frac{40}{100} \times \frac{100}{100} = \quad \underline{2,800,000}$$

$$\text{Provision for Bad Debt} \quad \underline{(180,000)}$$

$$\text{Increase in provision} \quad \underline{4,134,800}$$

Note (5)

Transfer to Reserve:

Current bal. in statutory balance is less than paid-up-capital; hence 30% of PAT is transferred.

$$\frac{30}{100} \times \text{N}31,160,640 = \quad \text{N}9,348,192$$

Note (6): Other Appropriation

$$\text{Proposed Dividend} = \quad 0.02 \times 15,000,000 \text{ shares}$$

$$\quad \text{N } 300,000$$

Note (7): Cash & Short-term returns

$$\text{Cash Deposits Reserve with CBN} = 8,200,000$$

$$\text{Cash Balance} = \underline{2,100,000}$$

$$\quad \underline{10,300,000}$$

| | | |
|------------|-------------------------------------|-------------------|
| Note (8): | Investments | |
| | Investment in Debenture: | 750,000 |
| | Investment in Associated Coy. | 530,000 |
| | Investment in Preference Shares | <u>290,000</u> |
| | | <u>1,570,000</u> |
| Note (9): | Loans and Advances | |
| | Loans and Advances (Debtors) | 7,000,000 |
| | Less: Provision for bad debts (Wk4) | <u>4,314,800</u> |
| | | <u>2,685,200</u> |
| Note (10): | Sundry and Other Assets | 55,150,000 |
| | | <u>120,000</u> |
| | | <u>55,270,000</u> |
| Note (11): | Fixed Assets | |
| | Cost: Land & Building: | 3,000,000 |
| | Fixtures & Fittings | 1,400,000 |
| | Motor Vehicles | <u>2,300,000</u> |
| | | 6,700,000 |
| | Less: Accum. Depreciation | <u>(800,000)</u> |
| | | <u>5,900,000</u> |
| Note (12): | Other Liabilities | 2, 800,000 |
| | Proposed Dividend | 300,000 |
| | Accruals | 410,000 |
| | Corporate Tax | <u>13,354,560</u> |
| | | <u>16,864,560</u> |
| Note (13): | <u>Reserves</u> | |
| | Statutory Reserves | 14,000,000 |
| | Transfer | <u>9,348,192</u> |
| | | <u>23,348,192</u> |

4.3.5 ACCOUNTS OF CLUBS, SOCIETIES AND SCHOOLS

The accounts of non-trading organizations can be kept on the double entry system but with two important differences from accounts of trading or profit making organization.

1. There is no capital account indicating money put in and withdrawable by an owner or owners. Monies received are debited to cash or bank account and credited to the income and expenditure account or to a consolidated fund or some similarly named account, the equivalent of the capital account.

2. Final accounts prepared periodically as desired, will consist of a receipts and payments account, an income and expenditure account and a balance sheet. Copies of these are presented to the members.

The Receipts and Payments Account

This is a summary of the cash account and shows:

- a) The opening cash balance.
- b) All monies received during the period (whether referring to that period or not e.g. subscriptions received in advance refers to the next period).
- c) All monies paid out during the period (whether referring to that period or not).
- d) The closing cash balance.

The Income and Expenditure Account

This is easier to understand if it is thought of as specie of profit and loss account. All items of revenue expenditure for that period (whether paid in the previous or some subsequent period) are debited.

All items of revenue income, which belong to that period whether received in that period or not are credited. The excess of income over expenditure is called (a surplus) is credited to the Consolidated Fund Account; the excess of expenditure over income (a deficit) is debited to the Consolidated Fund Account.

The Statement of Financial Position

This will appear as usual. The debit side will show fixed and current assets and payments in advance, though sometimes the order is reversed and assets are placed in order of realizability, with cash first.

The credit side will show the balance of the consolidated fund with the 'profit' added or 'loss' deducted; any loan, sundry creditors; and payments in arrears or accrued due.

Illustration 1

The Circle Athletic Club was formed on 1st June 2001 with a membership of 50. The 30 adult members pay N250 per month; the 20 junior members pay N200 per month.

- (a) From the following summary extracted from the club's records, prepare the receipts and payments account, the income and expenditure account and the balance sheet as at 31st May.
 - i. Subscriptions were received for the month from 28 adult members of who 6 paid in advance for the next month. All junior members paid up.

- ii. A raffle to raise funds cost N400, Receipts N1,650.
 - iii. A sale of work was held. Cost N350, Receipts N1,650.
 - iv. Printing, stationary, advertising N855.
 - v. Hire of gymnasium, pitches from local schools N100.
 - vi. Purchase of second hand sport equipment N120.
- (b) From a professional point of view, identify the inadequacies of receipts and payments accounts.

Solution

(a) **Receipts and Payments Account for the Circle Athletic Club for the Month ended 31st June 2002**

| N | | N | |
|----------------------------|---------------|---------------------------|---------------|
| Subscription received: | | Expenses of raffle | 400 |
| 28 Audit members – June | 7,000 | Expenses of sale of work | 350 |
| 6 Audit members – June | 1,500 | Printing, stationary etc. | 855 |
| 20 Junior members – June | 4,000 | Hire of gymnasium | 100 |
| Receipts from raffle | 1,250 | Second hand sports | |
| Receipts from sale of work | 1,650 | equipment | 120 |
| | | Balance of cash c/f | <u>13,575</u> |
| | <u>15,400</u> | | <u>15,400</u> |
| Bal b/d | 13,575 | | |

Income and Expenditure Account for the Circle Athletic Club

| N | | N | |
|-----------------------------------|---------------|----------------------------|---------------|
| Expenses of raffle | 400 | Subscription receivable: | |
| Expenses of sale of work | 350 | 30 Audit members | |
| Printing, stationary etc. | 855 | at N250 | 7,500 |
| Hire of gymnasium | 100 | 20 Junior members | |
| Excess of income over expenditure | | at N200 | 4,000 |
| | | Receipts from raffle | 1,250 |
| | <u>12,695</u> | Receipts from sale of work | <u>1,650</u> |
| | <u>14,400</u> | | <u>14,400</u> |

Statement of Financial Position of Circle Athletic Club as at 31st May 2002

| Liabilities | | Assets | |
|-----------------------|--------|-------------------------|--------|
| N | | | N |
| Excess of income over | | Cash in hand | 13,575 |
| Expenditure | 12,695 | Subscription in arrears | 500 |

| | | | |
|---------------------------------|----------------------|-----------------|----------------------|
| Subscription receive in Advance | | Sport Equipment | 120 |
| | <u>1,500</u> | | |
| | <u>14,195</u> | | <u>14,195</u> |

b) Inadequacies of Receipts and Payments Accounts

From professional viewpoint, it is easy to observe some weaknesses in the Receipts and Payments accounts.

1. The accounts do not show us the assets that the club previously acquired before the current financial year e.g. vehicles, furniture, and office equipment.
2. The previous liabilities such as overdraft, loan and trade creditors are not reflected.
3. Even the cash receipts recorded did not clarify if the subscriptions were for current year or payment in arrears or advance payment.
4. The account, although reflects actual cash received or payments, it does not show us if the cash payment is revenue expenditure or capital expenditure. For example, while the purchase of a new typewriter may be classified as capital expenditure, the cash expenses paid for the repair of old typewriters should be classified as revenue expenditure.

Illustration 2

The Federal University of Agriculture, Makurdi, launched an appeal fund for the construction of a standard stadium for the hosting of NUGA games on 15th January, 2006 and the following transactions took place:

| | |
|--|------------|
| | N |
| Donations from Federal Government | 10,000,000 |
| Donations from States and Local Government | 4,000,000 |
| Donations from Individuals and Companies | 4,000,000 |
| Launching Expenses | 200,000 |
| Advertisement Expenses | 80,000 |

From 16th January, 2006 to 31st December, 2006 before the event took place, the following transactions were recorded:

| | |
|---|-----------|
| | N |
| Construction of Sport Building | 4,000,000 |
| Construction of Arena and Spectators' Stand | 3,500,000 |
| Purchase of Sport Equipment | 5,000,000 |
| Purchase of Sport Bus | 2,000,000 |

It was agreed that the sport equipment and sport bus be depreciated at the rate of 20%. You are required to prepare the following for submission to the Vice-Chancellor of the University:

- (a) Receipts and Payment Account.
- (b) Income and Expenditure Account.
- (c) Statement of Affairs as at 31st December, 2006.

Solution

(a) **Federal University of Agriculture, Makurdi**

Receipts and Payment Account, 31st December, 2006

| N | | N | |
|------------------------------------|-------------------|---------------------------------|-------------------|
| Donations from Fed. Govt. | 10,000,000 | Launching Expenses | 200,000 |
| Donations from States & Loc. Govt. | 4,000,000 | Advertisement Exp. | 80,000 |
| Donations from Ind. and Company | 4,000,000 | Construction of Sport Buildings | 4,000,000 |
| | | Construction of arena and stand | 3,500,000 |
| | | Purchase of Sport equipment | 5,000,000 |
| | | Purchase of Sports Bus | 2,000,000 |
| | | Balance c/d | <u>3,220,000</u> |
| | <u>18,000,000</u> | | <u>18,000,000</u> |
| Balance b/d | 3,220,000 | | |

(b) **Income and Expenditure Account**

| N | | N | |
|--------------------|-------------------|---------------------------------------|-------------------|
| Launching Expenses | 200,000 | Donations from Federal Govt. | 10,000,000 |
| Advert Expenses | 80,000 | Donations from States % Local Govt. | 4,000,000 |
| Depreciation | 1,400,000 | Donations from Individual & Companies | 4,000,000 |
| Surplus | <u>16,320,000</u> | | |
| | <u>18,000,000</u> | | <u>18,000,000</u> |

(c)

Statement of Affairs as at 31st December, 2006

| N | | N | | N |
|---------|------------|---------------------|------------------|-----------|
| Surplus | 16,320,000 | <u>Fixed Assets</u> | | |
| | | Buildings | 4,000,000 | |
| | | Arena & Stand | 3,500,000 | |
| | | Equipment | 5,000,000 | |
| | | Less: Dep. | <u>1,000,000</u> | 4,000,000 |

| | | | |
|--|----------------------|----------------|-------------------|
| | Bus | 2,000,000 | |
| | Less: Dep. | <u>400,000</u> | 1,600,000 |
| | <u>Current Asset</u> | | |
| | Cash | | <u>3,220,000</u> |
| | <u>16,320,000</u> | | <u>16,320,000</u> |

Workings

Depreciation on Sport Bus = $\frac{20}{100} \times \text{N}2,000,000$

= N400,000

Depreciation on Equipment = $\frac{20}{100} \times \text{N}5,000,000$

= N1,000,000
N1,400,000

4.04 Review Questions

Accounting for Lease/Contracts

1. Anthony Limited, a construction company is undertaking the construction of a dam for Niger Basin Development Authority. The contract started on 1/1/86 is expected to be completed on 30/11/87. The following additional information is given: N

| | |
|--|------------|
| Total Contract Price | 15,000,000 |
| Estimated Future Cost | 10,000,000 |
| Value of Work Certified | 18,000,000 |
| Cash Received and Receivable at 31/12/86 | 10,000,000 |

Required:

- (a) State the major problems associated with long term contracts.
(b) Calculate the amount to be shown in the books of B. Ltd. for the year ended 31/12/86.
(c) Show the ledger entries in the book of Niger Basin Authority for the year 31/12/89.
- 2.
- a) What is the recommended treatment of the following under SAS 5?
(i) Pre-contract Costs
(ii) Advance Payments
(iii) Retention
(iv) Claims and Variations
- b) What are the methods of accounting for construction contracts and what are the advantages of one over the other?
3. A Limited purchased office equipment on 1st January 2001 from B Limited on hire purchase terms under which A Limited paid a deposit of N15,505 to be followed by four annual instalments of the cash price of the equipment is N220,000.
The accounting year of the both companies ends on 31st December. Depreciation on the equipment is 20% per annum on straight – line basis. All the sums due were paid on the due dates.

Required:

Show the relevant ledger entries in the books B limited and balance sheet extract at 31st December 2003.

4. TOLU's Salon bought a hair dryer on hire purchase terms from Handsome Limited on 1st July 2017 paying a deposit of N2,000 immediately to be followed by 6 quarterly instalments of N1500.00 cash commencing on 1st October 2017.

Handsome Products Limited recognizes gross profit on the basis of the proportion, which the amounts received, bears to the cash price while hire purchase interest is recognized on a sum-of-the – digits basis.

The cash price of the hair dryer is N9,500 while its cost to the seller is N8,000 TOLU’s Salon paid only two instalments before she decided to close down her business on 1st April 2017 to join her husband in the Canada Beauty Products Limited repossessed the hair dryer same date and reconditioned it at a cost N500 before taking it into stock at a valuation of N5,000.

The accounting year of Handsome Products Limited ends on 30th June.

Required: You are required to show the ledger in the books of Handsome Products Limited.

Accounting for Price Level Changes

Set out below are the opening balance sheet of Cass Biggs Ltd. As at 1/1/20 when the company was formed, the profit and loss for the year ended 21/12/20 and the balance sheet as at that date.

Balance Sheet as at 1/1/20

| | N | N |
|-------------------------------|-----------------|-----------------|
| Plant & Machinery | | 16,000 |
| Current Assets: | | |
| Stock taken over | 14,000 | |
| Debtors taken over | 6,000 | |
| Bank | <u>3,000</u> | |
| | 23,000 | |
| Creditors due within one year | <u>(13,000)</u> | <u>10,000</u> |
| | | 26,000 |
| 12% Loan | | <u>(10,000)</u> |
| | | <u>16,000.</u> |

Profit or loss account for the year ended 31/12/20

| | N | N |
|----------------------|---------|------------------|
| Sales | | 250,000 |
| Cost of sales & Exp. | 200,000 | |
| Reproduction | 4,000 | |
| Less: Interest | 1,200 | <u>(205,200)</u> |
| | | 44,800 |
| Taxation | | <u>(17,000)</u> |
| | | 27,800 |
| Proposed dividend | | <u>(5,000)</u> |
| | | <u>22,800</u> |

Balance sheet as at 31 December, 2020

| | N | N | N |
|--------------|---|----------------|--------|
| P & M | | 20,000 | |
| Depreciation | | <u>(4,000)</u> | 16,000 |

| | | | |
|---|---------------|-----------------|-----------------|
| <u>Current assets:</u> | | | |
| Stock | 40,000 | | |
| Debtors | 20,000 | | |
| Bank | <u>25,800</u> | 85,800 | |
| <u>Current liabilities:</u> | | | |
| Trade creditors | 31,000 | | |
| Taxation | 17,000 | | |
| Proposed dividend | <u>5,000</u> | <u>(53,000)</u> | <u>32,800</u> |
| | | | 48,800 |
| 12% Loan | | | <u>(10,000)</u> |
| | | | <u>38,800</u> |
| Share capital 16,000 N1 ordinary shares | | | 16,000 |
| Retained profit | | | <u>22,800</u> |
| | | | <u>38,800</u> |

i. The following figures from RPI are required:

| <u>Date</u> | <u>Index</u> |
|------------------------|--------------|
| 1/01/90 | 239.4 |
| 31/12/90 | 275.6 |
| Ave. for the year 1990 | 263.7 |
| 30/6/1990 | 265.7 |
| 31/08/1990 | 268.6 |
| 30/11/1990 | 274.1 |

ii. Loan interest is paid half yearly on 30th June and 31st December.

iii. The new plant and machinery was purchased on 31/8/2020, in closing stock was acquired on average on 30/11

iv. All purchases. Sales and expenses accrued evenly over the year.

v. Depreciation is 20% on straight line.

Note: As the company was formed on 1/1/2000: all opening stocks & liabilities were acquired on that date.

Required:

Prepare in current purchasing power (CPP) at 31/12/20, the Profit and Loss account for the year ended and the balance sheet as at that date.

Specialized Accounts

1. The Receipts and Payment account of Country Club Universal for the year ended 31st December 2006 is as follows:

Receipts and Payments Accounts

| | N | | N |
|-----------------------|---------------|-------------------------|---------------|
| Balance b/f | 400 | Bar supplies | 5,700 |
| Subscription for 2006 | 7,200 | Wages (Bar) | 700 |
| Subscription for 2007 | 500 | General expenses | 800 |
| Receipts from bar | 9,000 | Printing and Stationary | 240 |
| Receipts from dance | 1,000 | Equipment | 700 |
| Sundry receipts | 800 | Furniture | 600 |
| | | Repairs | 400 |
| | | Balance c/d | <u>9,760</u> |
| | <u>18,900</u> | | <u>18,900</u> |

You are given the following additional information:

| | 1/1/2006 | 21/12/2006 |
|------------------------|----------|------------|
| | N | N |
| Equipment | 5,000 | 5,700 |
| Furniture and fittings | 4,000 | 4,600 |
| Stock – Bar | 2,400 | 6,400 |
| Bar supplies | 4,800 | 11,200 |

You are required to prepare:

- a. Statement of affairs as at 1st January 2006
- b. Income and expenditure account for the year ended 31st December 2006

2. The following is a summary of the receipts and payments of the Concord Club during the year ended 31st December 2006

| Receipts | | Payments | |
|---------------------|----------------|---------------------------|----------------|
| | N | | N |
| Subscription (2006) | 102,400 | Entertainments | 7,680 |
| Subscription (2005) | 2,880 | New equipment | 8,640 |
| Subscription (2007) | 800 | Depreciation of equipment | 9,600 |
| Donations to NAPASS | 2,000 | Lighting | 13,600 |
| Deficit | 560 | Rent | 61,120 |
| | | Honorarium | <u>8,000</u> |
| | <u>108,640</u> | | <u>108,640</u> |

On 31st December 2005, the outgoing treasurer had presented the following balance sheet, which you may take to be correct in both presentation and content.

| | N | | N |
|------------------|--------------|--------------------------|--------------|
| Accumulated fund | 23,280 | Equipment (at valuation) | 18,560 |
| Rent (2005) | <u>1,120</u> | Cash at bank | <u>5,940</u> |
| | 24,400 | | 24,400 |

At the end of 2006, no members were in arrears with their subscriptions.

You are required to prepare:

- The Income and expenditure for 2006
- Prepare the club's Statement of Financial Position as at 31st December 2006

Show all workings

MODULE 5
COMPANY ACCOUNTS

5.00

Preparation and Presentation of Financial Statements to Comply with Standard International Accounting Practice

5.01 Learning Outcomes

On successful completion of this Module, Students should be able to:

- i. Determine the requirements of registering a company;
- ii. Prepare accounts of quoted companies;
- iii. Determine the statutory requirements of accounting standards in financial reporting;
- iv. Prepare accounts for issues and redemption of shares;
prepare accounts for issues of debentures;
- v. Prepare the accounts involve in liquidating a company.

5.02 Accounting for Companies Formation

5.2.1 Issues of Shares

Shares are securities evidencing ownership interest in a company. They are the small units, each of equal amounts, into which the capital of a company is divided.

Types of Shares

Ordinary Shares:

These are shares whose holders receive dividend only after the preference shareholders have received theirs. They are regarded as the risk bearers because they bear the heaviest loss in the event of liquidation of the company. On other hand, the surplus profits after appropriation and surplus of assets in the event of liquidation belong solely to ordinary shareholders unless the Articles of Association stipulate otherwise.

Preference Shares:

These are shares which have the following characteristics:

- i. Their holders receive dividends at specified rates.
- ii. Their holders receive dividends ahead of ordinary shareholders; and
- iii. Their holders are not entitled to partake in the surplus in liquidation unless the Articles of Association stipulate otherwise.

Preference shares may be of any of the following types:

- i. Redeemable Preference Shares
- ii. Irredeemable Preference Shares
- iii. These four types of Preference shares should be explained before Deferred Founders` Shares
- iv. Cumulative Preference Shares
- v. Non-cumulative Preference Shares.

Deferred Founders' Shares:

The holders of these shares are not entitled to receive dividends until the ordinary shareholders have received theirs. They are however entitled, like the other classes of shareholders, to attend and vote at the Annual General Meeting.

Types of Issues

i. Public Issue:

This is the issue of the shares of a company to members of the public. This issue is normally preceded by the issue of a prospectus by the company. The prospectus is the document which sets out such salient details regarding the offer (as a brief history of the company, the past financial statements of the company in abridged form, a projection of future earnings and the mode of payment for the shares) as would assist potential investors to assess the company.

ii. Private Placement

This is the issue of shares of a company to selected persons. The basis of selection of the persons is usually arbitrary and subjective. A private placement is not usually preceded by the issue of a prospectus.

iii. Bonus Issue:

This is the issue of fully-paid shares of a company to existing shareholders in proportion to their existing shareholding. Bonus shares are issued to shareholders free of charge. The shares are paid up from the existing reserves of the company. Bonus issue is sometimes referred to as capitalization issues because its effect is that existing reserves are capitalized into paid-up capital thereby reducing the reserves and increasing the paid-up capital. Another name for bonus issues is scrip issue.

iv. Rights Issue

This is the issue of shares of a Company to existing shareholders in proportion to their existing shareholding at a price known as rights price. The rights price is usually higher than the par value but lower than the market value (market price). The attraction of this issue to the existing

shareholders is that they have opportunity to acquire more shares of the company at a price lower than the market price. In a rights issue, a shareholder may:

- (a) Take up the rights
- (b) Renounce the rights
- (c) Sell the rights.

v. Conversion Issue

This is the issue of shares of a company in exchange for convertible securities of the company such as convertible debentures. An advantage of this kind of issue to holders of such securities is that it enables them to acquire the company's share as well as the benefits accruing to shareholders. The advantages of conversion issues to the company include the fact that it is able to settle its debt without paying cash.

Accounting Entries on issue of shares

Shares can be issued at par, premium or discount

- 1) Dr: Banks a/c
Cr: Application / allotment a/c (with the money paid on application and allotment).
- 2) Dr: Application / allotment a/c
Cr: Bank a/c (with refund made to unsuccessful applicant)
- 3) Dr: Application / allotment a/c
Cr: Share capital a/c (with the nominal value)
Cr: Share premium a/c (with the premium)
- 4) Dr: Calls a/c
Cr: Share capital a/c (with the nominal value of call amount due)
- 5) Dr: Bank a/c
Cr: Calls a/c (with the moneys paid on calls)
- 6) a. Dr: Calls in arrears a/c
Cr: Calls a/c (with any arrears by shareholders)
b. Dr: Calls a/c
Cr: Calls in advance a/c (with any advance made by shareholders)
c. Dr: Calls in advance a/c
Cr: Calls a/c (when transfer is made to the actual call)

- 7) a. Dr: Share capital a/c
Cr: Forfeited share capital a/c (with the called-up amount of shares forfeited).
- b. Dr: Forfeited share capital a/c
Cr: Calls in arrears a/c (with the balance therein)
- 8) a. Dr: Forfeited share reissue a/c
Cr: Share capital a/c (with the called-up value of share reissue)
- b. Dr: Forfeited share capital a/c
Cr: Forfeited share reissued a/c (with the balance therein)
- c. Dr: Bank a/c
Cr: Forfeited share reissued a/c (with the proceeds on reissue)
- d. Dr: Forfeited share reissued a/c
Cr: Share premium a/c (with premium on reissue).

