NATIONAL OPEN UNIVERISTY OF NIGERIA

SCHOOL OF MANAGEMENT SCIENCES

COURSE CODE: ACC 312

COURSE TITLE: INTERMEDIATE FINANCIAL ACCOUNTING II

INTERMEDIATE FINANCIAL ACCOUNTING II

ACC312

Course Guide

Course Developer/Writer:	**ICAN STUDY PACK**
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INTRODUCTION

You are holding in your hand the course guide to ACC312 (Financial Accounting). The purpose of the course guide is to relate to you the basic structure of the course material you are expected to study as an Accounting Student in National Open University of Nigeria. Like the name 'course guide' implies, it is to guide you on what to expect from the course material and at the end of studying the course material.

COURSE CONTENT

The course content consists basically of the treatment of transactions according to the provisions of accounting standards. More specifically, the accounting standards as provided by standard setting bodies are the content of this course material such as Statement of Accounting Standards (SAS), International Accounting Standards (IAS), International Financial Reporting Standards (IFRS), and other related standards provided by standard setting bodies.

COURSE AIM

The aim of the course is to bring to your cognizance the conceptual and regulatory framework that provides the basis for the treatment and presentation of financial transactions.

COURSE OBJECTIVES

At the end of studying the course material, among other objectives, you should be able to:

1. Explain the accounting method for oil and gas, farmers, estate agencies and property companies;
2. To prepare accounts relating to solicitors, provident funds, voyage/shipment, cooperative societies.
3. Explain some of the provisions concerning issues in the Statement of Accounting Standard 18, 19, 20;
4. Explain the accounting treatment of government grants;
5. State accounting treatment of borrowed costs.
6. Explain some of the provision of International Accounting Standard (IAS) 24: Related Party Disclosures, IAS 29: Financial Reporting in Hyper Inflationary economy.
7. Redraft the financial statement, using the current purchasing power basis.

COURSE MATERIAL

The course material package is composed of:

The Course Guide

The study units

Self-Assessment Exercises

Tutor Marked Assignment

References/Further Reading

THE STUDY UNITS

The study units are as listed below:

MODULE 1: SPECIALIZED BUSINESSES AND ACCOUNTING STANDARDS

Unit 1: Accounting for Specialized Businesses 1

Unit 2: Accounting for Specialized Businesses 2

Unit 3: Generally Accepted Accounting Principles

Unit 4: Development of Accounting Standards

Unit 5: The International Accounting Standards Board

Unit 6: Content and Application of Accounting Standards

MODULE 2: ACCOUNTING FOR PETROLEUM ACTIVITIES AND FINANCIAL INSTITUTIONS

Unit 1: Leases and Accounting for Investment

Unit 2: Accounting in the Petroleum Industry: Upstream Activities and Accounting by Banks and Non-banks Financial Institutions

Unit 3: Accounting for Insurance Business and Accounting in the Petroleum Industry: Downstream

MODULE 3: FINANCIAL REPORTING 1

Unit 1: Statement of Cash flow, Accounting for Taxes and Abridged Financial Statements

Unit 2: Earnings per Share, Research and Development, and Provisions, Contingent Liabilities and Contingent assets

Unit 3: Segment Reporting and Telecommunication Activities

MODULE 4: FINANCIAL REPORTING 2

Unit 1: Business Combinations, Interim Financial Reporting, Presentation of Financial Statements, Events after the Reporting Period and Revenue

Unit 2: Accounting for Government Grants and Disclosure of Government Assistance, Borrowing Costs, Related Party Disclosures and Financial Reporting in Hyper Inflationary Economy

Unit 3: Impairment Loss

Unit 4: First-time Adoption of IFRS, Share Based Payment, Non-current Assets held for Sale and Discontinued Operations

MODULE 5: REGULATORY FRAMEWORK

Unit 1: Regulatory Framework of Financial Accounting 1

Unit 2: Regulatory Framework of Financial accounting 2

Unit 3: Legal and Regulatory framework of Group Accounts

ASSIGNMENTS

Each unit of the course has a self assessment exercise. You will be expected to attempt them as this will enable you understand the content of the unit.