5.2.2 Redemption of Shares

Accounting Entries

- 1) Dr: Preference share capital
Cr: Pref. Share Redemption a/c (with the nominal value of the shares to be redeemed on declaration of redemption)
- 2) Dr: Premium on redemption a/c
Cr: Pref. Share Redemption a/c (with premium on redemption)
- 3) a. Dr: Share premium a/c
Cr: Premium on redemption a/c (with any amount available for utilization in the share premium a/c)
- b. Dr: P & L Account
Cr: Premium on redemption a/c (with any amount to be utilized through distributable profit)
- 4) Dr: Bank a/c
Cr: Share capital (with proceed of a fresh issue of shares for the purpose of redemption)
- 5) Dr: P or L Account a/c
Cr: Capital Redemption Reserve Fund (with the nominal value of the shares redeemed which shall be transferred out of the distributable profit)

- 6) Dr: Preference share redemption a/c
 Cr: Bank a/c (with the payment for redemption)

Illustration 1

Issues of share at par

Bayoade Limited has an authorized ordinary share capital of 10,000,000 of N3 each. On January 2, 2006 public subscription/offer was made for 2,000,000 ordinary shares payable as follows:

| | |
|-----------------------|-------------|
| On application | 1.20 |
| On allotment | 1.40 |
| First call | 0.20 |
| Second and final call | <u>0.20</u> |
| | <u>3.00</u> |

All monies were collected as at when due.

Required:

- 1) Open necessary ledger to record the above transactions.
- 2) Show the balance sheet extract after completing the transactions.

Solution

Money receivable on sales of 2,000,000 shares

- (1) Application Money = 2,000 shares x ~~N~~1.20 = ~~N~~2,400,000
 Allotment Money = 2,000,000 shares x ~~N~~1.40 = ~~N~~ 2,800,000

Total Money on Application and Allotment = 5,200,000

Bank collection on Application and Allotment = 5,200,000

- (2) First call Money = 2,000,000 Shares x 0.2 = ~~N~~400,000
 Bank Collection on first call = 400,000

- (3) Second and final call money = 2,000,000 shares x ~~N~~0.20 = ~~N~~ 400,000

Application and Allotment Account

| | N | | N |
|-----------------|-------------------------|------|-------------------------|
| Ordinary Shares | 2,400,000 | Bank | 5,200,000 |
| Ordinary Shares | <u>2,800,000</u> | | |
| | <u>5,200,000</u> | | <u>5,200,000</u> |

Ordinary Share Capital Account

| | N | | N |
|----------|------------------|-----------------------------------|------------------|
| Bal. c/d | 6,000,000 | App. & Allotment | 2,400,000 |
| | | App. & Allotment | 2,800,000 |
| | | 1 st Call Account | 400,000 |
| | | 2 nd and Final Account | <u>400,000</u> |
| | <u>6,000,000</u> | Bal. b/d | <u>6,000,000</u> |

First Call Account

| | N | | N |
|--------------------|----------------|------|----------------|
| Ord. Share Capital | <u>400,000</u> | Bank | <u>400,000</u> |

Second and Final Call Account

| | N | | N |
|--------------------|----------------|------|----------------|
| Ord. Share Capital | <u>400,000</u> | Bank | <u>400,000</u> |

Bank Account

| | N | | N |
|--------------------------------|------------------|----------|------------------|
| App. & Allotment | 5,200,000 | Bal. c/d | 6,000,000 |
| 1 st Call | 400,000 | | |
| 2 nd and Final Call | <u>400,000</u> | | |
| | <u>6,000,000</u> | | <u>6,000,000</u> |
| Bal. b/d | 6,000,000 | | |

Financial position (Extract)

| | N | | N |
|----------------------|-------------------|-----------------------|-----------|
| Authorised Share Cap | <u>10,000,000</u> | <u>Current Asset:</u> | |
| Ord. Share Capital | 6,000,000 | Bank | 6,000,000 |

Illustration 2

Issues of Shares at a Discount

Gusau Limited has made application to public to subscribe for 5,000,000 Share of N10 each at N8 payable as follows:

| | |
|----------------------------------|------|
| On Application | 2.00 |
| On Allotment | 1.00 |
| First call | 3.00 |
| And the balance is to be paid on | |
| Second and final call is | 2.00 |

All monies due were received at the right time.

Required:

- 1) Prepare relevant ledger to record the above transactions.
- 2) Show the balance sheet extract.

Solution

Computation of discount on share price

| | | |
|-------------------------------------|---|------------|
| Nominal value (price) of Share | - | <u>₦10</u> |
| Less: Market Value (price) of Share | - | <u>₦8</u> |
| Discount on Share Price | - | <u>₦2</u> |

Money receivable on sales of 5,000,000 Shares

$$\text{Application Money} = 5,000,000 \text{ Shares} \times \cancel{\text{₦2}} = \text{₦10,000,000}$$

$$\text{Allotment Money} = 5,000,000 \text{ Shares} \times \cancel{\text{₦1}} = 5,000,000$$

$$\text{First Call Money} = 5,000,000 \times \cancel{\text{₦3}} = \text{₦15,000,000}$$

$$\text{Second and final call money} = 5,000,000 \text{ shares} \times \cancel{\text{₦2}} = \text{₦10,000,000}$$

$$\text{Discount on shares money} = \cancel{\text{₦5,000,000}} \text{ shares} \times \cancel{\text{₦2}} = 10,000,000$$

$$\text{Total Bank Money collection on shares sold} = \cancel{\text{₦8}} \times \text{₦5,000,000 shares} = \text{₦40,000,000}$$

Computation of Premium on Shares Price

| | |
|---------------------------|-----|
| Market Price of Shares – | ₦25 |
| Nominal Price of Shares - | ₦20 |
| Premium on Shares - | ₦5 |

Money receivable on sales of 6,000,000 Shares

Application Money = 6,000,000 Shares x ~~₦5~~ = ~~₦30,000,000~~

Allotment Money = 6,000,000 Shares x ~~₦7~~ = ~~₦42,000,000~~

Share premium Money = 6,000,000 Shares x ~~₦6~~ = ~~₦30,000,000~~

1st call money = 6,000,000 Shares x 6 = 36,000,000

2nd & Final call money = 6,000,000 Shares x 2 = 12,000,000

Total Bank Money collected on shares sold

= 25, x 6,000,000 = 150,000,000

Application and Allotment Account

| N | | N | |
|-----------------|-------------------|------|-------------------|
| Ordinary Shares | 10,000,000 | Bank | 15,000,000 |
| Ordinary Shares | <u>5,000,000</u> | | <u>15,000,000</u> |
| | <u>15,000,000</u> | | |

Ordinary Share Capital Account

| N | | N | |
|----------|-------------------|-----------------------------------|-------------------|
| Bal. c/d | 50,000,000 | App. & Allotment | 10,000,000 |
| | | App. & Allotment | 5,000,000 |
| | | 1 st Call Account | 15,000,000 |
| | | 2 nd and Final Account | 10,000,000 |
| | | Discount of Shares | <u>10,000,000</u> |
| | <u>50,000,000</u> | | <u>50,000,000</u> |
| | | Bal. b/d | 50,000,000 |

First Call Account

| | | | |
|--------------------|------------------------|------|------------------------|
| Ord. Share Capital | N <u>15,000,000</u> | Bank | N <u>15,000,000</u> |
|--------------------|------------------------|------|------------------------|

Second and Final Call Account

| | | | |
|--------------------|------------------------|------|------------------------|
| Ord. Share Capital | N <u>10,000,000</u> | Bank | N <u>10,000,000</u> |
|--------------------|------------------------|------|------------------------|

Discount on Share Account

| | | | |
|--------------------|------------------------|----------|------------------------|
| Ord. Share Capital | N <u>10,000,000</u> | Bal. c/d | N <u>10,000,000</u> |
| Bal. d/d | 10,000,000 | | |

Bank Account

| | | | |
|--------------------------------|-------------------|----------|-------------------|
| App. & Allotment | N 15,000,000 | Bal. c/d | N 40,000,000 |
| 1 st Call | 15,000,000 | | |
| 2 nd and Final Call | <u>10,000,000</u> | | |
| | <u>40,000,000</u> | | <u>40,000,000</u> |
| Bal. b/d | 40,000,000 | | |

Balance Sheet (Extract)

| | | | |
|--------------------|-----------------|---------------------|------------|
| Ord. Share Capital | N 50,000,000 | <u>Fixed Asset:</u> | N |
| | | Discount on Share | 10,000,000 |
| | | Bank | 40,000,000 |

Illustration 3

Issues of Shares at Premium

On 1st Jan. 2007, Joyce International Ltd. offered 6,000,000 Ordinary. shares of N20 each to the public at N25 per share. Payment is to be made as follows:

| | |
|-------------------------------|-------|
| Application | 5.00 |
| Allotment (including premium) | 12.00 |
| 1 st Call | 6.00 |
| 2 nd & Final Call | 2.00 |

All the monies were collected as at when due.

Required:

- 1) Prepare relevant ledger to record the above transactions.
- 2) Show the balance sheet extract.
- 3) Journalize the transactions.

Solution:

| Application and Allotment Account | | | |
|-----------------------------------|--------------------|------|--------------------|
| | N | | N |
| Ord. Shares Cap. | 30,000,000 | Bank | 102,000,000 |
| Ord. Shares Cap. | 42,000,000 | | |
| Share Premium | <u>30,000,000</u> | | |
| | <u>102,000,000</u> | | <u>102,000,000</u> |

| Ordinary Share Capital Account | | | |
|--------------------------------|--------------------|-----------------------------------|--------------------|
| | N | | N |
| Bal. c/d | 120,000,000 | App. & Allotment a/c | 30,000,000 |
| | | App. & Allotment a/c | 42,000,000 |
| | | 1 st Call Account | 36,000,000 |
| | | 2 nd and Final Account | <u>12,000,000</u> |
| | <u>120,000,000</u> | | <u>120,000,000</u> |
| | | Bal. b/d | 120,000,000 |

| Share Premium Account | | | |
|-----------------------|-------------------|------------------|-------------------|
| | N | | N |
| Bal. c/d | <u>30,000,000</u> | App. & Allotment | <u>30,000,000</u> |
| | | Bal. b/d | 30,000,000 |

| First Call Account | | | |
|--------------------|-------------------|------|-------------------|
| | N | | N |
| Ord. Share Capital | <u>36,000,000</u> | Bank | <u>36,000,000</u> |

Second and Final Call Account

| | | | |
|--------------------|-------------------|------|-------------------|
| | N | | N |
| Ord. Share Capital | <u>12,000,000</u> | Bank | <u>12,000,000</u> |

Bank Account

| | | | |
|------------------------------------|--------------------|----------|--------------------|
| | N | | N |
| App. & Allotment | 102,000,000 | Bal. c/d | 150,000,000 |
| 1 st Call a/c | 36,000,000 | | |
| 2 nd and Final Call a/c | <u>12,000,000</u> | | |
| | <u>150,000,000</u> | | <u>150,000,000</u> |
| Bal. b/d | 150,000,000 | | |

Balance Sheet (Extract)

| | | | |
|--------------------|-------------|-----------------------|-------------|
| | N | | N |
| Ord. Share Capital | 120,000,000 | <u>Current Asset:</u> | |
| Share Premium | 30,000,000 | Bank | 150,000,000 |

Journal

| | | | |
|--|------------|--|------------|
| | Dr | | Cr |
| | N | | N |
| Application and Allotment | 30,000,000 | | |
| Ordinary Shares Capital | | | 30,000,000 |
| <u>Being the amount due on Application</u> | | | |
| Application & Allotment | 42,000,000 | | |
| Ordinary Share Capital | | | 42,000,000 |
| <u>Being the amount due on App & Allotment</u> | | | |

| | | |
|---|-------------|-------------|
| Application & Allotment | 30,000,000 | |
| Share / Premium | | 30,000,000 |
| <u>Being the amount due on Share Premium</u> | | |
| Bank | 102,000,000 | |
| Application & Allotment | | 102,000,000 |
| <u>Being money paid on Application & Allotment</u> | | |
| 1 st Call | 36,000,000 | |
| Ordinary share capital | | 36,000,000 |
| <u>Being amount received on 1st Call</u> | | |
| Bank | 12,000,000 | |
| 2 nd & Final Call a/c | | 12,000,000 |
| <u>Being amount received 2nd& Final Call</u> | | |
| 2 nd & Final Call | 12,000,000 | |
| Ordinary Shares | | 12,000,000 |

Illustration 4

Calls in Arrears and Calls in Advance

Zebrudiah Investment Ltd. offered for application to the public 4,000,000 ordinary shares of N100 each at par payable as follows:

| | |
|----------------------------------|--------|
| On Application | N30.00 |
| On Allotment (including premium) | N20.00 |
| 1 st Call | N35.00 |
| 2 nd & Final Calls | N15.00 |

All monies were dully received except for holders of 500,000 shares who refused to pay the amount due on first call. Holders of 300,000 shares paid for the 2nd and final call alongside with amount due on first call.

Required:

- Prepare relevant ledger to record the above transactions.
- Show the balance sheet extract.
- Journalize the above transactions.

Solution

Application and Allotment Account

| | N | | N |
|------------------|--------------------|------|--------------------|
| Ord. Shares Cap. | 120,000,000 | Bank | 200,000,000 |
| Ord. Shares Cap. | <u>80,000,000</u> | | |
| | <u>200,000,000</u> | | <u>200,000,000</u> |

Ordinary Share Capital Account

| | N | | N |
|----------|--------------------|--------------------------------|--------------------|
| Bal. c/d | 400,000,000 | App. & Allotment | 120,000,000 |
| | | App. & Allotment | 80,000,000 |
| | | 1 st Call | 140,000,000 |
| | | 2 nd and Final Call | <u>60,000,000</u> |
| | <u>400,000,000</u> | Bal. b/d | <u>400,000,000</u> |
| | | | 400,000,000 |

First Call Account

| | N | | N |
|--------------------|--------------------|------------------|--------------------|
| Ord. Share Capital | 140,000,000 | Calls in Arrears | 17,500,000 |
| Call in Advance | <u>4,500,000</u> | Bank | <u>127,000,000</u> |
| | <u>144,500,000</u> | | <u>144,500,000</u> |

Second and Final Call Account

| | N | | N |
|--------------------|-------------------|-----------------|-------------------|
| Ord. Share Capital | 60,000,000 | Call in Advance | 4,500,000 |
| | | Bank | <u>55,500,000</u> |
| | <u>60,000,000</u> | | <u>60,000,000</u> |

Calls in Arrears

| | N | | N |
|--------------------------|-------------------|----------|-------------------|
| 1 st Call a/c | <u>17,500,000</u> | Bal. c/d | <u>17,500,000</u> |
| Bal. b/d | 17,500,000 | | |

Calls in Advance

| | N | | N |
|--|---|--|---|
| | | | |

2nd& Final Call a/c 4,500,000 1st Call A/c 4,500,000

Bank Account

| N | | N | |
|--------------------------------|--------------------|----------|--------------------|
| App. & Allotment | 200,000,000 | Bal. c/d | 382,500,000 |
| 1 st Call | 127,000,000 | | |
| 2 nd and Final Call | <u>55,500,000</u> | | |
| | <u>382,500,000</u> | | <u>382,500,000</u> |
| Bal. b/d | 382,500,000 | | |

Balance Sheet (Extract)

| N | | N | |
|--------------------|-------------|-----------------------|-------------|
| Ord. Share Capital | 400,000,000 | <u>Current Asset:</u> | |
| Call in Arrears | 17,500,000 | Bank | 382,500,000 |

Journal

| | Dr | | Cr |
|--|-------------|--|-------------|
| | N | | N |
| Application & Allotment | 120,000,000 | | |
| Ordinary Share Capital | | | 120,000,000 |
| Being amount due on Application | | | |
| Application & Allotment | 80,000,000 | | |
| Ordinary Share Capital | | | 80,000,000 |
| Being the amount due on Allotment | | | |
| 1 st Call | 140,000,000 | | |
| Ordinary share | | | 140,000,000 |
| Being amount due on 1 st Call | | | |
| 2 nd & Final Call a/c | 60,000,000 | | |
| Ordinary Share Capital | | | 60,000,000 |
| Being amount due on 2 nd & Final Call | | | |
| Calls in Arrears | 17,500,000 | | |

| | | |
|--|-------------|-------------|
| 1 st Call Account | | 17,500,000 |
| Being Calls in Arrears | | |
| Calls in Advance | 4,500,000 | |
| 2 nd & Final Call | | 4,500,000 |
| Being Calls in Advance | | |
| Bank | 200,000,000 | |
| Application & Allotment | | 200,000,000 |
| Being amount received on Application & Allotment | | |
| Bank | 127,000,000 | |
| 1 st Call | | 127,000,000 |
| Being amount received on First call | | |
| Bank | 55,500,000 | |
| 2 nd & Final Call | | 55,500,000 |

Illustration 5

Applications were made to the public by Emerald Ltd. to subscribe for 400,000 shares of N20 each at N22 payable as follows:

| | |
|---------------------|-----------------------|
| On application | 10 |
| On allotment | 6 (including premium) |
| First Call | 4 |
| Second & Final Call | 2 |

All the monies were dully received except for the money due on 5,000 shares which were not paid when the first call was made. The directors had a meeting and decided to forfeit the shares.

Required:

- 1) Show the relevant ledgers to record the above transactions.
- 2) Journalize the transactions.
- 3) Show the balance sheet extract.

Solution:

Application and Allotment Account

| N | | N | |
|----------------------|------------------|------|------------------|
| Ord. Shares Cap. a/c | 4,000,000 | Bank | 6,400,000 |
| Ord. Shares Cap. a/c | 1,600,000 | | |
| Share Premium a/c | <u>800,000</u> | | |
| | <u>6,400,000</u> | | <u>6,400,000</u> |

Ordinary Shares Capital Account

| N | | N | |
|---------------------|--------|---------------------------------------|-----------|
| Forfeited share a/c | 90,000 | App. & Allotment a/c | 4,000,000 |
| | | App. & Allotment a/c | 1,600,000 |
| | | 1 st Call Account a/c | 1,600,000 |
| | | 2 nd and Final Account a/c | 800,000 |
| | | Forfeited share re-issued | 100,000 |

Share Premium Account

| N | | N | |
|---|--|------------------|---------|
| | | App. & Allotment | 800,000 |

Call a/c in arrears is 5,000 x N4 = 20,000

First Call Account

| N | | N | |
|--------------------|------------------|------------------|------------------|
| Ord. Share Capital | 1,600,000 | Calls in arrears | 20,000 |
| | <u>1,600,000</u> | Bank | <u>1,580,000</u> |
| | | | <u>1,600,000</u> |

Second and Final Call Account

| N | | N | |
|------------------------|----------------|------|----------------|
| Ord. Share Capital a/c | <u>800,000</u> | Bank | <u>800,000</u> |

Call in Arrears Account

| | | | |
|----------------------|---------------|---------------------|---------------|
| | N | | N |
| 1 st Call | <u>20,000</u> | Forfeited share a/c | <u>20,000</u> |

Forfeited Shares Account

| | | | |
|------------------|---------------|-----------------------------|---------------|
| | N | | N |
| Calls in Arrears | <u>20,000</u> | Ordinary Shares Capital a/c | <u>90,000</u> |

Assuming the directors decided to reissue the shares forfeited at the rate of N6 per share, the accounting entries will be as follows:

1. Dr. Forfeited Shares Re-issue a/c: by the Called-up Capital up to re-issue.

Cr. Ordinary Capital Share A/c

Application = N10

Allot. = N4

Re-issue = N6

20 x 5,000 = 100,000

2. Dr Forfeited Shares A/c
Cr Forfeited Re-issue A/c

3. Dr Bank
Cr Forfeited Share Re-issue A/c
Cr Share Premium

Forfeited Shares Re-issue Account

| | | | |
|------------------------|----------------|------------------|----------------|
| | N | | N |
| Ordinary Share Capital | 100,000 | Forfeited Shares | 70,000 |
| | Bank | | <u>30,000</u> |
| | <u>100,000</u> | | <u>100,000</u> |

Forfeited Shares Account

| | | | |
|--------------------------|---------------|-----------------------------|--------|
| | N | | N |
| Calls in Arrears | 20,000 | Ordinary Shares Capital a/c | 90,000 |
| Forfeited Share Re-issue | <u>70,000</u> | | _____ |

| <u>90,000</u> | | <u>90,000</u> | |
|------------------------------------|------------------|---------------|------------------|
| Bank Account | | | |
| | N | | N |
| App. & Allotment | 6,400,000 | Bal. c/d | 8,780,000 |
| 1 st Call a/c | 1,580,000 | | |
| 2 nd and Final Call a/c | <u>800,000</u> | | |
| | <u>8,780,000</u> | | <u>8,780,000</u> |
| Bal. b/d | 8,780,000 | | |

Illustration 6

Redemption of Redeemable Preferential Shares

Below is the Statement of Financial Position of Jos Ltd as at 31st December 2005

| Statement of Financial Position | | | |
|--|-------------------|-----------------------|-------------------|
| | N | | N |
| | | <u>Fixed Assets</u> | |
| Ordinary Shares of N1 8,000,000 | 8,000,000 | Land and Building | 5,000,000 |
| 15% Redeemable Preference Shares of N1 | 2,000,000 | Machinery | 4,000,000 |
| 10% Debentures | 1,800,000 | Motor Vehicle | 3,500,000 |
| | | Furniture | <u>500,000</u> |
| | | | 13,000,000 |
| <u>Liabilities</u> | | <u>Current Assets</u> | |
| Creditors | 1,900,000 | Stock | 200,000 |
| | | Debtor | 1,300,000 |
| <u>Reserves</u> | | Prepayment | 250,000 |
| Share Premium | 1,100,000 | Bank | <u>1,050,000</u> |
| General Reserve | 400,000 | | 2,800,000 |
| Profit and Loss | <u>600,000</u> | | |
| | <u>15,800,000</u> | | <u>15,800,000</u> |

90% of the Redeemable Preference Shares are to be redeemed on 1st January 2006 at a premium of 5% on the following terms:

- 1) Issuance of a fresh 1,000,000 ordinary shares of N1 each at N1.50
- 2) The balance of the funds required for redemption is to be provided for out of profits.
- 3) The following assets are to be re-valued as follows:

| | N |
|-------------------|-----------|
| Land and Building | 5,120,000 |
| Machinery | 4,020,000 |
| Motor Vehicle | 3,480,000 |

Furniture 470,000

- 4) Debtors to settle their accounts.
- 5) Creditors are to be paid in full less 5% discount.

Required:

- (a) Prepare the relevant ledgers required to record the above transactions.
- (b) Prepare the revised Statement of Financial Position immediately after the redemption.

Solution

| Dr | | 15% Redeemable Preference A/c | | Cr | |
|----------------|------------------|-------------------------------|---|------------------|---------|
| | N | | N | | |
| Redemption A/c | 1,800,000 | Balance c/d | | 2,000,000 | |
| Bal. c/d | <u>200,000</u> | | | | |
| | <u>2,000,000</u> | | | <u>2,000,000</u> | |
| | | Bal. c/d | | | 200,000 |

| Dr | | Redemption A/c | | Cr | |
|------|-------------------|--------------------|---------------|------------------|--|
| | N | | N | | |
| Bank | 1,890,000 | 15% Red. Pref. A/c | | 1,800,000 | |
| | <u> </u> | Red. Premium | <u>90,000</u> | | |
| | <u>1,890,000</u> | | | <u>1,890,000</u> | |

| Dr | | Ordinary Share Capital A/c | | Cr | |
|----------|-------------------|----------------------------|---|------------------|-----------|
| | N | | N | | |
| Bal. c/d | 9,000,000 | Balance b/f | | 8,000,000 | |
| | <u> </u> | Bank | | <u>1,000,000</u> | |
| | <u>9,000,000</u> | | | <u>9,000,000</u> | |
| | | Bal. b/d | | | 9,000,000 |

| Dr | | Share Premium A/c | | Cr | |
|------------------|------------------|-------------------|---|------------------|-----------|
| | N | | N | | |
| Red. Premium A/c | 90,000 | Balance b/f | | 1,100,000 | |
| Bal. c/d | <u>1,510,000</u> | Bank | | <u>500,000</u> | |
| | <u>1,600,000</u> | | | <u>1,600,000</u> | |
| | | Bal. b/d | | | 1,510,000 |

| Dr | | Redemption Premium A/c | | Cr | |
|----------------------|------------------|------------------------|-------------------|------------------|--|
| | N | | | N | |
| Redemption A/c | <u>90,000</u> | | Share Premium A/c | <u>90,000</u> | |
| | <u>90,000</u> | | | <u>90,000</u> | |
| Dr | | Land & Building A/c | | Cr | |
| | N | | | N | |
| Bal. b/f | 5,000,000 | Balance c/d | | 5,120,000 | |
| P & L | <u>120,000</u> | | | | |
| | <u>5,120,000</u> | | | <u>5,120,000</u> | |
| Dr | | Machinery A/c | | Cr | |
| | N | | | N | |
| Bal. b/f | 4,000,000 | Balance c/d | | 4,020,000 | |
| P & L | <u>20,000</u> | | | | |
| | <u>4,020,000</u> | | | <u>4,020,000</u> | |
| Bal. b/d | 4,020,000 | | | | |
| Dr | | Motor Vehicle A/c | | Cr | |
| | N | | | N | |
| Bal. b/f | 3,500,000 | P & L | | 20,000 | |
| | <u>3,500,000</u> | Bal. c/d | | <u>3,480,000</u> | |
| Bal. b/d | 3,480,000 | | | <u>3,500,000</u> | |
| Dr | | Furniture A/c | | Cr | |
| | N | | | N | |
| Bal. b/f | 500,000 | P & L | | 30,000 | |
| | <u>500,000</u> | Bal. c/d | | <u>470,000</u> | |
| Bal. b/d | 470,000 | | | <u>500,000</u> | |
| Dr | | Debtors A/c | | Cr | |
| | N | | | N | |
| Bal. b/f | <u>1,300,000</u> | Bank | | <u>1,300,000</u> | |
| | <u>1,300,000</u> | | | <u>1,300,000</u> | |
| Dr | | Creditors A/c | | Cr | |
| | N | | | N | |
| Discount (P & L a/c) | 95,000 | Balance b/f | | 1,900,000 | |

| | | | | |
|--------------------|-------------------|-----------------------|--|------------------|
| Bank | <u>1,805,000</u> | | | |
| | <u>1,900,000</u> | | | <u>1,900,000</u> |
| Dr | Profit & Loss A/c | | | Cr |
| | N | | | N |
| Motor Vehicle | 20,000 | Balance c/f | | 600,000 |
| Furniture | 30,000 | Land & Building | | 120,000 |
| CRRF | 390,000 | Machinery | | 20,000 |
| Balanced c/d | <u>395,000</u> | Discount on Creditor` | | <u>95,000</u> |
| | <u>835,000</u> | | | <u>835,000</u> |
| | | Bal. b/d | | 395,000 |
| Dr | CRRF A/c | | | Cr |
| | N | | | N |
| Bal. c/d | <u>390,000</u> | P & L A/c | | <u>390,000</u> |
| | | Bal. b/d | | 390,000 |
| Dr | Bank A/c | | | Cr |
| | N | | | N |
| Bal. b/f | 1,050,000 | Redemption A/c | | 1,890,000 |
| Ordinary Share A/c | 1,000,000 | Creditor | | 1,805,000 |
| Share Premium | 500,000 | Balance c/d | | 155,000 |
| Debtor | <u>1,300,000</u> | | | |
| | <u>3,850,000</u> | | | <u>3,850,000</u> |
| Bal. b/d | 155,000 | | | |

JOS LTD

REVISED STATEMENT OF FINANCIAL POSITION

| | | | |
|-----------------------------------|----------------|-----------------------|-------------------|
| | N | | N |
| Ordinary Share of N1 each | 9,000,000 | Noncurrent Assets | |
| 15% Redeemable Pref. Shares of N1 | 200,000 | Land & Building | 5,120,000 |
| 10% Debentures | 1,800,000 | Machinery | 4,020,000 |
| <u>Liabilities</u> | | Motor Vehicle | 3,480,000 |
| Reserves: | | Furniture | 470,000 |
| Share Premium | 1,510,000 | <u>Current Assets</u> | |
| General Reserves | 400,000 | Stock | 200,000 |
| Profit & Loss | 395,000 | Prepayment | 250,000 |
| CRRF | <u>390,000</u> | Bank | 155,000 |
| <u>13,695,000</u> | | | <u>13,695,000</u> |

5.2.3 Issues of Debentures

Debentures are securities evidencing long term creditorship interest in an organization. It is also a loan obtained by a company from investor through the capital market. Only a company has access to this kind of loan. Unincorporated business such as partnerships and sole proprietorships do not.

Issue Price

Debentures may be issued at par, at a premium or at a discount. They are normally issued in units of N100.

(i) Issue of debentures at Par

In this type of issue, the debentures are issued at the nominal value i.e. N100 debentures are issued for the same amount. In examination questions, issue of debentures at par may be expressed as "... Issued at 100"...The entry is to debit the proceeds to cash book while the debenture account is credited.

(ii) Issue of Debentures at a Premium

Where debentures are issued at a price above the nominal, they are said to be issued at a premium. Thus, the premium is the excess of the issue price over the nominal value.

If, for example, debentures of N100 are issued at N120, this may be expressed, in examination questions, as "... issued at 120.

(iii) Issue of Debentures at a Discount

In this type of issue, the debentures are issued at a price lower than the nominal value. Thus, the discount is the excess of nominal value over the issue price. If, for example, debentures of N100 are issued at N95, this may be expressed, in examination questions, as "... issued at 95".

The balance on the discount on debentures shall be carried to the balance sheet as a fictitious asset to be written off to reserves as follows:

- i. Equal annual instalments against existing reserves if the debentures are redeemable at a specified date without a sinking fund being build up;
- ii. In full against the sinking fund at the date of redemption if a sinking fund had been accumulated; or
- iii. On reducing balance basis or in equal annual instalments against existing reserves if the debentures are redeemable by annual drawings.

Types of Debentures (S.171 – 174, CAMA 1990)

(i) Secured Debentures

Secured Debentures are those which carry a charge or mortgage on the assets of the company. Secured debentures are two (2) categories namely: - those which carry a fixed / specific charge and those which carry a floating charge.

A Fixed Charge is a mortgage on specific assets which deprives the company of the right to deal with such assets in any manner prejudicial to the rights of the debenture holders.

A Floating Charge is a mortgage on all or a class of the present and future assets of the company. The assets charged are however not specified or named. A floating charge does not preclude the company from dealing with the assets in any way it deems necessary in the ordinary course of business. The floating charge “floats” with or “hovers” over the assets (as they continuously change in form in the ordinary course of business) until some event occurs (e.g. default in paying principal or interest) which crystallizes or fixes the charge [178(2), CAMA. 1990].

(ii) Unsecured Debentures

Also known as simple or naked debentures, these are debentures which carry no charge on the assets of the company. In other words, such debentures do not confer any security on the holders.

(iii) Redeemable Debentures

These are debentures which are redeemable (i.e. repayable) at a specified future date.

(iv) Irredeemable Debentures

Also known as perpetual debentures these are debentures which the company is not under any obligation to repay at a specified date unless the company is being liquidated or the company defaults in paying interest within a specified time limit.

(v) Convertible Debentures

These are debentures which, in lieu of redemption or repayment, may be converted into shares of the company at the option of the company or the holder.

Accounting Entries

- (i) Issue of Debentures at Par: } with the proceeds of the issue.
 DR: Cash Book
 CR: Debentures A/c
- (ii) Issue of Debentures at a Premium:
 DR: Cash Book - with the proceeds of the issue.
 CR: Debentures A/c - with the nominal value of the debentures.
 CR: Debentures Premium A/c - with the premium on the debentures
- (iii) Issue of Debentures at a Discount:
 DR: Cash Book - with the proceeds of the issue.
 DR: Discount on Debenture A/c - with the discount on the debentures.
 CR: Debentures A/c - with the nominal value of the debenture
- (iv) Payment of Debenture Interest Net of With-holding Tax:
 DR: Debenture Interest A/c } with the amount paid.
 CR: Cash Book
- (v) Withholding Tax Deducted: } with the amount of the withholding tax.
 DR: Debenture Interest A/c
 CR: Withholding Tax A/c
- (vi) Payment of Withholding Tax to Tax Authorities:
 DR: Withholding Tax A/c } with the amount paid
 CR: Cash Book

Illustration 1

No Withholding Tax

Samson Limited normally makes accounts to 31st December annually. On 1st March, 1995 the company issued N50,000 12% Debenture Stock at 95. Interest is payable half yearly on 30th June and 31st December.

Required:

Show the following ledger accounts up to 31st December, 1996.

- a) 12% Debenture Stock Account
- b) Debenture Interest Account
- c) Discount on Debenture Account.

Ignore withholding tax.

Solution

| | | 12% Debenture Stock Account | |
|-------------------|---------------|---|---------------|
| | | N | N |
| 31/12/05 Bal. c/d | 50,000 | 1/3/05 Bank (N50,000 x 0.95) | 47,500 |
| | | 1/3/05 Discount on Debentures (N50,000 x 0.05) | <u>2,500</u> |
| | <u>50,000</u> | | <u>50,000</u> |
| 31/12/06 Bal. c/d | <u>50,000</u> | 1/1/06 Bal. b/d | <u>50,000</u> |
| | | 1/1/07 Bal. b/d | <u>50,000</u> |

| | | Debenture Interest Account | |
|--------------------------------------|--------------|----------------------------|--------------|
| | | N | N |
| 30/6/05 Bank (N50,000 x 12% x 4/12) | 2,000 | 31/12/05 P & L Account | 5,000 |
| 31/12/05 Bank (N50,000 x 12% x 6/12) | 3,000 | | |
| | <u>5,000</u> | | <u>5,000</u> |
| 30/6/06 Bank (N50,000 x 12% x 6/12) | 3,000 | 31/12/06 P & L Account | 6,000 |
| 31/12/06 Bank (N50,000 x 12% x 6/12) | <u>3,000</u> | | |
| | <u>6,000</u> | | <u>6,000</u> |

| | | Discount on Debenture Account | |
|-----------------------|--------------|-------------------------------|--------------|
| | | N | N |
| 1/3/05 12% Debentures | <u>2,500</u> | 31/12/05 Bal. c/d | <u>2,500</u> |
| 1/1/06 Bal. b/d | <u>2,500</u> | 31/12/06 Bal. c/d | <u>2,500</u> |
| 1/1/07 Bal. b/d | 2,500 | | |

5.2.4 Redemption of Redeemable Debentures

Illustration 2

Ayomide Limited issued N100,000 8% debentures at 105 on January, 1990. The terms under which the debentures were issued provided that a sinking fund be set up for the redemption of the debentures 5 years later. The sum to be set aside every year should be such that when invested annually at a compound interest rate of 12% per annum will amount to N120,000 at

the due date of redemption of the debentures. Interest is paid on the debentures on 31st March and 30th September, every year.

The debentures were redeemed on 31st December, 1994 at a premium of 10%. To provide cash for the redemption, the sinking fund investment was sold for N115,000.

You are required to show the following Accounts:

- (a) 8% Debentures A/c
- (b) Sinking Fund A/c
- (c) Sinking Fund Investment A/c
- (d) Redemption A/c
- (e) Sinking Fund Investment Disposal A/c.

Solution

Using the sinking fund formula to calculate the amount to set aside annually:

$$\begin{aligned}
 S &= \frac{a [(1+r)^n - 1]}{r} \\
 120,000 &= \frac{a [(1+0.12)^5 - 1]}{0.12} \\
 120,000 &= \frac{a [1.12^5 - 1]}{0.12} \\
 120,000 \times 0.12 &= a (1.7623 - 1) \\
 14,400 &= 0.7623a \\
 a &= \frac{14,400}{0.7623} \\
 a &= \text{N}18,889
 \end{aligned}$$

(a) 8% Debentures Account

| | N | | | N |
|------------------------|----------------|----------|----------|-------------------------|
| 31/12/1990 Bal. c/d | <u>100,000</u> | 1/1/1990 | Bank | <u>100,000</u> |
| 31/12/1991 Bal. c/d | <u>100,000</u> | 1/1/1991 | Bal. b/d | 100,000, <u>100,000</u> |
| 31/12/1992 Bal. c/d | <u>100,000</u> | 1/1/1992 | Bal. b/d | 100,000, <u>100,000</u> |
| 31/12/1993 Bal. c/d | <u>100,000</u> | 1/1/1993 | Bal. b/d | 100,000, <u>100,000</u> |
| 31/12/1994 Bal. Redemp | <u>100,000</u> | 1/1/1994 | Bal. b/d | 100,000, <u>100,000</u> |

(b) Sinking Fund Account

| | N | | | N |
|-------------------|---------------|----------|----------------------|---------------|
| 31/12/90 Bal. c/d | <u>18,889</u> | 31/12/90 | P & L app. A/c | <u>18,889</u> |
| 31/12/91 Bal. c/d | 40,045 | 1/1/1991 | Bal. b/d | 18,889 |
| | | 31/12/91 | S.F.I (12% x 18,889) | 2,267 |

| | | | |
|------------------------|----------------|--------------------------------|----------------|
| | | 31/12/91 P & L A/c | <u>18,889</u> |
| | <u>40,045</u> | | <u>40,045</u> |
| 31/12/92 Bal. c/d | 63,739 | 1/1/1992 Bal. b/d | 40,045 |
| | | 31/12/92 S.F.I. (12% x 40,045) | 4,805 |
| | <u>63,739</u> | 31/12/92 P & L App. A/c | <u>18,889</u> |
| 31/12/93 Bal. c/d | 90,277 | | <u>63,739</u> |
| | | 1/1/1993 Bal. b/d | 63,739 |
| | <u>90,277</u> | 31/12/93 S.F.I (12% x 63,739) | 7,649 |
| 31/12/94 Redemption | | 31/12/93 P & L App. A/c | <u>18,889</u> |
| (prem. on Redemption | | | <u>90,277</u> |
| (10% x N100,000) | 10,000 | 1/1/1994 Bal. b/d | 90,277 |
| 31/12/94 Redemption | | 31/12/94 S.F.I (12% x 90,277) | 10,834 |
| (accrued Debt. Int.) | | 31/12/94 P & L App. A/c | 18,889 |
| (9% x N100,000 x 3/12) | 2,000 | | |
| 31/12/94 Disposal | | | |
| (Loss on Disposal) | 5,000 | | |
| 31/12/94 Gen. Res. | <u>103,000</u> | | |
| | <u>120,000</u> | | <u>120,000</u> |

| (c) Sinking Fund Investment Account | | | |
|-------------------------------------|---------------|-------------------|---------------|
| N | | N | |
| 31/12/90 Bank | <u>18,889</u> | 31/12/90 Bal. c/d | <u>18,889</u> |
| 1/1/91 Bal. b/d | 18,889 | 31/12/91 Bal. c/d | 40,045 |
| 31/12/91 Sinking Fund | | | |
| (12% x 18,889) | 2,267 | | |
| 31/12/91 Bank | <u>18,889</u> | | |
| | <u>40,045</u> | | <u>40,045</u> |
| 1/1/91 Bal. b/d | <u>40,045</u> | 31/12/92 Bal. c/d | 63,739 |
| 31/12/92 Sinking Fund | | | |
| (12% x 40,045) | 4,805 | | |
| 31/12/92 Bank | <u>18,889</u> | | |
| | <u>63,739</u> | | <u>63,739</u> |
| 1/1/93 Bal. b/d | 63,739 | 31/12/93 Bal. c/d | 90,277 |
| 31/12/1993 Sinking Fund | | | |
| (12% x 63,739) | 7,649 | | |
| 31/12/1993 Bank | <u>18,889</u> | | |
| | <u>90,277</u> | | <u>90,277</u> |

| | | | |
|-------------------------|----------------|---------------------|----------------|
| 1/1/1994 Bal. b/d | 90,277 | 31/12/1994 Disposal | 120,000 |
| 31/12/1994 Sinking Fund | | | |
| (12% x 90,277) | 10,834 | | |
| 31/12/1994 Bank | <u>18,889</u> | | |
| | <u>120,000</u> | | <u>120,000</u> |

(d) Redemption Account

| | | N | | | N |
|------------|------|----------------|------------|-----------------------|----------------|
| 31/12/1994 | Bank | 112,000 | 31/12/1994 | 8% Debentures | 100,000 |
| | | | | Sinking Fund | |
| | | | | [prem. on redemption] | 10,000 |
| | | | 31/12/1994 | Sinking Fund [accrued | |
| | | | | Debtore interest] | <u>2,000</u> |
| | | <u>112,000</u> | | | <u>112,000</u> |

(e) Sinking Fund Investment Disposal Account

| | | N | | | N |
|------------|-------|----------------|------------|--------------------|----------------|
| 31/12/1994 | S.F.I | 120,000 | 31/12/1994 | Bank | 115,000 |
| | | | | Sinking Fund | |
| | | | | (Loss on Disposal) | <u>5,000</u> |
| | | <u>120,000</u> | | | <u>120,000</u> |

5.03 Published Accounts of Quoted Companies

The Trading Account of a Limited Liability Company is the same as that of any other business. However, the profit and loss account of a limited liability company contains items which would not normally be found in the profit and loss account of a Sole Trader or a Partnership.

These items are:

- (b) Directors fees and salaries
- (c) Interest on debentures
- (d) Auditors fees
- (e) Taxation

Public Financial Statements include the following:

- 1) Chairman's Report
- 2) Director's Report
- 3) Auditor's Report
- 4) Audit Committee's Report
- 5) Statement of Accounting Policies.
- 6) Notes to the Accounts
- 7) Income Statements
- 8) Statement of Financial Position
- 9) Cash flow statement
- 10) Value added statement
- 11) Five year financial summary

The Relevance of Chairman's Report

- a) It highlights the financial performance of the Company in the current financial year.
- b) It highlights significant development in the company.
- c) It projects into the future as to how to improve the company's performance.
- d) It reviews the quality of management staff of the company and explains how the company intends to improve their performances for better productivity.
- e) It reviews the economy in which the company operates and highlights strategy to be adopted by the company to improve its performance.

Information Contained in Directors Report

- a) Principal activities and business review.
- b) List of the company directors and their shareholding structures.
- c) Details of the gift and donations to charitable organizations.
- d) Employment of disable persons.
- e) Staff welfare scheme and training.
- f) Names and addresses of the company's distributors and suppliers.
- g) Information relating to changes / movement in fixed assets.
- h) Directors interest in the economy shares.
- i.) Operating result of the company including appropriation from profit.
- j) Research and development activities of the company.
- k) Post balance sheet events.
- l) Acquisition of companies own shares.
- m) Auditor willingness to continue in office.

Auditor's Report vs. Audit Committee Report

| S/N | Auditor's Report | Audit Committee Report |
|-----|--|---|
| 1 | Issued by the company's auditor addressed to members of the company | Issued by the audit committee addressed to members of the company |
| 2 | Auditor expresses opinion as to whether the financial statements show the true and fair view. | Audit committee members confirm that they have performed tasks required of them in accordance with Section 359 (1) of the CAMA 1990 |
| 3 | The contents of the Auditor's report highlight respective responsibilities of Auditor and Directors of the company and also state basis of forming an opinion on company's financial statement | Committee members state specifically whether they have received Auditors finding and they have obtained management response thereon |
| 4 | Qualification may be applicable to auditor's report | Qualification is not applicable |
| 5 | Auditor's report is normally included in the annual report of both Private and Public Limited Liability Companies | Audit committee report is only required for Public Limited Liability Companies |

Illustration

Papawole Ltd. has an authorized, issued and fully paid share capital of N3,600,000,000 consisting of 2,000,000,000 Ordinary shares of N1 each and 1,600,000,000 8% Preference shares of N1 each. The company makes its account to 31st December each year.

Below is the trial balance of the company as at 31st December, 2007.

| | | |
|---------------------------------|--------|-----------|
| | N'000 | N'000 |
| Ordinary shares of N1 each | | 2,000,000 |
| 8% preference shares of N2 each | | 1,600,000 |
| Turnover | | 5,000,000 |
| Returns | 10,000 | 18,000 |

| | | |
|-----------------------------|-------------------|-------------------|
| Carriages Inward | 30,000 | |
| Carriages Outward | 25,000 | |
| Purchases | 1,900,000 | |
| General reserves | | 600,000 |
| Share premium | | 520,000 |
| Profit & loss – 1/1/07 | | 98,000 |
| Stock | 220,000 | |
| Bank | 298,000 | |
| Cash in hand | 155,000 | |
| Debtors | 67,000 | |
| Bills receivable | 92,000 | |
| Bills payable | | 120,000 |
| Land & building | 1,300,000 | |
| Furniture & Fittings | 970,000 | |
| Directors emolument | 72,000 | |
| Provision for depreciation: | | |
| Furniture & fittings | | 100,000 |
| Machinery | 5,432,000 | |
| Auditors remuneration | 82,000 | |
| Rent | 49,000 | |
| Electricity | 51,000 | |
| Salaries | 115,000 | |
| Salesmen commission | | 88,000 |
| 6% Debentures | | <u>900,000</u> |
| | <u>10,956,000</u> | <u>10,956,000</u> |

Additional Information:

1. Stock as at 31/12/07 was N300,000,000.
2. Provide for depreciation on F & F and M at 5% on cost.
3. The directors proposed to transfer N103,000,000 to general reserve.
4. The directors proposed to pay preference share dividend and 2% on ordinary shares as dividend.
5. The company's taxation is at the rate of 30%.
6. Make provision for debenture interest.

Required:

Prepare the final account in a form suitable for publication.