TUTOR MARKED ASSIGNMENT

The Tutor Marked Assignments (TMAs) at the end of each unit are designed to test your understanding and application of the concepts learned. Besides the preparatory TMAs in the course material to test what has been learnt, it is important that you know that at the end of the course, you must have done your examinable TMAs as they fall due, which are marked electronically. They make up 30 percent of the total score for the course.

SUMMARY

It is important you know that this course material was actually adapted from ICAN study pack. This provides you the opportunity of obtaining a degree in Accounting and preparation for your professional examinations. Therefore, it is very important that you commit adequate effort to the study of the course material for maximum benefit.

INTERMEDIATE FINANCIAL ACCOUNTING II

ACC312

Main Content

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TABLE OF CONTENT

MODULE 1: SPECIALIZED BUSINESSES AND ACCOUNTING STANDARDS

UNIT 1: ACCOUNTING FOR SPECIALIZED BUSINESSES 1

CONTENT

1.0 INTRODUCTION

In this unit, you will start with the preparation of accounting for a company. When preparing account for a company, it is common to think of companies that generally engage in the sale of goods and services, such that, the common way of presenting financial statements is used. Such accounting presentations are usually of general view. However, there are specialized businesses whose financial statements might be different from those of a general nature.

The financial statements are usually a summary of all the transactions posted in the various accounts. The balances of these accounts are reported by the preparation and presentation of the financial statements. Consequently, without the various accounts, we cannot have the financial statements. Similarly, the various accounts of specialized businesses will enable the preparation and presentation of financial statements for specialized businesses. Therefore, let us consider the accounts in some of these specialized businesses

2.0 OBJECTIVES

After studying this unit, you should be able to:

8. Prepare the accounts of estate agencies and property companies.
9. Prepare the accounts of Farmers.
10. Explain the accounting method for oil and gas accounting

3.0 MAIN CONTENT

3.1 ESTATE AGENT/PROPERTY COMPANY'S ACCOUNT

Estate Agents and Property Companies prepare profit and loss account and a balance sheet as a normal trading company and in addition, prepare appropriation account. The peculiarity in its balance sheet is that freehold land held for re-sale is classified as stock under current assets.

ILLUSTRATION 1

Iruland Estate Development Nigeria Plc, was registered in year 2005. It purchased freehold land at Ajah for the purpose of creating a highly developed holiday centre and retirement estate. The area of land purchased consists of 4,000 plots from which a block of 20 plots was designed as sports and entertainment arena whilst the remaining land was offered for sale at N15,000 per plot, for development of luxury bungalows. As at 30th April, 2008, the position of the company was as follows:

		N'000		N'000
Authorized share capital				50,000
Issued and fully paid:				
Ordinary shares @ N1.00 per share				27,000
9% redeemable preference shares				4,500
Unappropriated profit brought forward				9,600
				41,100
7% debentures				18,000
Debentures redemption fund				6,900
				66,000
				N'000
Fixed Assets:				45,330
Entertainment arena including land & filling at cost				(750)
				44,580
Debenture redemption fund investment, at cost				
(market value N7,500,000)				6,900
				51,480
Current Assets:		N'000		
Freehold land (2,000 plots unsold) at cost		12,000		
Arena stocks		750		
Arena debtors		130		
Bank		4,520		
		17,400		
Less: current liabilities:				
Trade creditors	180			
Proposed ordinary dividend	2,700			
		2,880		
Net current assets			14,520	
			66,000	

The following transactions took place in the year ended 30th April 2008:

a. On 1 July 2007, to be effective 1 May 2007, the company sold the entertainment arena to complete leisure ltd for N3 million together with arena stocks and debtors at the balance sheet figure. Cash settlement was made on 20th July 2007.
b. The preference shares were redeemed on 30 June 2007, within the terms of the original issue, at a premium of 105, to be in lieu of any accrued dividend. The premium on redemption is to be written off to capital reserve.
c. On 1 July 2007, the proposed ordinary dividend was paid.

d. On 31 October 2007, the 7% debentures were redeemed at 104 together with 6 months accrued interest. The premium on redemption is to be written off to capital reserve. The debenture redemption fund had been created out of profit.
e. On 1 November 2007, the company made a bonus share issue to the ordinary shareholders of one for every three ordinary shares held on that date. The capital reserve arising from the realization of fixed assets was issued for this purpose.
f. During the course of the year, 400 plots were sold at N15,000 a plot.
g. Also, within the year, the creditors as at 1 May 2007, were paid off at a discount of 5% and administrative expenses of N450,000 incurred, of which N210,000 was unpaid at 30th April, 2008.
h. Income from investments (market value on 31 October 2007 was N7,800,000) amounted to N270,000.

You are required to prepare for Iruland Estate Development Nigeria Plc the following for year ended 30 April 2008:

a. Profit and loss appropriation account.
b. Balance sheet as at 30 April 2008.
c. Bank account.

SUGGESTED SOLUTION 1

IRULAND ESTATE DEVELOPMENT LIMITED

a. Profit and Loss Appropriation Account for the year ended 30 April 2008

	N'000		N'000
Administrative expenses	450	profit on sale of land (w2)	3,600
Debenture interest	630	Income from Investment	270
Net profit c/d	2,800	Discount on creditors	10
	3,880		3,880
Capital redemption reserve fund	4,500	Bal. b/d	2,800
Unappropriated profit fund	12,000	Debenture redemption fund	6,900
Net profit c/d	2,800	unappropriated profit	9,600
	19,300		19,300

b. Balance Sheet as at 30 April 2008

	N'000	N'000		N'000	N'000
Share capital:					
Ordinary shares issued at			Investment (market value)		6,900
N1.00 per share		36,000	Current assets		
Capital reserve (w1)	8,470		Freehold land at cost	9,600	
Debenture redemption			Bank	47,480	57,080
Reserve fund	4,500				
Profit and loss a/c	14,800	27,770			
Creditors		210			
		63,980			63,980

c. **Bank account**

	N'000		N'000
Bal. b/d	4,520	Preference shares redemption	4,725
Sale of arena	3,000	Ordinary dividend	2,700
Sale of arena stock & debtors	880	Debenture redemption	18,720
Sale of land	6,000	Interest on debenture	630
Sale of fixed assets	59,755	Trade creditors	170
Investment income	270	Bal. c/d	47,480
	74,425		74,425

WORKINGS

	N'000	N'000
1. Captive reserve		
Amount of sales of fixed assets		18,420
N(6,300,000 – 4,458,000)		
Less : amount transferred to capital		
Reserve on issue of bonus shares	9,000	
Premium on redemption of pref. Shares	230	
Premium on redemption of debenture	720	9,950
		8,470
2. Profit on sale of land		
Proceeds on sale (400plots @ N15,000) per plot		6,000
Less cost (400 x N6,000)		2,400
Profit on sale		3,600

SELF ASSESSMENT EXERCISE

Without looking at the solution of the question in the illustration, solve the question and compare to the solution in the illustration.

3.2 FARMER'S ACCOUNT

Farmers prepare trading, profit and loss account, and balance sheet, just as every other business outfit. However, peculiarities in a farmer's account are mainly in the valuation of stock of arable plantation products and livestock. Statement of Accounting Standard No. 4(SAS) on stock, prescribes treatment of these peculiarities.

3.2.1 ARABLE PRODUCTS

a. First-time land clearing and stumping may involve substantial costs which are sometimes capitalised.

b. Tillage in-ground and harvested crops are three distinct operational stages requiring valuation. Each operational stage has its own peculiar problems of revaluation. Costs incurred are charged to each category.

c. The value of tillage usually includes the accumulated costs of labour and usage of machinery for preparing the land for planting, ploughing and fertilizer spreading.

d. In-ground crops are usually valued by including the costs associated with tillage, labour, seedlings, weeding, disease control and the attributable cost of machinery used.

e. The valuation of harvested crops involves the correct determination of actual input costs, labour, depreciation and storage costs at the time of harvest, to ensure that the value of harvested crops includes all the costs incurred from tillage to harvesting.

f. Most farm products are perishable or deteriorate quickly: therefore, it is appropriate to make reasonable provision for deterioration or animal spoilage based on norm within the industry or after consultation with experts.

g. Where there is adequate record keeping and an appropriate cost accounting system, cost forms the basis for the valuation of arable products. In other situations, net realisable value is used.

h. Official prices for certain products, such as, maize, sorghum and millet, are published by the appropriate commodity Boards, for example, National Grains Board. Use of such official prices is not, however, recommended except where they are below cost.