Solution

PAPAWOLE LTD

Trading, Profit or Loss Account for the Year ended 31/12/2007

| Notes | | N'000 |
|---------------------------------|------|--------------------|
| Turnover | (1) | 4,990,000 |
| Cost of sales | (2) | <u>(1,832,000)</u> |
| Gross profit | | 3,158,000 |
| Administrative expenses | (3) | (689,100) |
| Selling & Distribution expenses | (4) | <u>(113,000)</u> |
| Operating profit | | 2,355,900 |
| Less: Fixed interest charges | (5) | <u>54,000</u> |
| Profit before Tax | | 2,301,900 |
| Taxation at 30% | (6) | <u>(690,570)</u> |
| Profit after Tax | | 1,611,330 |
| Appropriation: | | |
| Preference share dividend | (7) | (128,000) |
| Ordinary share dividend | (8) | (40,000) |
| Transfer to general reserves | | <u>(103,000)</u> |
| Retained profit for the year | | 1,340,330 |
| Retained profit b/f | | <u>98,000</u> |
| Retained profit c/f | | <u>1,438,330</u> |
| EPS | (9) | 81k |
| DPS | (10) | 2k |

PAPAWOLE LTD

Statement of Financial Position as at 31st December, 2007

| Notes | | N'000 | N'000 | N'000 |
|-------------------|------|-------|-------|-----------|
| Noncurrent assets | (11) | | | 7,281,900 |

Current assets:

| | |
|------------------|----------------|
| Stock | 300,000 |
| Debtors | 67,000 |
| Bills receivable | 92,000 |
| Bank | 298,000 |
| Cash | <u>155,000</u> |
| | 912,000 |

Current liabilities:

| | | | |
|---------------------|---------------|--------------------|-------------------------|
| Bills payable | 120,000 | | |
| Taxation | 690,570 | | |
| Debenture interest | 54,000 | | |
| Preference dividend | 128,000 | | |
| Ordinary dividend | <u>40,000</u> | <u>(1,032,570)</u> | <u>(120,570)</u> |
| Working Capital: | | | <u>7,161,300</u> |

Financed by:

| | |
|-----------------------------|-----------|
| Ordinary share capital | 2,000,000 |
| 8% Preference share capital | 1,600,000 |
| 6% Debenture | 900,000 |

Reserves

| | |
|------------------|-------------------------|
| Share premium | 520,000 |
| General reserves | 703,000 |
| Retained profit | <u>1,438,330</u> |
| | <u>7,161,330</u> |

Workings **N'000**

| | |
|---------------------|------------------|
| 1. Turnover | 5,000,000 |
| Returns | <u>(10,000)</u> |
| | <u>4,990,000</u> |
| 2. Opening stock | 220,000 |
| Add: purchase | <u>1,900,000</u> |
| | 2,120,000 |
| Add: carriage | <u>30,000</u> |
| | 2,150,000 |
| Less: Returns | 18,000 |
| Less: closing stock | <u>300,000</u> |
| Cost of sales | <u>1,832,000</u> |

| | |
|--|------------------|
| | N'000 |
| 3. Directors emolument | 72,000 |
| Auditors remuneration | 82,000 |
| Rent | 49,000 |
| Salaries | 115,000 |
| Electricity | 51,000 |
| Depreciation: Furniture $5/100 \times 970,000$ | = 48,500 |
| Machinery $5/100 \times 5,432,000$ | = <u>271,600</u> |
| Administrative expenses | <u>689,100</u> |

4. Selling & distribution expenses:

| | |
|---------------------|----------------|
| Carriage outwards | 25,000 |
| Salesmen commission | <u>88,000</u> |
| | <u>113,000</u> |

5. Fixed interest charges $6/100 \times 900,000 = \text{N}54,000$

6. Taxation = $30/100 \times 2,301,900 = 690,570$

7. Preference dividend $8/100 \times 1,600,000 = 128,000$

8. Ordinary dividend $2/100 \times 2,000,000 = 40,000$

9. Earnings per share = $\frac{\text{Profit after Tax}}{\text{No. of Ordinary shares}}$
 $\frac{1,611,330}{2,000,000} = 81\text{k}$

10. Dividend per share = $\frac{\text{Dividend paid/payable}}{\text{No. of Ordinary shares}}$
 $\frac{40,000}{2,000,000} = 2\text{k}$

11. Fixed Assets Schedule:

| | L & B | Furniture | Machinery | Total |
|-----------|-----------|-----------|-----------|-----------|
| Cost: | N'000 | N'000 | N'000 | N'000 |
| Bal. b/d | 1,300,000 | 970,000 | 5,432,000 | 7,702,000 |
| Additions | - | - | - | - |

| | | | | |
|---------------------------|------------------|----------------|------------------|------------------|
| Disposals | - | - | - | - |
| | <u>1,300,000</u> | <u>970,000</u> | <u>5,432,000</u> | <u>7,702,000</u> |
| Accumulated depreciation: | | | | |
| Bal. b/d | - | 100,000 | - | 100,000 |
| Depreciation for the year | - | <u>48,500</u> | <u>271,600</u> | <u>320,100</u> |
| | | <u>148,500</u> | <u>271,600</u> | <u>1,420,100</u> |
| NBV | 1,300,000 | 821,500 | 5,160,400 | <u>7,281,900</u> |

5.04 Companies Liquidation

Liquidation is the process of winding up a company as a result of inability to pay its debts as at when due. Section 409(a) of CAMA 1990, said such debts must be in excess of N2,000 outstanding three weeks after being notified by the creditors.

The Statement of Affairs is prepared by the Directors or Secretary of the company and submitted to the liquidator or the official receiver within 14 days of the winding up order.

The assets are arranged as:

- Assets not specifically pledged (i.e. assets not used as security)
- Assets specifically pledged (assets used as security)

The liabilities are arranged in the following order:

- Secured creditors
- Preferential creditors
- Debenture holders
- Unsecured creditors
- Shareholders

A liquidator is expected to keep the following accounts:

- A statement of receipts and payments (cash book);
- A trading account, where he carries on business of the company;
- A record of the proceedings at the meetings.

Illustration

On 1st July, 1996 a compulsory winding up order was made against Coco Ventures limited. The following were the assets and liabilities on that date.

| | |
|-----|-----|
| Dr. | Cr. |
| N | N |

| | | |
|---|-----------------------|-----------------------|
| Land & Building | 75,000 | |
| Fixtures and fittings | 17,500 | |
| Stock | 51,000 | |
| Debtors | 38,000 | |
| 9% debentures (Secured on Land & Building) | | 50,000 |
| Bank overdraft | | 37,500 |
| Cash at bank | 1,100 | |
| Bills receivable | 5,500 | |
| Creditors-preferential | | 2,500 |
| Unsecured | | 29,600 |
| Share capital ordinary shares of N1 each | | 50,000 |
| Preferential shares of N1 each | | 40,000 |
| Profit & loss Account | <u>21,500</u> | <u> </u> |
| | <u>209,600</u> | <u>209,600</u> |

Additional information:

1. There is an estimated liability for bills discounted of N2,100. The contingent liability of legal cost of N1,100 is estimated to rank at N1,100.00

2. The assets are expected to be realised as shown below:

| | |
|----------------------|--------|
| | N |
| Land & building | 52,500 |
| Fixtures and fitting | 9,200 |
| Stock | 38,000 |
| Debtors | 29,100 |
| Cash in hand | 1,100 |
| Bill receivable | 5,200 |

3. The bank overdraft has a floating charge on all the assets of the company.

4. The company was formed on 1st January, 1995.

5. Under the company's Article of Association, the preference shares have no priority to repayment of capital over the ordinary shares.

6. The debenture interest was last paid on 31st December, 1995 and the half year interest is yet to be accrued.

Required:

Prepare the Statement of Affairs and the Deficiency Account.

Solution

COCO VENTURES LIMITED
STATEMENT OF AFFAIRS AS AT 1ST JULY, 1996.

| Assets not Specifically Pledge: | Estimated Realisable Value | | |
|--|--|----------------|-----------------|
| Cash in hand | | | 1,100 |
| Fixtures & fittings | | | 9,200 |
| Stock | | | 38,000 |
| Debtors | | | 29,100 |
| Bills receivable | | | <u>5,200</u> |
| | | | 82,600 |
| Surplus from assets specifically pledge (Note 1) | | | <u>250</u> |
| Balance carried forward | | | 82,850 |
| Gross | | | |
| Liabilities | | | |
| 52,250 | Secured creditors | | |
| 2,500 | Preferential Creditors | | <u>(2,500)</u> |
| | Estimated balance of Assets available for debenture holders secured by floating charge and unsecured creditors | | 80,350 |
| 37,500 | Bank loan with floating charge | | <u>(37,500)</u> |
| | Estimated surplus as regards Debenture holders | | 42,850 |
| | Unsecured Creditors | | |
| 29,600 | Creditors | 29,600 | |
| <u>Contingent liabilities</u> | | | |
| | Bill discounted | 2,100 | |
| 1,100 | Legal Costs | 1,100 | <u>(32,800)</u> |
| 125,050 | | | 10,050 |
| | Issued and called up capital | 40,000 | |
| | 40,000 preference share of N1 each | <u>50,000</u> | <u>90,000</u> |
| | Estimated deficiency as regards members | | <u>79,950</u> |
| Note 1 | Assets specifically pledged | | |
| | Estimated Realisation | Due to secured | Surplus |

| | Value | creditors | |
|-----------------|--------|-----------|-----|
| | N | N | N |
| Land & Building | 52,500 | 52,250 | 250 |

COCO VENTURES LIMITED

Deficiency Account

| | N | N |
|---|--------------|----------------------|
| Net Trading Losses | | 21,500 |
| <u>Loses: Other than trading losses:</u> | | |
| Land & building | 22,500 | |
| F & F | 8,300 | |
| Stock | 13,000 | |
| Debtors | 8,900 | |
| Bills receivable | <u>300</u> | |
| | 53,000 | |
| <u>Other items contributing to deficiency</u> | | |
| <u>or reducing Surplus:</u> | | |
| Debenture | 2,250 | |
| Contingent liabilities | <u>3,200</u> | <u>58,450</u> |
| Deficiency as shown by statement | | <u>79,950</u> |

5.05 Review Questions

1. EZENWUGO and CHINWE Limited decided to issue 400,000 N1 Ordinary Shares at N1.20 each. The terms of issue are 30k on application, 45k (including the premium) on allotment, 20k to be called one month after allotment, with the final call of 25k being made four months after allotment.

On December 29th applications were received for 60,000 shares. On 1st January, the shares were allotted so that every applicant received two thirds of the number of shares applied for. Excess application monies were held against the amount due on allotment. On January 4th the cash due on allotment was received. February 1st, the first call was made and February 3rd the cash was received.

On May 1, the second call was made and cash was received.

Required: Make the necessary Journal and Ledger entries to record these transactions.

2. JIRE and NISSI Limited advertised an issue of 750,000 12% Preference Shares of N1 each to be issued at N1.50 per share. Application for 1,370,000 shares were received with the correct application money of 30k per share, 70k per share (including premium) was due on allotment while 25k per share was due on each of the remaining two calls. All amounts due were received.

Application money for 120,000 shares was refunded to unsuccessful applicants and the remaining applicants were allotted shares on a pro-rata basis.

You are required to:

- a) Open all necessary ledger accounts and post the above transactions
 - b) Calculate the number of shares issued to Peter, James and John who applied for 275,000, 180,000 and 50,000 shares respectively and were among the successful applicants.
3. Olabode Limited issued N200,000 9% debentures at 110 on January, 2000. The terms under which the debentures were issued provided that a sinking fund be set up for the redemption of the debentures 5 years later. The sum to be set aside every year should be such that when invested annually at a compound interest rate of 15% per annum will amount to N240,000 at the due date of redemption of the debentures. Interest is paid on the debentures on 31st March and 30th September, every year.

The debentures were redeemed on 31st December, 2004 at a premium of 12%. To provide cash for the redemption, the sinking fund investment was sold for N220,000.

You are required to show the following Accounts:

- i. 9% Debentures A/c
- ii. Sinking Fund A/c
- iii. Sinking Fund Investment A/c
- iv. Redemption A/c
- v. Sinking Fund Investment Disposal A/c

4. Labake (Nig.) Ltd. has an authorised, issued and fully paid share capital of N600,000 consisting of 200,000 7% preference shares of N1 each and 400,000 ordinary shares of N1 each. The company makes up its account to 31st December each year and on 31st December 2003; the following trail balance was extracted from the books:

| | N | N |
|---|------------------|------------------|
| Preference share capital | | 200,000 |
| Ordinary share capital | | 400,000 |
| Cash in bank | 2,380 | |
| Creditors and accrued expenses | | 146,700 |
| Debtors | 164,240 | |
| Freehold land and building | 303,200 | |
| General reserve | | 60,000 |
| Goodwill at cost | 300,000 | |
| Income from investment: | | |
| Quoted | | 2,828 |
| Unquoted | | 1,932 |
| Plant & machinery at cost | 163,200 | |
| Preference dividend paid | 14,000 | |
| Stock | 122,560 | |
| Profit & loss balances on 31/12/2002 | | 45,624 |
| Bank overdraft | | 51,264 |
| Provision for doubtful debts | | 6,248 |
| Provisions for depreciation on P & M On 31/12/02 | | 35,000 |
| Quoted investments at cost | 40,000 | |
| Share premium account | | 20,000 |
| Unquoted investments @ Directors current valuation | 60,000 | |
| Trading profit for the year | | 269,984 |
| Work in progress 31/12/03 | <u>70,000</u> | |
| | <u>1,239,580</u> | <u>1,239,580</u> |

You are also given the following information:

- (i) The trading profit for the year ended 31st December, 2003 is arrived at after charging auditors remuneration N2,050 (fixed by the directors) and managing directors salary of N14,000; but before charging Depreciation.
- (ii) Turnover was N600,000.

- (iii) Adjustment are to made for
- A provision for directors fees N6,000
 - Depreciation to be provided for the year on the plant and machinery, at 15% on cost;
 - The provision for doubtful debts are to adjusted for 5% on outstanding debtors;
 - A transfer to general reserve of N20,000;
 - A proposed dividend on the ordinary share capital of 8%
 - Company income tax on the profits of the year ended 31st December 2003 is estimated N45,000. assume that the withholding tax rate is 12.5%
- (iv) The bank overdraft is secured on freehold land and buildings
- (v) The market value of the quoted investment is N24,800, which the cost of the unquoted investment is N40,000.

Required

Prepare in vertical form for publication:

- (a) the company's profit and loss account for the year ended 31st December 2003 and
- (b) Statement of Financial Position as at the date.

5. The Balance Sheet of Rockwell Limited represents its financial position when the company went into voluntary liquidation on 30th September, 2000.

BALANCE SHEET

| | N | | N |
|---|-----------------------|---------------------|-----------------------|
| Share Capital | | | |
| Authorized 100,000 Ordinary Shares of N1 each | <u>100,000</u> | Goodwill | 20,000 |
| | | Plant and Machinery | 21,700 |
| | | Stock | 37,800 |
| <u>Issued</u> | | Sundry Debtors | 25,300 |
| 49,400 Ordinary Shares of N1 each fully paid | 49,400 | P & L Acct. bal. | 51,850 |
| <u>Sundry Creditors</u> | | | |
| Preferential | 5,500 | | |
| Unsecured | 99,800 | | |
| Bank Overdraft (unsecured) | <u>1,950</u> | | |
| | <u>156,650</u> | | <u>156,650</u> |

The liquidator, whose remuneration was agreed at 2.5% on the amount realized and 2% on the amount distributed to the unsecured creditors, realized the assets as follows:

| | N |
|---------------------|--------|
| Plant and Machinery | 22,300 |
| Stock | 31,700 |
| Sundry Debtor | 19,200 |

At first and final dividend was distributed to creditors, after paying expenses of the liquidation which amounted to N570.

Required: Prepare the liquidator's final account; showing how much is the N dividend.

MODULE 6

6.00 GROUP ACCOUNTS AND BUSINESS COMBINATIONS

6.01 Learning Outcomes

On successful completion of this Module, Students should be able to:

- i. Explain key terms associated with group accounts and business combination;
- ii. Determine the key techniques involved in preparing consolidated accounts;
- iii. Determine the key techniques involved in business combination;
- iv. Prepare consolidated statement of financial position;
- v. Prepare consolidated statements of profit or loss and other comprehensive income;
- vi. Prepare financial statements using amalgamation.

6.02 Overview of Group Accounts

A group comprises a parent and its subsidiaries. When an investor company acquires over 50% interest in another company, there exists a holding subsidiary relationship between the investor and investee company. This relationship by law culminates into a group account wherein the financial statements of the holding company are consolidated with that of the subsidiary company as if they are one. On the other hand, where individual persons or companies engaged in similar type of businesses come together to merge their businesses to form one, the existing names and identities are lost and a new organization emerges; this is amalgamation. This module begins with a definition of some terminologies that relate to group accounts and business combinations. The module further explains and illustrates the techniques of acquisition and amalgamation and the preparation of group accounts based on acquisition method, the preparation of various accounts to record takeover of partnership and sole traders and accounts of organizations on amalgamation.

6.03 Consolidated Statements of Financial Position

This Group statement of financial position is the combination of the information in the statement of financial positions of the holding company and that of the subsidiary with such adjustments as the directors of the holding company think necessary.

Terminologies

Before going into details, let us consider some of the terminologies that we will be using in relation to the consolidation schedule under the purchase or acquisition method.

- (i) Cost of Acquisition: - This is the amount paid by the holding company to acquire the shares in the subsidiary and may consist of partly cash, shares, loan stock or debenture.
- (ii) Pre-Acquisition Reserve: - This is the reserve of the subsidiary existing at the date of acquisition of controlling interest by the holding company.

- (iii) Post-Acquisition Reserve: - Is the reserve of the subsidiary generated by it subsequent to the date of acquisition of controlling interest by the holding company.
- (iv) Net Asset: -It is share capital and reserves of the subsidiary at any time. Net assets at the date of acquisition represent the subsidiary's share capital and the pre-acquisition reserves.
- (v) Goodwill on Consolidation: - This is the difference between the cost of acquisition and the acquired net asset of the subsidiary. Acquired net asset of the subsidiary represents the holding company's share of the net asset of the subsidiary existing at the date of acquisition.
- (vi) Capital Reserve on Consolidation or Negative Goodwill: - This is the difference in consolidation arising when the cost of acquisition paid by the holding company for the shares acquired in the subsidiary is less than the acquired net asset of that company.
- (vii) Minority Interest or Non-Controlling Interest (NCI): - This is the net asset of the subsidiary attributable to interest which is not owned directly or indirectly through subsidiaries by the holding company.

FORMAT OF CONSOLIDATED STATEMENT OF FINANCIAL POSITION AT A GLANCE

| | N | N | N |
|--|-----------|---|-------------|
| Goodwill on Consolidation | | | xx |
| Fixed Assets (H Ltd + S Ltd – Unrealised profit) | | | xx |
| Inventory (H Ltd + S Ltd – Unrealised profit \pm goods in transit) | xx | | |
| Payables (H Ltd + S Ltd – Inter-coy Indebtedness) | xx | | |
| Cash and Bank Balance (H Ltd + S Ltd \pm Cash in transit) | xx | | |
| Dividends receivable from Associated Company | <u>xx</u> | | xx |
| Creditors (H Ltd + S Ltd - Inter-coy Indebtedness) | xx | | |
| Taxation (H Ltd + S Ltd) | xx | | |
| Proposed Dividends (H Ltd + NCI portion of S Ltd) | <u>xx</u> | | <u>(xx)</u> |
| Net Current Assets/ (Liabilities) | | | <u>xx</u> |
| | | | XX |
| Debentures/Long term loan (H Ltd + NCI portion of S Ltd) | | | <u>(xx)</u> |
| | | | <u>XXX</u> |
| Financed by: | | | |
| Ordinary Share Capital (H Ltd only) | | | xxx |
| Preference Share Capital | | | xxx |
| P or L A/c | | | xxx |
| Other reserves | | | <u>xxx</u> |
| | | | Xxx |
| Non-Controlling Interest (NCI) | | | <u>xxx</u> |
| | | | <u>Xxx</u> |

Illustration 1

Blue Plc. has two subsidiaries Black Plc. and White Ltd. The Statement of Financial Position of the holding company and its subsidiaries as at 31st March 2002 are set out below

| | Blue Plc. N'000 | Black Plc. N'000 | White Plc. N'000 |
|----------------------------|-----------------------|-----------------------|----------------------|
| Plant & Machinery | 25,000 | 2,000 | 10,000 |
| Other fixed assets | 115,000 | 45,000 | 38,000 |
| Investment in subsidiaries | | | |
| Shares in Black Ltd | 56,500 | - | - |
| Shares in White Ltd | 29,300 | - | - |
| <u>Current assets:</u> | | | |
| Stocks | 45,600 | 30,000 | 15,000 |
| Debtors | 32,400 | 27,600 | 9,000 |
| Bills receivable | - | 12,000 | |
| Dividend receivable | 3,200 | - | - |
| Cash and bank balance | 18,200 | 6,400 | 7,500 |
| Due to Blue Plc. | - | <u>3,000</u> | <u>2,000</u> |
| | <u>325,200</u> | <u>126,000</u> | <u>81,500</u> |
| <u>Financed by:</u> | Blue | Black | White |
| Ordinary shares cap | 100,000 | 40,000 | 40,000 |
| 10% preference | 50,000 | 20,000 | - |
| General reserves | 82,400 | 25,000 | 11,500 |
| Profit or loss | 42,500 | 22,000 | 3,500 |
| 15% debentures | 15,000 | 10,000 | - |
| Creditors | 25,500 | 5,000 | 9,500 |
| Bills payable | - | - | 15,000 |
| Dividend proposed | 5,000 | 4,000 | 2,000 |
| Due from: Black Ltd | 3,000 | - | - |
| White Ltd | <u>1,800</u> | <u>-</u> | <u>-</u> |
| | <u>325,200</u> | <u>126,000</u> | <u>81,500</u> |

Additional Information:

- (i) Blue Plc. Acquired its 80% interest in Black Plc. when the general reserve and profit and loss account were N15,000,000 and N10,000,000 respectively and its 75% interest in White Ltd when the general reserve balance was N5,000,000 and a debit balance of N4,500,000 in the profit and loss account.

- (ii) During the year Blue Plc. transferred a plant costing N2,000,000 to White Ltd at N3,000,000
- (iii) Included in the stock of Black Plc. were goods worth N6,000,000 purchased from Blue Plc. It is the policy of Blue Plc. to invoice goods at cost plus 25%.
- (iv) An amount of N200,000 remitted from White Ltd to Blue plc. is still in transit at year end.
- (v) Part of the bills receivable accepted from White Ltd has been discounted by Black Ltd.
- (vi) Blue Plc. is yet to accrue for its dividend receivable from White Ltd.
- (vii) All the preference shares in Black Ltd are held outside the group.
- (viii) It is group's policy to account for its shares of inters company profits. All shares are denominated in N1 per shares par value.