3.2.2 PLANTATION PRODUCTS

a. The major problem with the determination of the value of a plantation product is that, a plantation does not usually start to produce until after a long gestation period. Thus, all costs associated with land preparation, planting, pruning and development are accumulated until the trees come to maturity are amortized over the estimated productive life of the plantation.

b. It is the normal practice to have planting done in lots or batches so as to have a continuous flow of plantation output. Where possible, costs of such lots or batches are accumulated separately in order to match their revenue with associated costs, when harvested and sold.

c. Each year the cost of plantation output consists of the preparation of the cost accumulated for the quantities harvested plus the cost of extracting and transporting them to the point of sale.

d. Some enterprises prefer to use average cost of production in assigning value to the quantities harvested and those not harvested. This method is justifiable because most plantation products are homogenous.

e. Some plantation crops such as sugarcane and banana are annual crops which yield produce within the first year of being planted. Stocks of such produce are valued in the same manner as arable products.

On the other hand, certain fruit trees such as oranges, mangoes are often grown on a much smaller scale than would normally be regarded as plantation. However, stocks of their products are valued in the same manner as those in plantations.

3.2.3 LIVESTOCK

a. Two major problems are associated with the valuation of livestock:

i. Determining the actual number and their existence, especially, grazing animal; and

ii. Identifying the various stages of their development.

b. The following three approaches to valuation of stock are generally in use:

i. Cost approach; the value is based on the actual cost incurred on each category of livestock.

ii. Net realisable value; the value is based on the expected returns allowing for the costs of fattening, preparation for sale and selling.

iii. Appraised value: the value is determined by professional valuers, taking into consideration the current market value, the mortality factor and the relative marketability of the breed or class of stock.

c. Where livestock is raised primarily for its products rather than for consumption. Such as dairy cattle or egg-laying poultry, different considerations arise in the valuation of such stock. It is usual to accumulate the cost of bringing such livestock to the point of maturity at which they begin to yield products and to amortise such costs over their estimated productive lives.

d. The stocks in livestock enterprise usually include feeds- stock, drugs, small implements and other essential materials. They are usually valued at cost after a physical count.

3.2.4 Main Features of Farm Accounts

a. Open departmental accounts for different activities such as dairy, crops, fruits and livestock rearing, and where necessary, sub-divide the activities.

b. Open ledger accounts as in commercial activities, for example, debit purchases account and credit creditor's account, for purchases of input on credit.

c. Rotation of crops resulting in a number of fields lying "fallow", occasionally sown with "fallow crops", that is, a number of fields are not in full production.

d. Large mechanised farms keep financial records but most small farm records are incomplete or at best; single entries recording receipts and payments.

e. Large expenditure incurred on seeds and fertilizers may occasionally be spread over a period. Farming equipment purchased that are of material value and expected to be in use for a long period should be capitalized.

f. Valuation of stock and manorial rights are carried out by farm experts.

g. Where destruction of animals and crops as a result of disease and pest respectively occur, compensation for loss is computed for possible insurance claim.

h. Large farms take insurance cover for loss of livestock due to infection or loss of cattle as a result of straying.

ILLUSTRATION 2

The trial balance of Multinational Farms as at 31 December 2008 is as follows:

	DR	CR
	N'000	N'000
Regular labour expenses	5,120	
Repair of motor vehicles	680	
Petrol, oil and lubrications	336	
Electricity	240	
Depreciation	1,080	
Rent and rates	720	

Insurance	120	
Debtors	7,200	
Repairs of property	720	
Telephone	96	
Bank charges	136	
Generator repairs and diesel	960	
Other general expenses	240	
Cash at bank	320	
Equipment	6,400	
Drawings	2,800	
Capital		17,200
Creditors		2,360
Opening stock	5,536	
Purchases	6,192	
Sales		25,120
Subsidies		904
Fertilizer	560	
Seeds	1,280	
Contract work- crop	1,680	
Casual labour- crop	40	
Other expenses- crop	208	
Feed	2,240	
Casual labour- livestock	120	
Vetenary medicine-livestock	320	
Dairy expenses	80	
Sundry expenses- livestock	160	
	45,584	45,584

Further information relevant to the accounts are as follows:

1. Closing stock: Cassava N240,000, Yam N540,000, Cow 240,000, Ram N400,000.
2. Sales: Cassava N2,400,000, Yam N3,680,000, Cow N16,560,000, Ram N2,480,000.
3. 2/3 of rent and rates; petrol, electricity and telephone should be charged to the farm's account.
4. The opening stocks for the following product lines: Cassava N1,256,000, Yam N1,240,000, Cow N2,200,000, Ram N1,840,000.
5. Purchases of: Cow N4,720,000 and Ram N1,472,000.
6. Own consumption: Cassava N64,000; Cow N120,000.
7. Subsidies: Cassava N160,000, Yam N224,000, Cow N320,000, Ram N200,000.

You are required to prepare trading, profit and loss account of Multinational Farms for the year ended 31 December 2008 and its balance sheet as at that date.

SUGGESTED SOLUTION 2

MULTINATIONAL FARMS

STATEMENT OF GROSS OUTPUT FOR THE YEAR ENDED 31 DECEMBER 2008

	CROPS		LIVESTOCK	
	CASSAVA	YAM	COW	RAM
	N'000	N'000	N'000	N'000
Sales	2,400	3,680	16,560	2,480

Subsidies		160	224	320	200
Own consumption		64	-	120	-
	2,624	3,904	17,000	2,680	
Cost of sales:					
Opening stock		1,256	1,240	2,200	840
Purchases		-	-	4,720	1,472
		1,256	1,240	6,920	2,312
Less: closing stock		240	544	240	400
	1,016	696	6,680	1,912	
Gross output (a-b)		1,608	3,208	10,320	768

MULTINATIONAL FARMS

TRADING, PROFIT & LOSS ACCOUNT FOR THE YEAR ENDED 31 DECEMBER 2008

Crops:	N'000	N'000	N'000
Gross Outputs			
Cassava	1,608		
Yam	3,208		
		4,816	
Less: direct expenses:			
Fertilizer	560		
Seed	1,280		
Contract work	1,680		
Casual labour	40		
Other expenses	208		
		3,768	
Gross profit			1,048
Livestock:			
Gross output:			
Cow	10,320		
Ram	768		
		11,088	
Direct expenses: feed	2,240		
Casual labour	120		
Vet. Medicine	320		
Dairy	80		
Sundry expenses	160	(2,920)	
Gross profit			8,168
Total gross profit			9,216
General Expenses:			
Regular labour	5,120		
Repair of motor vehicles	680		
Petrol, oil & lubrication (2/3 x N336)	224		
Electricity (2/3 x N240)	160		
Depreciation	1,080		
Insurance	120		
Repairs of property	720		
Telephone (2/3 x N96)	64		
Bank charges	136		
General repairs and diesel	960		
Other general expenses	240		(9,984)
Net loss for the year			(768)

MULTINATIONAL FARMS
BALANCE SHEET AS AT 31 DECEMBER 2008

	N'000	N'000
Fixed Assets: Equipment		6,400
Current Assets:		
Stock (240 + 544 + 240 + 400)	1,424	
Debtors	7,200	
Cash at bank	320	
	8,944	
Current liabilities:		
Creditors	(2,360)	
		6,584
		12,984
Financed By:		
Capital		17,200
Less: Net loss for the year		(768)
		16,432
Drawings: N(2,800 + 184 + 112 + 80 + 240 + 32)		(3,448)
		12,984

Self assessment exercise
State the main features of farm accounts.

3.3 OIL AND GAS ACCOUNTING- UPSTREAM ACTIVITIES

Companies involved in prospecting and production of crude oil are guided by the Statement of Accounting Standard (SAS) No. 14. The basic principles and illustration of peculiar accounting treatment and methods of calculating depletion, depreciation and amortization of prospecting and production costs of oil and gas will be made. Readers are advised to have another look at SAS No. 14 for the definition of terms and other details.

3.3.1 Costs in oil and gas operations may be classified broadly as:

a. Mineral rights acquisition costs;

b. Exploration and drilling costs;

c. Development costs;

d. Production costs;

e. Support Equipment and facilities costs; and

f. General costs

3.3.2 Oil and Gas accounting methods, full costs, successful effort

Methods and procedures followed by oil companies in accounting for explorations and development costs diverge significantly. Two basic accounting methods that are in common use are the full cost and the successful efforts methods. Both methods are widely followed and each of them has a valid conceptual justification.