Required:

Prepare the Consolidated Statement of Financial Position of Blue group as at 31st March 2002 show all relevant workings. Ignore adjustments for excess depreciation arising to transfer of plant.

Solution

Blue Plc. and its Subsidiaries
Consolidated Statement of Financial Position as at 31st March 2002

| | N'000 | N'000 | |
|-------------------------------|----------------|----------------|--|
| Noncurrent Assets: | | | |
| Plant & machinery | 36,000 | | |
| Other noncurrent assets | <u>198,000</u> | 234,000 | |
| Goodwill on consolidation | | <u>3,425</u> | |
| | | 237,425 | |
| Current assets: | | | |
| Stock | 89,400 | | |
| Debtors | 69,000 | | |
| Bills receivable | 12,000 | | |
| Dividend receivable | 4,700 | | |
| Cash and bank balances | <u>32,300</u> | <u>207,400</u> | |
| | | <u>444,825</u> | |
| Financed by: | | | |
| Ordinary share capital | 100,000 | | |
| 10% Preference shares capital | | 50,000 | |
| Reserves | | 95,275 | |
| Profit or Loss | | 57,400 | |
| 15% Debenture | | 25,000 | |
| Creditors | | 40,000 | |
| Bills payable | | 15,000 | |

| | |
|-------------------|----------------|
| Dividend proposed | 11,000 |
| Minority interest | <u>51,150</u> |
| | <u>444,825</u> |

Workings:

- Unrealized profit on Plant: N

| | |
|-------------------------|--------------------|
| Transfer price of plant | 3,000,000 |
| Less: cost of plant | <u>(2,000,000)</u> |
| Unrealized profit | <u>1,000,000</u> |

- Unrealized profit on stock:

| | | | | |
|---------------------------|--------------------|----------------|---|-------------------------|
| <u>Cost</u> | + | <u>25 cost</u> | = | 6,000,000 |
| 1 | | 100 | | |
| <u>100 cost + 25 cost</u> | | | = | 6,000,000 |
| 100 | | | | |
| 125 cost = | | | | 600,000,000 |
| Cost = | <u>600,000,000</u> | | | =N4,800,000 |
| | 125 | | | |
| Unrealized profit | | | = | N6,000,000 – N4,800,000 |
| | | | = | N1,200,000 |

- Items on Transit:

Due to Blue Plc.

| | |
|-----------|-------------------|
| Black Ltd | N3,000,000 |
| White Ltd | <u>N2,000,000</u> |
| | N5,000,000 |

Due from:

| | |
|-----------------|------------------|
| Black Ltd | 3,000,000 |
| White Ltd | <u>1,800,000</u> |
| Cash in transit | <u>N 200,000</u> |

Accounting Entry:

Dr. Consolidated cash and bank

Cr. Due from Black and White Ltd

- Divided Receivable from White Ltd

| | |
|-----------------------|-------------------|
| Dividend of White Ltd | <u>N2,000,000</u> |
| 75% thereof | N1,500,000 |

Accounting Entries:

Dr. Dividend receivable

Cr. Consolidated profit and Loss

Consolidation Schedule

| | | COC | M.I | COC | M.I | Cons.Res. | Cons. P&L |
|-----------------------------|--------------|----------------------|------------|----------------------|------------|------------------|----------------------|
| | N'000 | Blue in Black | | Blue in White | | ₦'000 | ₦'000 |
| Black Ltd | | 80% | 20% | 75% | 25% | | |
| Ordinary shares | 40,000 | 32,000 | 8,000 | | | | |
| General reserve | 25,000 | 12,000 | 5,000 | | | 8,000 | |
| Profit & loss | 22,000 | 8,000 | 4,400 | | | | 9,600 |
| White Ltd | | | | | | | |
| Ordinary Shares | 40,000 | | | 30,000 | 10,000 | | |
| General reserve | 11,500 | | | 3,750 | 2,875 | 4,875 | |
| Profit & Loss | 3,500 | | | <u>(3,375)</u> | 875 | | 6,000 |
| | | 52,000 | | 30,375 | | | |
| Investment at cost | | (56,500) | | <u>(29,300)</u> | | | |
| Goodwill/Capital Res | | (4,500) | | 1,075 | | | |
| Transfer of Cap Res | | <u>1,075</u> | | <u>(1,075)</u> | | | |
| Goodwill | | <u>3,425</u> | | <u>-</u> | | | |
| Unrealized profit on plant | | | | | | | (1,000) |
| Unrealized profit on stock | | | | | | | (1,200) |
| Dividend due from White Ltd | | | | | | | 1,500 |
| Transfer of Blue Plc's | | | | | | | |
| Reserve and P & L account | | | | <u>20,000</u> | | <u>82,400</u> | <u>42,500</u> |
| | | <u>17,400</u> | | <u>33,750</u> | | <u>95,275</u> | <u>57,400</u> |

Illustration 2

The following are the Statements of Financial Position of Umoru Ltd. and subsidiaries, Adura and Usman as at 31st March, 2007.

| | Umoru | Adura | Usman |
|-------------------------------------|----------------|---------------|---------------|
| | N | N | N |
| Ord. Share Cap @ N1 each fully paid | 400,000 | 360,000 | 320,000 |
| General Reserve | 120,000 | - | - |
| Profit and Loss Account | <u>170,000</u> | <u>54,400</u> | <u>40,000</u> |
| | 690,000 | 414,400 | 360,000 |

| | | | |
|---------------------------------|------------------|----------------|----------------|
| Debenture 10% secured | 350,000 | 260,000 | 80,000 |
| Current liabilities | | | |
| Current Account with Umoru Ltd | - | 30,000 | 2,000 |
| Sundry creditors | 300,000 | 120,000 | 80,000 |
| Taxation | 100,000 | 80,000 | 60,000 |
| Bank overdraft | <u>200,000</u> | <u>80,000</u> | <u> </u> |
| | <u>1,640,000</u> | <u>984,400</u> | <u>582,000</u> |
| Fixed Assets: | | | |
| Plant and Machinery | 342,500 | 245,500 | 191,000 |
| Freehold and property | 300,000 | 150,000 | 91,500 |
| Furniture and fittings | <u>51,500</u> | <u>30,500</u> | <u>25,450</u> |
| | 694,000 | 426,000 | 307,950 |
| Investment in Adura Ltd | | | |
| 240,000 ordinary shares at cost | 350,000 | - | - |
| Investment in Usman Ltd | | | |
| 80,000 ordinary shares at cost | 1 48,000 | - | - |
| Investment in Usman Ltd | | | |
| 200,000 shares at cost | - | 340,000 | - |
| Current Asset: | | | |
| Current Account with Umoru | 40,000 | - | - |
| Current Account with Adura | 5,000 | - | - |
| Stocks | 170,500 | 103,800 | 125,010 |
| Sundry Debtors | 232,500 | 114,600 | 146,040 |
| Cash | <u> </u> | <u> </u> | <u>3,000</u> |
| | <u>1,640,000</u> | <u>984,400</u> | <u>582,000</u> |

Additional Information:

- (i) Umoru Ltd. purchased its shares in Adura Ltd. on 31st March 2002 when Adura Ltd. Profit and Loss Account had a credit balance of N42,000.
- (ii) Both Umoru Ltd. and Adura Ltd. purchased their shares in Usman Ltd. on 31st March 2003, when Usman Ltd. Profit and Loss Account had a credit balance of N32,000.
- (iii) Cheques of N10,000 from Adura Ltd. to Umoru Ltd. and of N3,000 from Usman Ltd. to Umoru Ltd. were in transit at 31st March, 2007.
- (iv) Umoru Ltd. sold goods to Adura Ltd. during the year ended 31st March 2007, at cost plus 33¹/₃%. Adura Ltd. had N49,600 in value of these stocks on hand at the year end.

Required:

Prepare the Consolidated Statement of Financial Position as at 31st March, 2007.

Solution

Umoru Ltd and its Subsidiaries Adura and Usman Ltd
Consolidated Statement of Financial Position as at 31st March, 2007

| | N | N |
|--|------------------|---|
| Goodwill | | 220,620 |
| Noncurrent Assets | | |
| Plant and Machinery | 779,000 | |
| Freehold and Property | 541,500 | |
| Furniture and Fittings | <u>107,450</u> | 1,427,950 |
| Current Assets | | |
| Stock | 387,003 | |
| Sundry Debtors | 493,140 | |
| Cash | <u>3,000</u> | |
| | <u>883,143</u> | |
| Current Liabilities | | |
| Sundry Creditors | 500,000 | |
| Taxation | 240,000 | |
| Bank Overdraft | <u>267,000</u> | |
| | <u>1,007,000</u> | |
| Working Capital | | <u>(123,857)</u> |
| | | <u>1,524,713</u> |
| Financed by: | | |
| Ordinary Share Capital | | 400,000 |
| General Reserve | | 120,000 |
| Profit and Loss | | 171,361 |
| Debentures | | 350,000 |
| Minority Interest (143,352 + 260,000 + 80,000) | | <u>483,352</u> |
| | | <u>1,524,713</u> |
| Workings | | |
| 1). Umoru in Adura | = | $\frac{240,000}{360,000} \times 100 = 67\%$ |
| 2). Umoru in Usman (Direct) | = | $\frac{80,000}{320,000} \times 100 = 25\%$ |

Umoru in Usman (Indirect):

$$\text{Acura in Usman} = \frac{200,000}{320,000} \times 100 = 63 \times 67\% = \frac{42\%}{67\%}$$

$$3). \quad \text{Acura in Usman} = \frac{200,000}{320,000} \times 100 = 63\%$$

4). Consolidation Schedule

| | COC Umoru in Acura 67% | COC Umoru in Usman 67% | M.I | CPL |
|---|------------------------------------|------------------------------------|------------------|----------------|
| <u>Acura Ltd.</u> N | N | N | N | N |
| Ordinary shares 360,000 | 241,200 | | 118,800 | |
| Profit and Loss 54,400 | 28,140 | | 17,952 | 8,308 |
| <u>Usman Ltd.</u> N | | | | |
| Ordinary shares 320,000 | | 214,400 | 105,600 | |
| Profit and Loss 40,000 | | <u>21,440</u> | <u>13,200</u> | 5,360 |
| | 269,340 | 235,840 | 255,552 | |
| Cost of Acquisition | <u>(350,000)</u> | <u>(375,800)</u> | <u>(112,200)</u> | |
| Goodwill | (80,660) | (139,960) | | |
| Goodwill Transfer | <u>(139,960)</u> | <u>139,960</u> | | |
| Goodwill on Consolidation | <u>220,620</u> | - | | |
| | | | 143,352 | |
| Unrealized Profit | | | | (12,307) |
| Transfer of Umoru P & L | | | | <u>170,000</u> |
| | | | | <u>171,361</u> |
| 5). Cost of Acquisition (Umoru in Usman) - Direct | | | | 148,000 |
| - Indirect: (0.67x 340,000) | | | | <u>227,800</u> |
| | | | | <u>375,800</u> |
| 6). Item in Transit: | N | | | |
| Acura to Umoru | 10,000 | | | |
| Usman to Umoru | <u>3,000</u> | | | |
| | <u>13,000</u> | | | |

Entry: Dr. Consolidated Bank } by 13,000
 Cr. Current Account with Umoru }

Consolidated Bank A/c

| | | N | N | |
|-----------------------------|------------------------|----------------|---------------|----------------|
| Cheques in Transit: | | | Bal. b/d: | |
| | Aura | 10,000 | Umoru | 200,000 |
| | Umoru | 3,000 | Aura | 80,000 |
| | Bal. c/d | <u>267,000</u> | | <u>280,000</u> |
| | | <u>280,000</u> | Bal. b/d | 267,000 |
| Current Account with Umoru: | | | N | |
| | Aura | | 30,000 | |
| | Usman | | <u>2,000</u> | |
| | | | 32,000 | |
| | Add: Cheque in transit | | <u>13,000</u> | |
| | | | <u>45,000</u> | |

7). $C + 0.33C = N49,600$
 $1.33C = N49,600$
 $\therefore C = \frac{N49,600}{1.33} = N37,293$

Unrealized Profit = $N49,600 - N37,293$
 = $N12,307$

Entry:

Dr Consolidated P & L by N12,307

Cr Consolidated Stock

Consolidated Stock A/c

| | | N | | | N |
|-----------|----------|----------------|-------------------|--|----------------|
| Bal. b/d: | | | Unrealized Profit | | 12,307 |
| | Umoru | 170,500 | Bal. c/d | | 387,003 |
| | Aura | 103,800 | | | |
| | Usman | <u>125,010</u> | | | |
| | | <u>399,310</u> | | | |
| | Bal. b/d | 387,003 | | | |
| | | | | | <u>399,310</u> |

6.04 Consolidated Statement of Profit or Loss/Other Comprehensive Income

Group Profit and Loss Account is to combine the information in the accounts of the holding company and that of the subsidiary with such adjustments as the directors of the holding company think necessary.

FORMAT

| XYZ Group | | | | |
|---|--------------|-------------|------------|--------------|
| Consolidated Profit and Loss Account for the Year Ended 31/12/x4 | | | | |
| | Step | Note | N | N |
| Turnover | (1) | (1) | | xxx |
| Cost of Sales | (2) | | | <u>xxx</u> |
| Gross Profit | | | | xxx |
| Distribution Costs | (3) | | | (xx) |
| Administrative Expenses | (4) | | | (xx) |
| Other Operating Income | (5) | | <u>xx</u> | <u>(xxx)</u> |
| | | | | xxx |
| Operating Profit | | | | |
| Income from shares in related companies | (6) | | xx | |
| Income from other fixed assets investments (7) | | xx | | |
| Interest receivable and similar incomes | (8) | | xx | |
| Interest payable and similar charges | (9) | <u>(xx)</u> | <u>xxx</u> | |
| Profit on Ordinary activities before Tax | (2) | | | xxx |
| Tax on profit on ordinary activities | (10) | | | <u>xxx</u> |
| Profit on ordinary activities after Tax | | | xxx | |
| Less Minority Interest & Pre-acquisition | (11, 12, 13) | | | (xx) |
| Extraordinary item | (14) | | | <u>xxx</u> |
| Profit attributable to the group | (3) | | | xxx |
| Appropriation | | | | |
| Dividend: Interim paid | (16a) | | xx | |
| Final proposed | (16a) | | xx | |
| Transfer to reserves | (16b) | | <u>xx</u> | <u>xxx</u> |
| Retained profit for the year | | | | <u>xxx</u> |
| Statement of Retained Profit | | | | |
| Retained profit for the year | | | | xxx |
| Retained profit at beginning of the Year | (17) | | | <u>xxx</u> |
| Retained profit at end of the year | | | | <u>xxx</u> |

Notes:

- (1) Turnover: -Represents the invoiced value of goods and services to third parties during the year and has been stated net of
- a. Trade discounts
 - b. Value added tax
 - c. Other taxes based on turnover

- (2) Profit on Ordinary Activities before Tax

This is stated after charging

| | N |
|-------------------------|----|
| • Depreciation | xx |
| • Hire plant | xx |
| • Auditors remuneration | xx |
| • Directors emolument | xx |

- (3) Profit Attributable to the Group

Of the profit attributable to the group, Nxxx, has been dealt with in the accounts of H Ltd.

Steps to Consolidated Profit or Loss Account

Let us now consider the steps as highlighted in the format above. Note that while answering examination question you need not indicate the steps as we have done above. In these steps, whenever you see H + S, we mean holding company's figure plus subsidiary's figure. If there is adjustment, a note explaining how to effect this will follow. We, therefore, proceed as follows.

- (1) Turnover: H + S. This should exclude intra-group sales. Where the consolidated schedule is used, this adjustment should be in the column of the company making the sales.
- (2) Cost of Sales: H + S. Intra-group costs of sales should also be eliminated. This cost should be the cost to the buying company and not the cost to the selling company and therefore will be the same as the selling price. You may be surprised at this since the adjustment is to be effected in the column of the selling company but note that we are talking of column not profit. Moreover this is only workings, our final figure being those shown in the group profit and loss column. Adjustment for unrealised profit will also pass through cost of sales and should be effected in holding company's column always irrespective of whatever makes the sales. Our accounting entry will be.

| | |
|----|---------------|
| DR | Cost of Sales |
| CR | Stock |

This is because there is no profit and loss as obtained in group balance sheet adjustment. We are trying to determine the profit and, therefore, any entry that normally affects the profit and loss account will now affect the particular expense heading. You would have observed that a debit to cost of sales will increase it and consequently reduce profit.

- (3) Distribution cost: - H + S
- (4) Admin. Expenses: - H + S

Where there is intra group transfer of assets resulting in

- ❖ Unrealized profit
- ❖ Over depreciation

These adjustments may affect, cost of sales, distribution costs or admin. expenses depending on the asset in question. In this situation accounting entry for unrealized profit will be the asset in question. In this situation accounting entry for unrealized profit will be:-

DR Cost of Sales / Distribution / Admin Expenses
CR Asset

While for the over-depreciation it will be

DR Provision for depreciation
CR Cost of Sales / Distribution costs / Admin Expenses.

- (5) Other Operating Income: H + S. eliminate intra-group.
- (6) Income from Shares in related Company: Take the % of the holding company
- (7) Income from other fixed asset investment: H + S. No Adjustments
- (8) Interest Receivable & similar Income: H + S. Eliminate intra-group
- (9) Interest payable & similar charges: - H + S. Eliminate intra-group
- (10) Tax on profit on ordinary activity: H + S. No Adjustment.
- (11) Preference Dividend of Subsidiary: - This should be shared between holding company and minority interest. The holding company's share should be analysed into pre and post-acquisition. Only the post-acquisition dividend should be consolidated.
- (12) Minority Interest in the Profit for the year: - It is calculated by applying minority interest percentage holding on the subsidiary's profit after tax and preference dividend.
- (13) Pre-acquisition Profit: - This will be applicable for acquisition during the year where the whole year consolidation method is used. It is calculated using the formula.

$$\frac{\text{No. of Months Pre}}{12} \times \text{Balance of Subsidiary's Profit after deducting minority interest}$$

$$\% \text{ Holding} \times \frac{\text{No. of Months Pre}}{12} \times \frac{\text{Balance of Subsidiary's Profit before deducting}}{\text{Minority interest}}$$

This step will not apply where the part year method is adopted to account for purchase of subsidiary during the year.

- (14) Extra-ordinary Item: - Extraordinary item for holding company should be accounted for as given. Where it is a profit, it should be added but if a loss it should be deducted. Extraordinary item for a subsidiary should also be accounted for the same way except that the figure will be the holding company's share of the post extraordinary item in the subsidiary.
- (15) Ordinary Dividend of Subsidiary: - Under this step we determine the holding company's share of the post-acquisition ordinary dividend of the subsidiary. This will be deducted from subsidiary's profit and added to the holding company. The resultant effect in the consolidated profit and loss account column will be nil. The purpose of this step is to determine that portion of the group's profit that has been dealt with in the account of the holding company.
- (16) Appropriation:-
- (a) Dividend: The one to be considered is that of the holding company alone
 - (b) Transfer to reserves: Should comprise holding company and its share of post-acquisition transfer to reserve in the subsidiary.
- (17) Group Retained Profit Brought Forward: - Again, this should be made up of holding company and its share of the post-acquisition profit of the subsidiary at the beginning of the year. Where the shares in the subsidiary are acquired at the beginning or during the year, there will be no retained profit brought forward. This is because everything will be pre-acquisition profit. Note that there are circumstances under which the retained profit of the holding company at the beginning of the year may require adjustment. Example: prior year adjustment. If this is the case you should remember to adjust for it.

Illustration

Abuja Ltd. acquired 80% of the shares in Kwali Ltd on 1st January. 2008. The Profit or Loss Accounts of the two companies for the year ended 31st December 2010 were as follows.

| | Abuja Ltd. | Kwali Ltd. |
|--------------------------------|--------------------|--------------------|
| | N | N |
| Turnover | 10,000,000 | 7,000,000 |
| COGS | <u>(3,000,000)</u> | <u>(2,000,000)</u> |
| Gross Profit | 7,000,000 | 5,000,000 |
| Distribution Costs | (300,000) | (200,000) |
| Administrative Costs | <u>(200,000)</u> | <u>(100,000)</u> |
| Operating profit | 6,500,000 | 4,700,000 |
| Income from Associated Company | 400,000 | - |

| | | |
|---------------------------------|--------------------|------------------|
| Income from Fixed Asset Invest. | 700,000 | 550,000 |
| Interest & Similar Income | 505,000 | 330,000 |
| Interest & Similar Charges | <u>(40,000)</u> | <u>(80,000)</u> |
| Profit before Tax | 8,065,000 | 5,500,000 |
| Tax @ 30% | <u>2,419,000</u> | <u>1,650,000</u> |
| Profit after Tax | 5,645,500 | 3,850,000 |
| Extra Ordinary Income | <u>465,000</u> | <u>-</u> |
| | 6,110,500 | 3,850,000 |
| Appropriation | | |
| Divided Proposed | (2,100,000) | (500,000) |
| Transfer to Gen. Revenue | <u>(1,200,000)</u> | <u>(640,000)</u> |
| Retained Profit for the year | 2,810,500 | 2,710,000 |
| Retained Profit b/f | <u>1,200,000</u> | <u>1,100,000</u> |
| | <u>4,010,500</u> | <u>3,810,000</u> |

Abuja Ltd acquired shares in Kwali Ltd when the P&L account of Kwali Ltd stood at N700,000

Required: Prepare the Consolidated P & L of Abuja Ltd. & its subsidiary Kwali Ltd. for the year ended 31 Dec. 2010. Show all workings.

Solution

Abuja Plc. and its Subsidiary Kwali Ltd
Consolidated Profit and Loss for the year ended 31st December 2008

| | |
|------------------------------------|--------------------|
| | N |
| Turnover | 17,000,000 |
| COGS | <u>(5,000,000)</u> |
| Gross profit | 12,000,000 |
| Distribution Cost | <u>(500,000)</u> |
| Administrative expenses | <u>(300,000)</u> |
| Operating profit | 11,200,000 |
| Income from fixed asset Invest. | 1,250,000 |
| Interest Rec. and similar income | 835,000 |
| Interest payable & similar charges | <u>(120,000)</u> |
| Profit before tax | 13,165,000 |
| Tax | <u>(4,069,500)</u> |
| PAT | 9,095,500 |
| Minority Interest (wk. 1) | <u>(770,000)</u> |
| | 8,325,500 |
| Extra Ordinary income | <u>465,000</u> |

| | |
|----------------------------------|--------------------|
| Profit attributable to the group | 8,990,500 |
| <u>Appropriation</u> | |
| Dividend proposed | (2,100,000) |
| Transfer to reserve (wk. 2) | <u>(1,712,000)</u> |
| Reserved profit for the year | 4,978,500 |
| Reserved profit b/fwd. (wk. 3) | <u>1,520,000</u> |
| Retained profit c/fwd. | <u>6,492,500</u> |

Workings

- Minority Interest $20\% \times N3,850,000 = N770,000$
- Transfer to General Reserve
 $80\% \times 640,000 + 1,200,000 = N1,712,000$
- On retained profit

| | | |
|---------------------------|-----------------------|------------------|
| Abuja | 1,200,000 | |
| Kwali | 1,100,000 | |
| Pre-acquisition reserve | <u>(700,000)</u> | |
| Post-acquisition retained | $400,000 \times 80\%$ | <u>320,000</u> |
| | | <u>1,520,000</u> |

6.05 Consolidated Statement of Cash Flow

Cash Flow Statement is a part of financial statement that explains the difference between profitability and liquidity of an enterprise during a financial period.

It is usually segmented into the following four parts:

- Cash flow from or applied to operating activities
- Cash flow from or applied on investing activities
- Cash flow from or applied on financing activities
- Statement of cash and cash equivalent.

Operating Activities: This refers to the normal or basic business of an enterprise. It may be derived by either the direct method or indirect method.

Investing Activities: Funds included under this subject are those applied on or received from disposal and returns on fixed assets and investments other than short-term investments of a term below 90 days which are regarded as cash equivalent.

Financing Activities: Funds generated from injection of capital and applied on returns to shareholders and capital redemption (including long-term liability) is brought into the cash flow statement under this heading.

Statement of Cash and Cash Equivalent: This statement is sometimes excluded by some who prepare the financial statement. It explains the composition of cash & cash equivalent of the business at the balance sheet date.

Illustration 1

Set out below is the information concerning Deola Group

Consolidated Statement of Comprehensive Income For The Year Ended 31 December 20X6

| | N'm | N'm |
|---------------------------------|------------|-----------------|
| Profit from Operation: | | |
| Group companies | | 23,240 |
| Associated company | | <u>1,372</u> |
| Profit before taxation | | 24,612 |
| Taxation: | | |
| Group companies | 11,060 | |
| Associate | <u>588</u> | <u>(11,648)</u> |
| Profit after tax | | 12,964 |
| Non-controlling interests | | (2,170) |
| Group profit | | 10,794 |
| Proposed dividend | | (2,940) |
| Retained profit | | 7,854 |
| Retained profit brought forward | | 10,080 |
| Retained profit carried forward | | 17,934 |

Consolidated Statement of Financial Position as at the year ended

| | 31/12/x6 | | 31/12/x5 | |
|-----------------------------|---------------|--------------|---------------|--------------|
| | N'000 | N'000 | N'000 | N'000 |
| Tangible non-current assets | | 29,680 | | 23,660 |
| Goodwill | | 616 | | 392 |
| Investment in associate | | <u>8,680</u> | | <u>7,980</u> |
| | | 38,976 | | 32,032 |
| Current assets: | | | | |
| Inventories | 23,240 | | 17,080 | |
| Trade Receivables | 21,000 | | 13,020 | |
| Cash in hand | <u>70</u> | | <u>2,023</u> | |
| (a) | <u>44,310</u> | | <u>32,123</u> | |

| | | | |
|--------------------------|---------------|---------------|---------------|
| Less Current Liabilities | | | |
| Trade Payables | 10,780 | 8,120 | |
| Taxation | 12,740 | 6,860 | |
| Proposed dividend | 2,940 | 1,960 | |
| Bank overdraft | <u>1,792</u> | <u>-</u> | |
| (b) | <u>28,252</u> | <u>16,940</u> | |
| Net current assets (a-b) | | <u>16,058</u> | <u>15,183</u> |
| | | <u>55,034</u> | <u>47,215</u> |

Financed by:

| | | |
|--------------------------|---------------|---------------|
| Ordinary share capital | 19,600 | 18,200 |
| Share premium | 3,703 | 2,303 |
| Consolidated reserves | <u>17,934</u> | <u>10,080</u> |
| | 41,237 | 30,583 |
| Non-controlling interest | <u>11,480</u> | <u>9,240</u> |
| | 52,717 | 39,823 |
| 10% debentures | <u>2,317</u> | <u>7,392</u> |
| | <u>55,034</u> | <u>47,215</u> |

Additional information:

- (i) On July 20x6, Deola group acquired 80% of the issued share capital of Ondo Plc, whose net assets at that date were as follows:

| | |
|---------------------------------|--------------|
| | N'000 |
| Tangible non-controlling assets | 3,640 |
| Inventories | 1,260 |
| Receivables | 1,372 |
| Cash | 280 |
| Payables | (1,932) |
| Taxation | <u>(420)</u> |
| | <u>4,200</u> |

The purchase consideration was N3.9 million in cash

- (ii) Depreciation charged in the year amounted to N3,080,000. There were no disposals of non-current assets during the year.

Required

Prepare a statement of cash flows of Deola Group

Solution

Step 1 Movement on:

| | At 1/120x6 + New acquisition-At 31/12/x = As per statement of cash flows | | | |
|-------------|--|---------|----------|-------|
| | N'000 | N'000 | N'000 | N'000 |
| Inventory | 17,080 + | 1,260 - | 23,240 = | 4,900 |
| Receivables | 13,020 + | 1,372 - | 21,000 = | 6,608 |
| Payables | 8,120 + | 1,932 - | 10,780 = | 728 |

Step 2 Amortization of goodwill/impairment loss written off

| | N'000 |
|---|--------------|
| Opening balance | 392 |
| Increase due to acquisition N3.9m – (80% \times N4.2) | 540 |
| Amortization (balancing Figure) | <u>(316)</u> |
| Closing balance | <u>616</u> |

Step 3 Dividend paid to non-controlling shareholders.

| | N'000 |
|---|---------------|
| Non-controlling interest at 1/1x6 | 9,240 |
| Non-controlling interest in profit for the year | 2,170 |
| Increase in non-controlling interest due to acquisition | 840 |
| Dividend paid to non-controlling shareholders (bal. fig.) | <u>(770)</u> |
| Non-controlling interest at 31 December 20x6 | <u>11,480</u> |
| Increase in non-controlling in interest due to acquisition in the identifiable net assets acquired times 20%: i.e. N4.2m \times 20% = <u>N840,000</u> | |

Step 4 Dividend received from associates:

| | N'000 |
|---|--------------|
| Investment in associates at 1/1x6 | 7,980 |
| Share of associate profit before tax | 1,372 |
| Share of tax charged for the year | (588) |
| Dividend received in the year (bal. Fig.) | <u>(84)</u> |
| | <u>8,680</u> |

Step 5 Tax paid during the year

| | N'000 |
|-------------------------------------|--------|
| Balance at 1/1/x6 | 6,860 |
| Increase due to acquisition in Ondo | 420 |
| Charge for the year | 11,060 |

| | |
|--------------------------------------|----------------|
| Cash paid (bal.fig) | <u>(5,600)</u> |
| Balance at 31/12/x6 | <u>12,740</u> |
| Step 6 Movement in noncurrent assets | |
| | N'000 |
| Balance at 1/1/x6 | 23,660 |
| Additions in the year: | |
| Due to acquisition of Ondo | 3,640 |
| Others (bal. fig.) | 5,460 |
| Depreciation charge for the year | <u>(3,080)</u> |
| Balance at 31/12/x6 | <u>29,680</u> |

Step 7 Ordinary shares:

| | Nominal value N'000 | Premium N'000 |
|----------------------------|---------------------------|------------------|
| Balance b/d | 18,200 | 2,303 |
| Issue of shares (Bal. fig) | <u>1,400</u> | <u>1,400</u> |
| Balance c/d | <u>19,600</u> | <u>3,703</u> |

Step 8 prepare statement of cash flows

DEOLA PLC

Consolidated statement of cash flows for the year ended 31 December 20x6

| | N'000 | N'000 |
|---|----------------|----------------|
| Cash flows from operating activities: | | 24,612 |
| Profit before tax | | |
| Adjustments for: | | |
| Amortization (step 2) | 316 | |
| Depreciation charges | 3,080 | |
| Share of associate's profit | <u>(1,372)</u> | |
| Operating profit before working capital changes | | 26,636 |
| Increase in inventory (step 1) | (4,900) | |
| Increase in receivables (step 1) | (6,608) | |
| Increase in payables | <u>728</u> | |
| Cash generated from operations | | 15,856 |
| Dividend received from associates (step 4) | | 84 |
| Income tax paid (step 5) | | <u>(5,600)</u> |
| Net cash from operating activities | | 10,340 |

| | | |
|---|----------------|----------------|
| Cash flow from investing activities: | | |
| Acquisition of Ondo net of cash acquired (note 1) | (3,620) | |
| Purchases of non-current assets (Step 6) | <u>(5,460)</u> | |
| Net cash used in investing activities | | (9,080) |
| Cash flow from financing activities: | | |
| Issue of ordinary shares (Step 7) | 2,800 | |
| Redemption of debentures | (5,075) | |
| Dividend paid to non-controlling shareholders | (770) | |
| Dividend paid to Deola shareholders | <u>(1,960)</u> | |
| Net cash used in financing activities | | <u>(5,005)</u> |
| Net decrease in cash and cash equivalents | | (3,745) |
| Cash and cash equivalents at the beginning | | <u>2,023</u> |
| Decrease in cash | | <u>1,722</u> |

Notes to the statement of cash flows

(a) Cash and cash equivalents:

| | 20x6 | 20x5 |
|-------------------------------|----------------|--------------|
| | N'000 | N'000 |
| Cash in hand | 70 | 2,023 |
| Bank draft | <u>(1,792)</u> | <u>-</u> |
| Net cash and cash equivalents | <u>(1,792)</u> | <u>2,023</u> |

(b) The cash outflow in respect of the purchases of Ondo in the accounting period is the amount paid (N3.9m) less the cash balance of Ondo at the date of acquisition, obtained as follows:

| | N'000 |
|--------------------------|--------------|
| Cash paid in acquisition | 3,900 |
| Cash balance of Ondo | <u>(280)</u> |
| Cash outflow | <u>3,620</u> |

Illustration 6

The information below relates to the financial statements of Ade Plc group

Consolidated Statement of Comprehensive income for the year ended 31 December 20x7

| | N'000 |
|-------------------|----------------|
| Profit before tax | 11,400 |
| Taxation | <u>(3,800)</u> |
| Profit after tax | 7,600 |

| | |
|-------------------------------|----------------|
| Non-controlling interests | <u>(1,140)</u> |
| Group profit | 6,460 |
| Proposed dividends | <u>(4,560)</u> |
| Retained profit for the year | 1,900 |
| Retained profit b/f | 8,360 |
| Exchange differences (note 1) | <u>950</u> |
| | <u>11,210</u> |

ADE PLC

Consolidated Statement of Financial Position As At 31 December 20x7

| | N'000 | N'000 |
|-----------------------------|---------------|---------------|
| Non-current assets (note 2) | 58,710 | 43,700 |
| Current assets: | | |
| Inventories | 15,200 | 13,300 |
| Receivables | 19,000 | |
| Cash in hand | <u>2,280</u> | <u>1,900</u> |
| | <u>95,190</u> | <u>76,000</u> |

| | | |
|---------------------------|---------------|---------------|
| Ordinary share capital | 15,200 | 15,200 |
| Statement of comp. income | <u>11,210</u> | 8,360 |
| | 26,410 | 23,560 |
| Non-controlling interest | <u>12,540</u> | <u>11,590</u> |
| | 38,950 | 35,150 |
| Debenture loan | <u>22,800</u> | <u>11,400</u> |
| | 61,750 | 46,550 |
| Current liabilities: | | |
| Trade payables | 11,400 | 10,640 |
| Taxation | 3,800 | 3,230 |
| Proposed dividend | 4,560 | 4,180 |
| Bank overdraft | <u>13,680</u> | <u>11,400</u> |
| | <u>95,190</u> | <u>76,000</u> |

Additional information:

- (a) The profit for the year was arrived at after charging
- | | |
|------------------------------------|-------|
| | N'000 |
| Depreciation on non-current assets | 6,080 |
| Interest payable | 3,800 |
- (b) No disposal of non-current assets took place during the year.

(c) The exchange differences on translation of the net assets of the foreign subsidiary were as follows:

| | |
|--------------------|--------------|
| | N'000 |
| Non-current assets | 1,045 |
| Inventories | 285 |
| Receivables | 361 |
| Cash in hand | 38 |
| Trade payables | (247) |
| Tax payable | (76) |
| Bank overdraft | <u>(228)</u> |
| | <u>1,178</u> |

The group share of these differences is included in the consolidated statement of comprehensive income

Required: Prepare the consolidated statement of cash flows for the year ended 31 December 20x7

Solution

ADE PLC

Consolidated Statement of Cash Flows for the Year Ended 31 December 20x7

| | N'000 | N'000 |
|--|-----------------|----------------|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Profit before tax | | 11,400 |
| Adjustments for non-cash items: | | |
| Depreciation | | 6,080 |
| Interest payable | | 3,800 |
| Increase in inventory (1,900-285) | | (1,615) |
| Increase in receivables (1,900-361) | | (1,539) |
| Increase in payables (760-247) | | <u>513</u> |
| Cash generated from operations | | 18,639 |
| Income tax paid (3,230+76) | | <u>(3,306)</u> |
| Net cash flow from operating activities | | <u>15,333</u> |
| CASH FLOW FROM INVESTING ACTIVITIES: | | |
| Purchases of non-current assets | <u>(20,045)</u> | |
| Net cash flow used in investing activities | (20,045) | |
| CASH FLOW FROM INVESTING ACTIVITIES: | | |
| Issue of debenture | 11,400 | |
| Dividend paid to non-controlling interest | (418) | |

| | | |
|---|----------------|---------------|
| Interest paid | (3,800) | |
| Dividend paid to Ade shareholders | <u>(4,180)</u> | |
| NET CASH FLOW FORM FINANCING ACTIVITIES: | <u>3,002</u> | |
| Net decrease in cash and cash equivalents | (1,710) | |
| Cash and cash equivalents b/f (note 1) | <u>(9,500)</u> | |
| Cash and cash equivalents c/f (note 1) | | <u>11,210</u> |

Notes to the cash flow statement

a) Cash and cash equivalents comprise of:

| | 20x7 | 20x6 |
|---|-----------------|----------------|
| | N'000 | N'000 |
| Cash in hand | 2,280 | 1,900 |
| Bank balances | (13,680) | (11,400) |
| Exchange differences on translation of: | | |
| Cash | (38) | |
| Bank balances | 228 | |
| | <u>(11,210)</u> | <u>(9,500)</u> |

b) There was acquisition or disposal of any subsidiary during the year.

Workings

| (a) | Non-controlling Interest | |
|---------------------------|--------------------------|----------------------------------|
| | N'000 | N'000 |
| Dividend paid (bal. fig.) | 418 | Balance b/f 11,590 |
| Bal b/d | 12,540 | Exchange difference 228 |
| | | Profit for the year <u>1,140</u> |
| | <u>12,958</u> | <u>12,958</u> |

Exchange difference on non-controlling interest is $N1,140 \times 20\% = 228$

| (b) | Taxation | |
|-----------------------|----------|--|
| | N'000 | N'000 |
| Cash paid (bal. fig.) | 3,306 | Balance b/f 3,230 |
| Balance c/d | 3,800 | Exchange loss 76 |
| | | Statement of comp. income <u>3,800</u> |

7,106

7,106

| c) | | Non-current Assets | |
|-----------------------|---------------|--------------------|-----------------|
| | N'000 | | N'000 |
| Cash paid (bal. fig.) | 43,700 | Depreciation | 6,080 |
| Exchange gain | 1,045 | Balance c/d | 58,710 |
| Cash paid (bal. fig.) | <u>20,045</u> | | <u> </u> |
| | <u>64,790</u> | | <u>64,790</u> |

Illustration 8

Global Plc manufactures baby wears and toys. The following relates to the financial statements of the company.

(a) Consolidated Statement of Comprehensive Income for the Year Ended 31 December, 2007

| | N'000 |
|------------------------------------|-----------------|
| Operating profit | 144,000 |
| Interest payable | <u>(10,080)</u> |
| Profit after interest | 133,920 |
| Profit from disposal of subsidiary | <u>5,040</u> |
| Profit before taxation | 138,960 |
| Taxation | <u>(46,800)</u> |
| Profit after taxation | 92,160 |
| Non-controlling interest | <u>(7,200)</u> |
| Group profit | 84,960 |
| Proposed dividends | <u>(21,600)</u> |
| Retained profit | 63,360 |
| Retained profit b/f | <u>212,400</u> |
| Retained profit c/f | <u>275,760</u> |

(b) Consolidated Statement of Financial Position As at 31st December 20x7

| | 2007 | | 2006 | |
|--------------------|---------|---------|---------|---------|
| | N'000 | N'000 | N'000 | N'000 |
| Non-current assets | | 369,720 | | 360,000 |
| Current assets: | | | | |
| Inventories | 180,000 | | 165,600 | |

| | | |
|--|----------------|----------------|
| Trade receivables | 151,200 | 136,800 |
| Cash in hand | <u>43,200</u> | <u>14,400</u> |
| | <u>374,400</u> | <u>316,800</u> |
| Less: payables (falling due within 1 year: | | |
| Trade payables | 108,000 | 93,600 |
| Taxation | 43,200 | 36,600 |
| Proposed dividend | 21,600 | 20,160 |
| Other payables | 3,600 | 3,240 |
| Bank overdraft | <u>43,200</u> | <u>36,000</u> |
| | <u>219,600</u> | <u>189,000</u> |
| Net current assets | <u>154,800</u> | <u>127,800</u> |
| | <u>524,520</u> | <u>487,800</u> |
| Financed by: | | |
| Ordinary share capital | 144,000 | 144,000 |
| Statement of comprehensive income | 275,760 | 212,400 |
| Non-controlling interest | 36,360 | 41,400 |
| 10% debentures | <u>68,400</u> | <u>90,000</u> |
| | <u>524,520</u> | <u>487,800</u> |

(c) The following additional pieces of information are relevant:

- (i) Other payables represent dividends payable to Non-controlling shareholders.
- (ii) Depreciation for the year in the consolidated statement of comprehensive income was N72,720,000. Non-current assets were not disposed by the group except those made during disposal of the investment in the shares of Local Limited.
- (iii) Global Plc sold its investment in Local Limited in July 2007. The entire 80% shareholding in the subsidiary was disposed off and it realized N39.6 million. Information about the disposal are:

| | N'000 | N'000 |
|--------------------|----------|----------|
| Inventories | | 14,400 |
| Receivables | | 18,000 |
| Non-current assets | | 28,600 |
| Trade payables | (10,800) | |
| Taxation | (2,160) | |
| Bank overdraft | (1,440) | |
| Debenture stock | (3,600) | (18,000) |
| | | 43,000 |

The investment was acquired many years ago for N13.68 million when the assets of Local Limited were 14.4 million. Goodwill had been written off before now due to impairment. Required: Prepare the Global Plc group consolidated statement of cash flows for the year ending 31st December, 2007.

Solution

| GLOBAL PLC | | |
|---|-----------------|-----------------|
| Group Consolidated Statement of Cash Flows for the Year Ended 31st December, 2007 | | |
| | N'000 | N'000 |
| Profit before taxation | | 138,960 |
| Adjustments for non-cash items: | | |
| Depreciation charges | 72,720 | |
| Profit on disposal of subsidiary (w1) | (5,040) | |
| Interest payable | <u>10,080</u> | |
| Operating profit before working capital changes | 216,720 | |
| CHANGES IN WORKING CAPITAL | | |
| Increase in inventory (w2) | (28,800) | |
| Increase in receivables (w2) | (32,400) | |
| Increase in payables (w2) | <u>25,200</u> | <u>(36,000)</u> |
| Cash generated from operations | | 180,720 |
| Income tax paid (w3) | | <u>(37,440)</u> |
| Net cash flow from operating activities | | 143,280 |
| CASH FLOW FROM INVESTING ACTIVITIES: | | |
| Purchases of non-current assets (w4) | (111,240) | |
| Sale of Local Limited (Sub.) (w5) | <u>41,040</u> | |
| Net cash used in investing activities | | (70,200) |
| CASH FLOW FROM FINANCING ACTIVITIES: | | |
| Redemption of 10% debenture (w6) | (18,000) | |
| Dividend paid to Non-controlling shareholders (w7) | (3,240) | |
| Interest paid | (10,080) | |
| Dividend paid to Global Plc shareholders | <u>(20,160)</u> | |
| Net cash used in financing activities | | (51,480) |
| Net increase in cash and cash equivalents | | 21,600 |
| Cash and cash equivalents b/f | | <u>(21,600)</u> |
| Cash and cash equivalents c/f | | Nil |
| CASH & CASH EQUIVALENT C/F IS REPRESENTED BY: | | |
| Cash in hand | 43,200 | |

| | |
|----------------|-----------------|
| Bank overdraft | <u>(43,200)</u> |
| | <u>Nil</u> |

Working

(w1) Profit on disposal of subsidiary

The entire 80% shareholding were disposed

| | |
|--|---------------|
| | N'000 |
| Net asset of subsidiary sold (shown in the question) | 43,200 |
| Sales proceeds | 39,600 |
| Less net asset sold x 80% = (80% x N43,200) | <u>34,560</u> |
| Profit on disposal of subsidiary | <u>5,040</u> |

(w2) Movement in working capital

| | 31/12/20x7 | Add Disposal | Less Bal. 31/12/x6 | = Cash flow statement |
|----------------|------------|--------------|--------------------|-----------------------|
| | N'000 | N'000 | N'000 | N'000 |
| Inventory | 180,000 | 14,400 | 165,600 | 28,800 |
| Receivables | 151,200 | 18,000 | 136,800 | 32,400 |
| Trade Payables | (108,000) | (10,800) | (93,600) | (25,200) |

Taxation Accounts

| | N'000 | | N'000 |
|-----------------|---------------|-------------------------|---------------|
| Tax on disposal | 2,160 | Balance b/f | 36,000 |
| Cash/Bank | 37,440 | Tax for the year P or L | 46,800 |
| Balance c/f | <u>43,200</u> | | <u>82,800</u> |
| | <u>82,800</u> | | <u>82,800</u> |

Non-current Assets Accounts

| | N,000 | | N,000 |
|-------------|----------------|-----------------------|----------------|
| Balance b/f | 360,000 | Disposal | 28,800 |
| Cash/Bank | 111,240 | Depreciation (P or L) | 72,720 |
| | <u>471,240</u> | Balance c/f | <u>369,720</u> |
| | <u>471,240</u> | | <u>471,240</u> |

(w5) Cash Flow From Sale of Local Limited A Subsidiary

| | |
|---|---------------|
| | N'000 |
| As per question | 39,600 |
| Add bank overdraft of Local Limited on disposal | <u>1,440</u> |
| | <u>41,040</u> |

(w6) Movement on Debenture Accounts:

| | |
|-----------------------------------|-----------------|
| | N'000 |
| Balance b/f at 1/1/07 | 90,000 |
| Disposal of subsidiary | (3,600) |
| Cash paid (bal. fig.) | <u>(18,000)</u> |
| Balance c/f at 31/12/2007 (w7) | <u>68,400</u> |

| Non-controlling Interest Accounts | | | |
|-----------------------------------|---------------|---------|---------------|
| | N'000 | | N'000 |
| Disposal | 8,640 | Bal b/d | 41,400 |
| Cash/Bank | 3,240 | P or L | 7,200 |
| Dividend | 360 | | |
| Balance b/d | <u>36,360</u> | | |
| | <u>48,600</u> | | <u>48,600</u> |

6.06 Takeover of Partnership and Sole Traders

Individual persons engaged in similar type of business may come together to merge their businesses to form one. The process of merging two or more businesses together to form one is amalgamation.

Accounts Required

- Bank account
- Revaluation Account
- Capital account
- Purchase consideration account - New Firm
- Realization Account
- Other relevant ledgers e.g. creditors and debtors ledgers

Illustration

Two Professional men, Gregory and Henry, decided to amalgamate their practices and to form a partnership with effect from 1st May 2017.

Their respective balance sheets on 30th April 2000, disclosed the following figures.

| | Gregory | Henry | | Gregory | Henry |
|--------------------|---------------|----------------------------|---------------------|---------------|---------------|
| | N | N | | N | N |
| Capital | 15,300 | 23,300 | Premises | 7,000 | 12,000 |
| Creditors | 200 | 400 | Office equip. | 2,600 | 10,000 |
| Loan from business | | | Stock of Stationery | 500 | 900 |
| Associates | - | 9,000 | Debtors for fees | 3,200 | 5,700 |
| | | Bank and Cash <u>2,200</u> | | <u>4,100</u> | |
| | <u>15,500</u> | <u>32,700</u> | | <u>15,500</u> | <u>32,700</u> |

For the purpose of the amalgamation:

Gregory's premises were valued at N10,000 and were to be used as a branch office and office equipment, valued at N800, was written off as obsolete; the fee debtors included an amount of N600 which was to be regarded as irrecoverable; the creditors were paid out of the bank balance; otherwise assets were brought in at book value.

Henry had agreed to acquire out of his private resources additional equipment costing N3,000, to pay his creditors from his bank balance, to repay the loan from his private resources, and to bring his other assets in at book value.

Required:

- i. Show the closing entries in the books of Gregory and Henry.
- ii. Prepare the Statement of Financial Position for the partnership of Gregory Henry and Co on 1st May 2017.

Solution:

i.

Books of Gregory

Premises

| N | | N | |
|----------|---------------|----------|---------------|
| Bal. b/d | 7,000 | Bal. c/d | 10,000 |
| Rev. a/c | <u>3,000</u> | | |
| | <u>10,000</u> | | <u>10,000</u> |
| Bal. b/d | 10,000 | | |

Capital A/c

| N | | N | |
|----------|---------------|----------|---------------|
| Bal. c/d | 16,900 | Bal. b/d | 15,300 |
| | Rev. a/c | | <u>1,600</u> |
| | <u>16,900</u> | | <u>16,900</u> |
| | | Bal. b/d | 16,900 |

Revaluation A/c

| N | | N | |
|------------------|--------------|----------|--------------|
| Office Equipment | 800 | Premises | 3,000 |
| Debtors a/c | 600 | | |
| Capital a/c | <u>1,600</u> | | |
| | <u>3,000</u> | | <u>3,000</u> |

Equipment A/c

| N | | N | |
|----------|-------|-------------|--------------|
| Bal. b/d | 2,600 | Revaluation | 800 |
| | _____ | Bal. c/d | <u>1,800</u> |

| | | | |
|-------------------|--------------|-----------|--------------|
| | <u>2,600</u> | | <u>2,600</u> |
| Bal. b/d | 1,800 | | |
| Debtors A/c | | | |
| | N | | N |
| Bal. b/d | 3,200 | Rev a/c | 600 |
| | <u>3,200</u> | Bal. c/d | <u>2,600</u> |
| Bal. b/d | 2,600 | | <u>3,200</u> |
| Creditors A/c | | | |
| | N | | N |
| Bank | <u>200</u> | Bal. b/d | <u>200</u> |
| Bank and Cash A/c | | | |
| | N | | N |
| Bal. b/d | 2,200 | Creditors | 200 |
| | <u>2,200</u> | Bal. c/d | <u>2,000</u> |
| Bal. b/d | 2,000 | | <u>2,200</u> |

Books of Henry

| | | | |
|-------------------|---------------|-----------|---------------|
| Bank and Cash A/c | | | |
| | N | | N |
| Bal. b/d | 4,100 | Creditors | 400 |
| | <u>4,100</u> | Bal. c/d | <u>3,700</u> |
| Bal. b/d | 3,700 | | <u>4,100</u> |
| Equipment A/c | | | |
| | N | | N |
| Bal. b/d | 10,000 | Bal. c/d | 13,000 |
| Capital a/c | <u>3,000</u> | | <u>13,000</u> |
| Bal. b/d | 13,000 | | |
| Capital A/c | | | |
| | N | | N |
| Bal. c/d | 35,300 | Bal. b/d | 23,300 |
| | <u>35,300</u> | Equipment | 3,000 |
| | | Loan a/c | <u>9,000</u> |
| | | Bal. b/d | <u>35,300</u> |
| | | | 35,300 |

| Loan A/c | | | |
|----------|--------------|----------|--------------|
| | N | | N |
| Capital | <u>9,000</u> | Bal. b/d | <u>9,000</u> |

| Creditors A/c | | | |
|---------------|------------|----------|------------|
| | N | | N |
| Bank | <u>400</u> | Bal. b/d | <u>400</u> |

| Business Acquisition A/c | | | |
|--------------------------|---------------|-----------------------|---------------|
| | N | | N |
| Capital: | | Premises | 22,000 |
| Gregory | 16,900 | Office Equipment | 14,800 |
| Henry | 35,300 | Stock of Stationeries | 1,400 |
| | | Debtors for Fess | 8,300 |
| | | Bank and Cash | <u>5,700</u> |
| | <u>52,200</u> | | <u>52,200</u> |

ii.

Gregory Henry and Co
Statement of Financial Position as at 1st May, 2017

| | N | N |
|----------------------------|---------------|---------------|
| Non-current Assets | | |
| Premises | 22,000 | |
| Office Equipment | <u>14,800</u> | 36,800 |
| Current Assets | | |
| Stock of Stationery | 1,400 | |
| Debtors for fees | 8,300 | |
| Bank and Cash | <u>5,700</u> | 15,400 |
| Current Liabilities | | |
| Creditors | | <u>-</u> |
| | | <u>52,200</u> |
| Capital – Gregory | | 16,900 |
| Henry | | <u>35,300</u> |
| | | <u>52,200</u> |

The capitals of Gregory and Henry as partners are different from what they were as sole proprietors, thus reflecting the effects of the new arrangements.

6.07 Business Combination

The external means of reorganizing the affairs of a company is through amalgamation. Amalgamation is a business combination where two or more companies come together to form one.

This involves the formation of a new company with a different capital structure to salvage the assets of the existing company, which is then wound up.

Illustration

Below are the Statement of Financial Positions of Wazo Ltd. and Bia Ltd as at 31st December, 2017.

| | Wazo Ltd. | Bia Ltd. |
|---------------------------------|------------------|------------------|
| Noncurrent assets: | N | N |
| Land & Building | 3,000,000 | 2,000,000 |
| M/ vehicle | 2,500,000 | 1,800,000 |
| Furniture | 1,500,000 | 1,200,000 |
| Current assets: | | |
| Stock | 900,000 | 800,000 |
| Debtor | 100,000 | 80,000 |
| Bank | <u>1,400,000</u> | <u>1,020,000</u> |
| | <u>9,400,000</u> | <u>6,900,000</u> |
| <u>Financed by:</u> | | |
| Ordinary share of N2 each | 6,000,000 | 3,000,000 |
| 6% preference shares of N1 each | 1,200,000 | 1,000,000 |
| 7% debentures | 800,000 | 500,000 |
| Share premium | 400,000 | 200,000 |
| General reserves | 300,000 | 1,300,000 |
| Liabilities | <u>700,000</u> | <u>900,000</u> |
| | <u>9,400,000</u> | <u>6,900,000</u> |

On the 1st January 2018, in order to take advantage of the synergy effects of merger, Wazo Ltd and Bia Ltd agreed to merge and form a new company to be known as Wazobia International on the following terms:-

1. The Ordinary shareholders in Wazo Ltd are to receive 8,000,000 ordinary shares of N2 each at N3 in Wazobia International, while the ordinary shareholders of Bia Ltd are to receive 2,000,000 ordinary shares of N2 each in Wazobia International.
2. Liquidation expenses is as follows:
 - Wazo Ltd N80,000

- Bia Ltd N70,000

3. The assets of Wazo Ltd. & Bia Ltd are to be taken over by the new company at their book value in addition to any balance in their bank account.
4. The preference shareholders of Wazo Ltd are to receive 900,000 8% preference shares in Wazobia International at the existing book value per shares. The preference shareholders of Bia Ltd are to be given 9% preference shares equal to 110% of their total preference shares in Bia Ltd.
5. The debenture holders in Wazo Ltd & Bia Ltd. are to receive 9,000units and 4,000units of debentures in Wazobia Ltd at par, de-nominated at 8% respectively.
6. The liabilities of the two companies are to be settled in full after deducting 5% discount.

Required:

- a. Open relevant ledgers to close the book of Wazo Ltd and Bia Ltd.
- b. Show the books in the new company i.e. Wazobia International.

Solution

The Book of Wazo Ltd

Realization Account

| | N | | N |
|-------------------------|-------------------|-------------------------|-------------------|
| Land & building | 3,000,000 | Purchase consideration: | |
| Motor Vehicle | 2,500,000 | Ordinary shares | 24,000,000 |
| Furniture | 1,500,000 | 8% Preference | 900,000 |
| Stock | 900,000 | 8% Debentures | <u>900,000</u> |
| Debtor | 100,000 | | 25,800,000 |
| Dissolution Exp. (Bank) | 80,000 | Discount received | 35,000 |
| Bank account | 655,000 | 6% Preference share | 300,000 |
| 7% Debenture | 100,000 | | |
| Sundry shareholders | <u>17,300,000</u> | | |
| | <u>26,135,000</u> | | <u>26,135,000</u> |

Bank Account

| | N | | N |
|----------|------------------|--------------------------------|------------------|
| Bal. b/f | 1,400,000 | Dissolution exp. (realization) | 80,000 |
| | | Liabilities | 665,000 |
| | | Realization account | <u>655,000</u> |
| | <u>1,400,000</u> | | <u>1,400,000</u> |

Sundry Shareholders a/c

| | N | | N |
|---------------------|------------|----------------|-----------|
| Realisation Account | 24,000,000 | Ordinary share | 6,000,000 |

| | |
|------------------|-------------------|
| Share Premium | 400,000 |
| General reserves | 300,000 |
| Realisation | <u>17,300,000</u> |
| | <u>24,000,000</u> |

24,000,000

24,000,000

6 % Preference share A/c

| | | | |
|------------------|------------------|----------|------------------|
| | N | | N |
| Realisation (8%) | 900,000 | Bal. b/d | 1,200,000 |
| Realisation | <u>300,000</u> | | |
| | <u>1,200,000</u> | | <u>1,200,000</u> |

7% Debenture A/c

| | | | |
|------------------------|----------------|-------------|----------------|
| | N | | N |
| Realisation (purchase) | 900,000 | Bal. b/d | 800,000 |
| | <u>900,000</u> | Realisation | <u>100,000</u> |
| | | | <u>900,000</u> |

Liabilities A/c

| | | | |
|------------------------|----------------|----------|----------------|
| | N | | N |
| Realisation (discount) | 35,000 | Bal. b/d | 700,000 |
| Bank | <u>665,000</u> | | |
| | <u>700,000</u> | | <u>700,000</u> |

The Book of Bia Nig Ltd

Realisation Account

| | | | | |
|------------------------|------------------|-------------------------|----------------|------------------|
| | N | | N | N |
| Land & building | 2,000,000 | Purchase consideration | | |
| M/V | 1,800,000 | Ordinary shares | 4,000,000 | |
| Furniture | 1,200,000 | 9% Preference shares | 1,100,000 | |
| Stock | 800,000 | 8% Debenture | <u>400,000</u> | 5,500,000 |
| Debtors | 80,000 | Discount received | | 45,000 |
| Dissolution exp (bank) | 70,000 | sundry shareholders A/c | | 500,000 |
| Bank | 95,000 | 7% debenture A/c | | 100,000 |
| 6% Preference share | <u>100,000</u> | | | |
| | <u>6,145,000</u> | | | <u>6,145,000</u> |

Bank A/c

| | | | |
|---------|-----------|---------------------------|---------|
| | N | | N |
| Bal b/d | 1,020,000 | Dissolution (realisation) | 70,000 |
| | | Liabilities | 855,000 |

| | | |
|------------------|-------------|-----------------------------------|
| <u>1,020,000</u> | Realisation | <u>95,000</u> <u>1,020,000</u> |
|------------------|-------------|-----------------------------------|

6% Preference Shares A/c

| | | | |
|---------------------------|------------------|-------------|------------------|
| | N | | N |
| 9% Realisation (purchase) | 1,100,000 | Bal. b/d | 1,000,000 |
| | <u>1,100,000</u> | Realisation | <u>100,000</u> |
| | | | <u>1,100,000</u> |

Sundry Shareholders A/c

| | | | |
|------------------------|------------------|-----------------|------------------|
| | N | | N |
| Purchase consideration | 4,000,000 | Bal. b/d | 3,000,000 |
| Realisation a/c | 500,000 | Share premium | 200,000 |
| | <u>4,500,000</u> | General reserve | <u>1,300,000</u> |
| | | | <u>4,500,000</u> |

Liabilities A/c

| | | | |
|------------------------|----------------|----------|----------------|
| | N | | N |
| Realisation (discount) | 45,000 | Bal. b/d | 900,000 |
| Bank | <u>855,000</u> | | |
| | <u>900,000</u> | | <u>900,000</u> |

7% Debenture A/c

| | | | |
|------------------------|----------------|----------|----------------|
| | N | | N |
| Realisation (purchase) | 400,000 | Bal. b/d | 500,000 |
| Realisation | <u>100,000</u> | | |
| | <u>500,000</u> | | <u>500,000</u> |

BOOKS OF WAZOBIA INTERNATIONAL LTD

Purchase Consideration A/c

| | | | |
|------------|-------------------|-----------------|-------------------|
| | N | | N |
| Securities | 31,300,000 | Land & building | 5,000,000 |
| | | M/V | 4,300,000 |
| | | Furniture | 2,700,000 |
| | | Stock | 1,700,000 |
| | | Bank | 750,000 |
| | | Debtors | 180,000 |
| | | Goodwill | <u>16,670,000</u> |
| | <u>31,300,000</u> | | <u>31,300,000</u> |

Statement of Financial Position as at 31st December 2008

| | N | N |
|-----------------------------|------------------|--------------------------|
| <u>Deferred charges:</u> | | |
| Goodwill | | 16,670,000 |
| <u>Noncurrent assets:</u> | | |
| Land and building | 5,000,000 | |
| Motor vehicle | 4,300,000 | |
| Furniture | <u>2,700,000</u> | 12,000,000 |
| <u>Current assets:</u> | | |
| Stock | 1,700,000 | |
| Debtors | 180,000 | |
| Bank | <u>750,000</u> | <u>2,630,000</u> |
| | | <u>31,300,000</u> |
| <u>Financed by:</u> | | |
| Ordinary share of N 2 each; | | 20,000,000 |
| 8% preference share | | 900,000 |
| 9% preference share | | 1,100,000 |
| 8% debentures | | 1,300,000 |
| Share premium | | <u>8,000,000</u> |
| | | <u>31,300,000</u> |

6.08 Review Questions

- Ruth and Naomi were in Partnership as Obed & Co. sharing profits in the ratio 3:2 respectively. Orpah was a sole trader in the same line of business. On January 2006 the two firms were to be merged, to form OBED & Co., the partners sharing profits in the ratio Orpah 3, Ruth 2, Naomi . The summarized balance sheets of the two firms on 31st December 2005 were:

BALANCE SHEET AS AT 31ST DECEMBER 2005.

| | OBED & Co. | Orpah |
|---------------------|---------------|--------|
| Assets | N | N |
| Freehold Property | | 40,000 |
| Plant and Machinery | 25,000 | |
| Debtors | 24,000 | |
| Cash | <u>16,000</u> | 4,000 |
| | 65,000 | |

| | | |
|-------------|-----------------|-----------------|
| Liabilities | | |
| Creditors | <u>(5,000)</u> | <u> </u> |
| | <u>60,000</u> | <u>44,000</u> |
| Capital | | |
| Ruth | 24,000 | |
| Naomi | 36,000 | |
| Orpah | <u> </u> | <u>44,000</u> |
| | <u>60,000</u> | <u>44,000</u> |

The Freehold property is to be valued at N48,000 and the Plant and Machinery at N22,000. Goodwill is agreed at N10,000 for Ruth and Naomi and N5,000 for Orpah but is not to appear in the books. All assets and liabilities were taken over by the new firm.

Required: Show the Partners' Capital Accounts in the Old and New firms, and the opening Balance Sheet (in draft form) of OBED & Co.

2. Abib Bank Ltd. establishes and administers a special purpose vehicle that enables two corporate clients – Companies A and B – to sell trade receivables in exchange for cash and rights to deferred consideration. The vehicle issues loan notes to outside investors to fund the purchases. Each company remains responsible for managing collection of its own transferred receivables. Abib Bank Ltd provides credit enhancements in exchange for a fee. The terms of the loan notes and contractual document establish how cash collected from each pool of receivables is allocated to meet payments of the loan notes. Cash collected in excess of the specified allocation is paid to the originators.

Required: What conditions must be met for a portion of an entity to be treated as a silo?

3. INTERFIN PLC an Abuja based conglomerate, has two subsidiaries within the country: MONUMENT Plc. and YATI Limited. The two subsidiaries operate from the South West and North East of Nigeria, respectively. The Statement of Financial Positions of the company along with its subsidiaries as at 31st December 2011 is below:

| | INTERFIN PLC | MONUMENT PLC | YATI LTD |
|-----------------------------|---------------------|---------------------|-----------------|
| | N' 000 | N' 000 | N' 000 |
| Plant and Machinery | 25, 000 | 2, 000 | 10, 000 |
| Other fixed Assets | 115, 000 | 45, 000 | 38, 000 |
| Investment in subsidiaries: | | | |
| Shares in Monument Plc | 56, 500 | | |
| Shares in Yati Limited | 29, 300 | | |
| | | | |
| CURRENT ASSETS: | | | |
| Stock | 45, 600 | 30, 000 | 15, 000 |
| Debtors | 32, 400 | 27, 600 | 9, 000 |

| | | | |
|--------------------------|-----------------|-----------------|----------------|
| Receivables | | 12, 000 | |
| Dividend from Investment | 3, 200 | | |
| Cash and Bank Balance | 18, 200 | 6, 400 | 7, 500 |
| Due to INTERFIN PLC | | <u>3, 000</u> | <u>2, 000</u> |
| | <u>325, 200</u> | <u>126, 000</u> | <u>81, 500</u> |
| Financing | | | |
| Ordinary Share Capital | 100, 000 | 40, 000 | 40, 000 |
| 10% preference shares | 50, 000 | 20, 000 | |
| General Reserves | 82, 400 | 25, 000 | 11, 500 |
| Profit and loss account | 42, 500 | 22, 000 | 3, 500 |
| 15% Debentures | 15, 000 | | |
| Creditors | 25, 500 | 5, 000 | 9, 500 |
| Bills payable | | | |
| Dividend (Proposed) | 5, 000 | 4, 000 | 2, 000 |
| Due: | | | |
| Monument Plc | 3, 000 | | |
| Yati Ltd | <u>1, 800</u> | | |
| | <u>325,200</u> | <u>126,000</u> | <u>81,500</u> |

Supplementary Information:

- i. INTERFIN Plc acquired 80% interest in Monument Plc when the general reserve and profit and loss account were N15,000,000.00 and N10,000,000.00 respectively and its 75% interest in Yati limited when the general reserve balance was N5,000,000.00 and negative balance of N4,500, 000 in the Profit and Loss Account.
- ii. The inventory of Monument Plc contains goods worth N6 million purchased from Interfin Plc. As a trade policy InterfinPlc invoices goods at cost plus 25%.
- iii. During the year Interfin Plc transferred a plant costing N2, 000, 000.00 to Yati limited at a cost of N3 million.
- iv. An amount of N2 million remitted from Yati limited to Interfin Plc was still being expected at as at the date of the balance sheet.
- v. A portion of the bill receivable accepted from Yati limited has been discounted by Monument limited.
- vi. Interfin Plc is yet to accrue its dividends receivable from Yati limited.
- vii. Preference shares of Monument Plc are held outside the group.
- viii. The group accounts for its shares of intercompany profits.
- ix. Interfin Plc transferred its head of operation to oversee record preparation of Monument Plc for period under review.

Required:

Prepare the consolidated Statement of Financial Position of INTERFIN Group as at 31st December,

2011. Show the Consolidation schedule.

MODULE 7

7.00 ANALYSIS OF FINANCIAL STATEMENTS

7.01 Learning Outcomes

On successful completion of this Module, Students should be able to:

- i. Enumerate the methods of interpreting financial statements;
- ii. Apply the relevant ratio formulas in assessing profitability, liquidity, solvency, activities and market performance of a firm;
- iii. Compute ratios and interpret results;
- iv. Determine the limitations of financial statements;
- v. Determine the limitations of accounting ratio analysis.

7.02 Ratio Analysis

Methods of Interpreting Financial Statements

1. Item by item analysis of the contents of financial statements.
2. Ratio analysis (Computed via items in the financial statements).

Formula of Ratios

1. Profitability Ratios: These ratios assess or indicate the profitability of a company and some of them include:

- a. Return on Capital Employed (ROCE)

$$\frac{\text{Operating Profit}}{\text{Capital Employed}} \times 100$$

- b. Return on Equity (ROE)

$$\frac{\text{Profit after Tax}}{\text{Equity/ Shareholders funds}} \times 100$$

- b. Operating Profit margin

$$\frac{\text{Operating Profit}}{\text{Sales}} \times 100$$

- d. Gross Profit Margin

$$\frac{\text{Gross Profit} \times 100}{\text{Sales}}$$

2. Liquidity Ratios: These ratios try to assess the liquidity position of a company. Some of them include:

a. Current Ratio:

$$\frac{\text{Current Assets}}{\text{Current Liabilities}}$$

b. Quick ratio /Acid-test:

$$\frac{\text{Current Assets} - \text{Stock}}{\text{Current Liabilities}}$$

c. Debtors Collection period:

$$\frac{\text{Average debtors} \times 365\text{days}/52\text{wks}/12\text{months}}{\text{Credit sales}}$$

d. Creditors payment period:

$$\frac{\text{Average creditors} \times 365\text{days}/52\text{wks}/12\text{months}}{\text{Credit purchases}}$$

e. Debtors Turnover:

$$\frac{\text{Credit Sales}}{\text{Trade Debtors}}$$

3. Stability/Gearing/Debt Ratios: These ratios assess what percentage of total funds used to finance operations is generated from outside sources i.e. it assesses the stability of a company. It is also expressed as a relationship between debt and internal sources of finance.

a. Debt ratio/ Gearing ratio/ Leverage ratio:

$$\frac{\text{Debt Capital} \times 100}{\text{Capital Employed}}$$

b. Debt/ Equity ratio

$$\frac{\text{Debt Capital}}{\text{Equity}}$$

c. Interest Cover:

$$\frac{\text{Operating Profit}}{\text{Interest Expense}}$$

Interest Expense

d. Proprietary ratio:

Shareholders' Fund

Total Assets

4. Investors/Shareholders/Stock Ratios: These ratios assess the return attributable to each share. They include:

a. Earnings per Share:

$$\frac{\text{Profit after tax}}{\text{No. of Ordinary shares in issue}}$$

b. Dividend per Share:

$$\frac{\text{Total Dividend}}{\text{No. of Ordinary shares in issue}}$$

c. Price Earnings ratio:

$$\frac{\text{Market price per share}}{\text{Earnings per share}}$$

d. Earnings Yield:

$$\frac{\text{Earnings per share}}{\text{Market price per share}} \times 100$$

e. Dividend Yield:

$$\frac{\text{Dividend per share}}{\text{Market price per share}}$$

f. Dividend Cover:

$$\frac{\text{Earnings per share}}{\text{Dividend per share}}$$

5. Activities Ratios: These ratios assess the efficient utilization of the company's resources by its management. Some of them include:

a. Stock Turnover:

$$\frac{\text{Cost of Sales}}{\text{Average Inventory}} \times 365 \text{ days} \quad \text{OR} \quad \frac{\text{Sales}}{\text{Average Inventory}} \times 365 \text{ days}$$

Average Stock

Closing stock

b. Assets Turnover:

$$\frac{\text{Sales}}{\text{Total assets/ fixed assets/ Net assets}}$$

c. Debtors collection period:

$$\frac{\text{Average Debtors} \times 365\text{days/ 52wks/ 12Months}}{\text{Credit Sales}}$$

d. Creditors Payment period:

$$\frac{\text{Average Creditors} \times 365\text{days/ 52wks/ 12Months}}{\text{Credit Purchases}}$$

e. Debtors Turnover

$$\frac{\text{Credit Sales}}{\text{Trade Debtors}}$$

Ratios of Banks

1. CAPITAL ADEQUACY: The standard set by BOFIA is 15% while the International Standard is 8% - BASEL.

a. Equity/ Total Assets:

$$\frac{\text{Equity}}{\text{Total Assets}} \times 100$$

b. Equity/ Loans and Advances:

$$\frac{\text{Equity}}{\text{Loans and advances}} \times 100$$

c. Permanent assets/ Equity:

$$\frac{\text{Fixed Assets}}{\text{Equity}} \times 100$$

2. ASSET QUALITY: These should not be less than 20%.

a. Classified loans/ Gross loans and advances:

$$\frac{\text{Classified loans}}{\text{Gross loans and advances}} \times 100$$

Gross loans and advances

b. Classified loans/ Equity:

$$\frac{\text{Classified loans}}{\text{Equity}} \times 100$$

c. Loan loss reserve/ classified loans

$$\frac{\text{Loan loss reserve}}{\text{Classified loans}} \times 100$$

3. PROFITABILITY: The higher the better for the bank.

a. Pre-tax profit margin:

$$\frac{\text{Profit before tax}}{\text{Gross Earnings}} \times 100$$

b. Return on total asset:

$$\frac{\text{Profit before tax}}{\text{Total Assets}} \times 100$$

c. Net Interest Margin:

$$\frac{\text{Net interest}}{\text{Gross Earnings}} \times 100$$

d. Return on Equity:

$$\frac{\text{Profit after tax}}{\text{Equity}} \times 100$$

e. Interest income/ Loans and advances:

$$\frac{\text{Interest income}}{\text{Loans and Advances}} \times 100$$

f. Interest Paid/ Total deposit:

$$\frac{\text{Interest paid}}{\text{Total deposit}} \times 100$$

g. Operating expenses/ Total revenue

$$\frac{\text{Operating expenses}}{\text{Gross Earnings}} \times 100$$

h. Non-interest income/ Total revenue

$$\frac{\text{Non-interest income}}{\text{Total Revenue}} \times 100$$

4. LIQUIDITY: 40% is the standard while 20% is problematic.

a. Loans and advances/ Total assets

$$\frac{\text{Loans and Advances}}{\text{Total Assets}} \times 100$$

b. Cash and Bank advances/ Total liabilities

$$\frac{\text{Cash and bank balances}}{\text{Total Liabilities}} \times 100$$

c. Loans and advances/ Total deposits

$$\frac{\text{Loans and advances}}{\text{Total deposits}} \times 100$$

7.2.1 Limitations of Financial Statements

- i. Financial Statements are prepared on going concern basis while company may fold up few months after the financial statement date.
- ii. Application of accounting concepts and conventions may not be the same from organization to organization.
- iii. Financial statements are prepared to show true and fair view hence the actual figures may not be shown in financial statements.
- iv. Financial statements only disclose monetary facts. Non-monetary facts can only be disclosed in the notes to the financial statements.
- v. Financial statements of two or more companies may be difficult to compare unless the statement of accounting policies used for the preparation of the statement is known.

7.2.2 Limitations of Accounting Ratio Analysis

- i. The difference in the methods adopted by two enterprises may distort the result of analysis and, therefore, misinform judgement. Examples of such difference being occasions "X" company adopting first in first out stock valuation whereas "Y" company used weighted average. The profit figures declared by the two companies may diverge, not as a result of varying levels of efficiency and effectiveness.
- ii. There is inherent assumption that the historical data used for ratio analysis are inviolate, fixed and applicable under all situations. However, the dynamics of political and economic factors may prove such data as "out of date".

- iii. Just as mathematics, which engages in “arm chair reasoning” and does not concerns itself with what goes on in the empirical world, ratio analysis are not supposed to be ends in themselves. Useful as they are, ratio analysis should be considered along with other quantitative and, indeed, qualitative factors.
- iv. The issues, which crop up are:
 - a. What is the suitable standard for comparison?
 - b. What is the suitable industry standard?
- v. Accounting ratios only trigger off points for further investigation.
 - a. No fixed standard can be laid for ideal ratio.

Illustration 1

The Managing Director of MEADOW Plc. a company in the leather industry has just received a statistical bulletin showing the performance of the industry as a whole for the year ended 30th September, 2014. He would like to assess the results of the company for the same period using these statistics for purposes of comparison. The accounts of MEADOW Plc. for the year ended 30th September, 2014 are given below:-

| STATEMENT OF FIANCIAL POSITION | | | |
|--------------------------------|-----------------------|---------------------------|-----------------------|
| | N'000 | | N'000 |
| Liabilities | | Assets | |
| General Reserve | 19,500 | Trade Debtors | 112,500 |
| Ordinary Share Capital | 75,000 | Equipment at cost | 39,000 |
| Trade Creditors | 71,250 | Goodwill | 18,750 |
| Long-Term Loan | 55,000 | Cash at Bank | 16,500 |
| Provision for Dep. on Equip | 20,000 | Freehold Property at Cost | 46,500 |
| Profit and Loss Account | 63,000 | Stock | 82,500 |
| Provision for Taxation | <u>12,000</u> | | |
| | <u>315,750</u> | | <u>315,750</u> |
| PROFIT OR LOSS ACCOUNT | | | |
| | N'000 | | N'000 |
| Retained Profit c/d | 63,000 | Sales | 632,000 |
| Loan Interest | 5,500 | Retained Profit b/f | 59,500 |
| Administrative Expenses | 46,500 | Discount Received | 500 |
| Depreciation of Equipment | 3,000 | | |
| Cost of Goods Sold | 554,500 | | |
| Dividend Paid | 7,500 | | |
| Company Taxation | <u>12,000</u> | | |
| | <u>692,000</u> | | <u>692,000</u> |

The following ratios were extracted for the industry:-

| | |
|----------------------------|----------|
| Return on Capital Employed | 10% |
| Stock Turnover | 15 times |
| Current Ratios | 1.8:1 |
| Gross Profit Margin | 10% |
| Gearing Ratio | 33% |
| Quick Ratio | 1.45:1 |

Required:

- Redraft the account in a form suitable for presentation to management.
- Calculate the above ratios for MEADOW Plc.
- Comment on the performance of MEADOW Plc. compared with the Industry.

Solution

| MEADOW PLC | | |
|--|---------------|-----------------------|
| Statement of financial position as at 30 th September, 2014 | | |
| | N'000 | N'000 |
| Non-Current Assets | | |
| Freehold Property at Cost | | 46,500 |
| Equipment at Cost | 39,000s | |
| Less Depreciation | <u>20,000</u> | 19,000 |
| Intangible Asset: | | |
| Goodwill | <u>18,750</u> | |
| | | 84,250 |
| Current Assets: | | |
| Stock | 82,500 | |
| Trade Debtors | 112,500 | |
| Cash at Bank | <u>16,500</u> | |
| | 211,500 | |
| Current Liabilities: | | |
| Trade Creditors | 71,250 | |
| Provision for Taxation | <u>12,000</u> | |
| | <u>83,250</u> | |
| Working Capital | | <u>128,250</u> |
| | | <u>212,500</u> |
| Financed by: | | |
| Ordinary Share | | 75,000 |
| General Reserve | | 19,500 |
| Profit and Loss Account | 63,000 | |

Long Term Liabilities:

| | |
|----------------|-----------------------|
| Long Term Loan | <u>55,000</u> |
| | <u>212,500</u> |

MEADOW PLC

Profit or Loss Account for the Year Ended 30th September, 2014

| | |
|------------------------------|----------------------|
| | N'000 |
| Sales / Turnover | 632,000 |
| Cost of Goods Sold | <u>(554,500)</u> |
| Gross Profit | 77,500 |
| Administrative Expenses | (46,500) |
| Depreciation of Equipment | (3,000) |
| Loan Interest | (5,500) |
| Discount Received | <u>500</u> |
| Profit before Tax | 23,000 |
| Taxation | <u>(12,000)</u> |
| Profit after Tax | 11,000 |
| Appropriation: | |
| Dividend Paid | <u>(7,500)</u> |
| Retained Profit for the Year | 3,500 |
| Retained Profit b/f | <u>59,500</u> |
| Retained Profit c/f | <u>63,000</u> |

b) (i) Return on Capital Employed = $\frac{\text{Operating Profit}}{\text{Capital Employed}} \times 100$
= $\frac{17,500 \text{ (i.e. Profit b/4 Tax minus Loans Interest)}}{295,750 \text{ (i.e. Fixed Assets + Current Asset)}}$
= 5.92% or 6%

(ii) Stock Turnover = $\frac{\text{Cost of Goods Sold or Sales}}{\text{Average Stock Closing Stock}}$
= $\frac{N632,000}{N82,500} = 7.66 \text{ times}$

(iii) Current Ratio = $\frac{\text{Current Asset}}{\text{Current Liab}} = \frac{N211,500}{N83,250} = 2.54:1$

(iv) Gross Profit on Sales = $\frac{\text{Gross Profit}}{\text{Sales}} \times 100$
= $\frac{N77,500}{N632,000} \times 100 = 12.26\%$

$$\begin{aligned}
 \text{(v) Gearing Ratios} &= \frac{\text{Debt Capital (Long term Debt)}}{\text{Capital Employed.}} \times 100 \\
 &= \frac{\text{N55,000}}{\text{N295,750}} \times 100 \\
 &= 18.6\% \text{ or } 19\%
 \end{aligned}$$

$$\begin{aligned}
 \text{(vi) Quick Ratio} &= \frac{\text{Current Assets} - \text{Stock}}{\text{Current Liabilities}} \\
 &= \frac{\text{N211,500} - \text{N 82,500}}{\text{N83,250}} = \frac{\text{N129,000}}{\text{N83,250}} \\
 &= 1.55:1
 \end{aligned}$$

c)

- i. The Return on Capital employed of 6% is poor when compared with the industry average of 10%.
- ii. Stock turnover of 7.66 times is also poor when compared with the industry average of 15 times.
- iii. The current ratio of MEADOW Plc. is above that of the industry 2.54:1 as against 1.8:1 indicating that for every N1 owed to outsiders, there is N2.54k current asset available to take care of it. This is OK.
- iv. The gross profit on sales of 12.26% of MEADOW is higher and better than the average of the industry of 10%. This is a good position.
- v. The gearing ratio of 19% is better than the 33% of the industry. It implies that less of outsiders' money / fund are being utilized.
- vi. The quick ratio of 1.55:1 is higher and better than the industry average of 1.45:1. This suggests more liquid assets available to take care of current liabilities.

Illustration 2

Jobach Nig. Ltd. is a manufacturer of Baby Foods. The balance sheet of the company is given below in line with format stated in CAMA.

Jobach Nigeria Ltd. statement of financial position as at 31st December 2010

| | N | N |
|-----------------------|-----------|-----------|
| Assets Employed | | 9,350,000 |
| Investment at cost | | 3,750,000 |
| <u>Current Assets</u> | | |
| Stock Balances | 8,140,000 | |
| Debtors & Prepayment | 5,800,000 | |

| | | |
|----------------------------------|------------------|-------------------|
| Cash & Bank balances | <u>4,920,000</u> | |
| | 18,860,000 | |
| Less: <u>Current Liabilities</u> | | |
| Creditors & Accrual | 7,050,000 | |
| Taxation | <u>1,685,000</u> | |
| | 8,735,000 | |
| | | <u>10,125,000</u> |
| | | <u>23,225,000</u> |
| Represented by: | | |
| Share Capital | | |
| Deposit for share | | 5,000,000 |
| Profit & Loss Account | 10,075,000 | |
| | | <u>8,150,000</u> |
| | | <u>23,225,000</u> |

Additional Information

- Turnover represents 75% of net asset
- Cost of sale represents 45% of the aggregate turnover
- Trade Debtors represent 31% of the aggregate Debtors
- Credit sales represent 1/5 of the aggregate sales
- Credit purchases represent 1/3 of cost of sales.

Required:

- Calculate the following ratios from the data above
 - Current ratio
 - Liquidity ratio
 - Debtors Turnover
 - Average Collection Period
 - Creditor Turnover
- State four (4) limitations of ratio analysis.

Solution

[a] i) Current Ratio = Current Assets ÷ Current Liabilities

$$\frac{\text{Current Assets}}{\text{Current Liabilities}} = \frac{18,860,000}{8,735,000} = \underline{2.2:1}$$

- Liquidity Ratio

$$\frac{\text{Current Assets – Stock}}{\text{Current Liabilities}} = \frac{18,860,000 - 8,140,000}{8,735,000} = \frac{10,720,000}{8,735,000} = \underline{\underline{1.2:1}}$$

iii) Debtors Turnover = $\frac{\text{Credit Sales}}{\text{Debtors}}$ = x times

Credit Sales = 1/5 of sales

: - Sales = 75% x 23,225,000 = 17,418,750

: - Credit Sales 1/5 of 17,418,750 = N3,483,750

Trade Debtors = 31% x 5,800,000 = N1,798,000

$$\text{Debtors Turnover} = \frac{3,483,750}{1,798,000} = \underline{\underline{1.94}} \text{ times}$$

iv) Average Collection Period

$$= \frac{\text{Average Debtors}}{\text{Credit Sales}} \times 365 \text{ days}$$

$$= \frac{1,798,000}{3,483,750} \times 365 \text{ days} = \underline{\underline{188}} \text{ days}$$

v) Creditors Turnover = $\frac{\text{Credit Purchases}}{\text{Creditors}}$

Credit Purchases = 1/3 of cost of sales

: - Cost of sales = 45% of 17,418,750

= N7,838,438

: - Credit Purchases = 1/3 x 7,838,438 = N2,612,813

: - Creditors Turnover = $\frac{2,612,813}{7,050,000} = \underline{\underline{0.37}} \text{ times}$

7,050,000

[b]

Limitations of Accounting Ratio Analysis

- i. The difference in the methods adopted by two enterprises may distort the result of analysis and therefore misinform judgement. Examples of such difference, “X” company adopting first in first out stock valuation method whereas “Y” company used weighted average.
- ii. The profit figures declared by the two companies may diverge, not as a result of varying levels of efficiency and effectiveness.
- iii. There is inherent assumption that the historical data used for ratio analysis are inviolate, fixed and applicable under all situations. However, the dynamics of political and economic factors may prove such data as “out of date”.
- iv. Just as mathematics, which engage in “arm chair reasoning” and does not concern itself with what goes on in the empirical world, ratio analysis are not supposed to be ends in themselves. Useful as they ratio analysis should be considered along with other quantitative and indeed qualitative factors.
- v. The issues, which crop up are:
 - What is the suitable standard for comparison?
 - What is the suitable industry standard?

7.03 REVIEW QUESTIONS

Question 1

The Profit or Loss Account and statement of financial position of ADEKING Plc. as at 31st December, 2013 and 2014 were as follows:

| | Profit or Loss Account | |
|--|------------------------|--------------------|
| | 2014 | 2013 |
| | N'000 | N'000 |
| Turnover | 2,713,285 | 3,089,973 |
| Cost of sales | <u>(1,907,419)</u> | <u>(1,954,626)</u> |
| Gross profit | 805,866 | 1,135,347 |
| Operating expenses | <u>(664,738)</u> | <u>(553,702)</u> |
| Trading profit | 141,128 | 581,645 |
| Exceptional items | 176,157 | (5,848) |
| Other income | 72,859 | 37,085 |
| Interest charges | <u>(105,976)</u> | <u>(80,273)</u> |
| Profit on ordinary activities before tax | 284,168 | 532,609 |
| Taxation | <u>(69,938)</u> | <u>(191,265)</u> |
| Profit on ordinary activities after tax | 214,230 | 341,344 |
| Debenture Redemption Reserve | - | (10,000) |
| Dividend proposed | <u>(132,875)</u> | <u>(199,313)</u> |
| Retained profit for the year | 81,355 | 132,031 |
| Reserve at the beginning of the year | 464,434 | 332,346 |
| Transfer from redemption reserve | <u>40,000</u> | <u>-</u> |
| Retained profit C/F | <u>585,789</u> | <u>464,377</u> |

Statement of financial position as at 31st December

| | 2014 | 2013 |
|----------------------------------|--------------------|--------------------|
| | N'000 | N'000 |
| Fixed Assets | 260,739 | 248,609 |
| Long-term investments | 160 | 160 |
| Current Assets: | | |
| Stocks | 1,456,182 | 1,387,073 |
| Debtors | 579,876 | 310,322 |
| Bank & Cash Balance | <u>525,574</u> | <u>792,059</u> |
| | 2,822,531 | 2,738,223 |
| Creditors: (due within one year) | <u>(1,479,217)</u> | <u>(1,557,347)</u> |
| Net Current Assets | 1,343,314 | 1,180,876 |

| | | |
|---------------------------------------|------------------|------------------|
| Creditors: (due after one year) | (10,795) | (8,700) |
| Provision for liabilities and charges | <u>(285,701)</u> | <u>(179,713)</u> |
| | <u>1,046,818</u> | <u>992,463</u> |
| Capital & Reserves | | |
| Called-Up Share Capital @ 50k each | 332,188 | 332,188 |
| Reserves | <u>714,630</u> | <u>660,275</u> |
| | <u>1,046,818</u> | <u>992,463</u> |
| Market Price of shares | 45k/share | 6k/share |

You are required to:

(a) Compute the following ratios for 2013 & 2014

- i. Gross Profit Margin
- ii. Return on Capital Employed
- iii. Net Profit Margin
- iv. Current ratio
- v. Liquid ratio
- vi. Debtors collection period
- vii. Earnings per share
- viii. Dividend per share
- ix. Price earnings ratio

(b) Based on the ratios computed in (a) above comment on the company's profitability and liquidity position over the period.

Question 2

Kwall Ltd. has a capital base of N5,000,000 (shares of N100 each) as at 31st December 2003. The company's profit after tax for the same year stood at N700,000. Assume the market value of the company's share was N400 each and a dividend of 4% was declared for the year to 31/12/2003.

Determine the following in respect of the company;

- i. Market value of the company's ordinary shares
- ii. Price Earnings Ratio
- iii. Earnings per share
- iv. Dividend yield
- v. Value of the retained profit

Question 3

Anan & Co. supplied you with the following statistics relating to its operation for the financial year ended 30th April, 2008

| | | |
|--|---|---------|
| Gross Profit | - | 25% |
| Average Inventory | - | N18,000 |
| Inventory turnover | - | 8 times |
| Net Profit/Revenue | - | 15% |
| Collection period | - | 50 days |
| Payment period | - | 35 days |
| Current Asset: Current Liability | - | 4:1 |
| Net Profit/Net Asset | - | 18% |
| Opening Inventory: Closing Inventory | - | 1:2 |
| Motor vehicles/furniture & fitting/loose tools | - | 9:1:0.5 |
| Drawings | - | N6,000 |

The payment and collection periods are based on year end Payables and Receivables. The current liabilities consist only of payables while current assets consist of inventory, receivables and cash. The non-current assets are motor vehicle, furniture and fittings and loose tools.

You are required to prepare in detailed form (much as the information above permits) an Income Statement for the year ended 30th April, 2018 and a Statement of Financial Position as at that date. Show all workings. Calculations should be made to the nearest whole number.

Recommended Further Readings

- Aborode, R. (2016) Advanced financial accounting, Lagos: Masterstroke Consulting.
- Adebisi, F. J. (2014) Advanced financial accounting and reporting plus IFRSs TIT-BITS. Jos: Hamtul Press Nigeria Ltd.
- Adejola, P. A (2014) Simplified international financial reporting standards: A practical application of IFRS in corporate reporting. Abuja, Nigeria: Arogbodo Prints.
- Adejola, P. A. (2013) IFRS: Practical implementation guides. Abuja Nigeria: Rainbow Prints,.
- Adejola, P. A. (2013) Financial accounting and reporting standards for students and professionals. Revised Edition
- David Young& Jacob Cohen (2013): Corporate Financial Reporting and Analysis, 3rd Edition
- Emile Woolf Study Text (2014) Paper P2 Corporate Reporting. Emile Woolf Publishing
- Glenn A., & Suzanne Kyle (2016) Intermediate Financial Accounting Volume 1.
- Idekwulim, C. P. (2014) Teach yourself IFRS. Yaba, Lagos: Piccas Global Concept.
- Kaplan Financial Limited (2017) Corporate Reporting EXAM KIT (ACCA P2) Kaplan Publishing UK
- Pearl Tan, Chu Yeong Lim and Peter Lee (2014) Advanced Financial Accounting 2nd edition Mc Graw-Hill Education Publishing
- Wood, F and Sangster A. (2005) Business accounting 2 10th ed. Pitman Inter
- Zubairu, D. A. (2014) Modern financial accounting IFRS adopted (Solution Pack). Hussab Global Press

OTHER RELEVANT MATERIAL TO AID COMPREHENSION

- www.frcn
- www.ifac.org
- <http://www.iasplus.com/en/standards>