3.3.3 Full cost method

a. All costs incurred on mineral rights acquisition, exploration and development activities (including future development costs) should be capitalized irrespective of whether or not the activities resulted in the discovering of reserves.

b. The companies using full cost method are referred to as "full cost companies" while those using successful efforts method is referred to as "successful efforts companies:

c. A third method known as reserve recognition accounting (RRA) allows an enterprise to recognise the "value" of proved oil and gas reserves as assets and changes in such reserve values as earnings in the financial statements. This method is not common, therefore, it is not recommended.

d. A ceiling test should be conducted at least annually, in order to determine whether the costs capitalized can be recovered from the proved reserve.

e. Proved reserves represent estimated quantity of oil and gas that can be expected to be recovered from known reservoirs using existing technology. Proved reserve may be developed or undeveloped.

3.3.4 Successful efforts method

a. Costs incurred prior to acquisition of mineral rights and other exploration activities not specifically directed to an identifiable structure, should be written off in the period they are incurred.

b. All costs incurred on mineral rights acquisition, exploration, appraisal and development activities should be capitalised, initially on the basis of wells, field or exploration cost centres, pending determination.

c. Such costs should be written off when it is determined that the well is dry.

d. Mineral rights acquisition costs that have not been allocated should be amortized over the remaining life of the licence.

ILLUSTRATION 3

Liboi Producing ltd was incorporated in year 2008 and has two oil mining leases (OML). Reserves in commercial quantities were discovered in 2008, in one of the OMLs. Expenditure were:

OML 200 (100 years)	N'000
Rent and signature bonus	3,200
Exploration costs	16,000
Development costs	12,000
Estimated future development costs	8,000
Estimated future abandonment costs (nets of salvage value)	800
	40,000

OML 201 (100 years)	
Rent and signature bonus	5,760
Exploratory/drilling costs (dry hole costs)	17,760
	23,520

Reserves and production data of crude oil were:

Proved reserves at 31/12/2008:

Developed	54,400 barrels
Undeveloped	16,000 barrels
Production- 2008	6,400 barrels

You are required to compute depletion, depreciation and amortisation (DD&A) for 2008 and prepare an extract of profit and loss account as at 31 December 2008 under:

a. The full cost method
b. Successful efforts method

SUGGESTED SOLUTION 3
LIBOI PRODUCING LTD

(a) FULL COST METHOD

OML 20	N'000
Acquisition costs	3,200
Exploration costs	16,000
Development costs	12,000
Future development costs	8,000
Estimated future abandonment costs	800
OML 201 (100 years):	
Acquisition costs	5,760
Exploration costs (dry hole)	17,760
	63,520

Depreciation, Depletion and Amortisation

Per barrel: 63,520,000/(70,400 + 6,400) = N827,083

DD & A for 2008 =6,400 x N827,083 = N5,293,331

Profit & Loss account

	N	N
DD & A	5,293,331	

Balance Sheet

Fixed Assets:	N
Oil & Gas Properties	63,520,000
DD & A	(5,293,331)
	58,226,669

(b) SUCCESSFUL EFFORTS METHOD

OML 200

Acquisition costs	N3,200,000
Lease period	100 years

DD & A for 2004 = N3,200,000/100 = N32,000

	N'000
Exploration costs	16,000
Development costs	12,000
Net abandonment costs	800
	28,800

Proved development reserve (54,400 + 6,400) = 60,800 barrels

DD & A for 2008 28,800,000 x 6,400/60,800 = N3,031,579

Profit & Loss account

	N	N
DD & A acquisition	32,000	
Exploration/ development	3,031,579	
Dry hole cost	23,520,000	

Balance Sheet

N		N
	Proved property	32,000,000
	DD & A	(3,031,579)
		28,968,421

Note:

Proved property of N32 million as shown in the trial balance is the expenditure to date on OML 200 for 100 years of 40 million, less estimated future development cost of N8 million.

ILLUSTRATION 4

From the following information, you are required to compute the value of the impairment (if any) and comment briefly on your comparative:

	COST	ASSESSED VALUE
	N	N
OML 100	30,000	48,000
OML 101	12,000	4,800
OML 102	6,000	1,200
OML 103	18,000	24,000

SUGGESTED SOLUTION 4

	COST	ASSESSED VALUE	IMPAIRMENT
	N'000	N'000	N'000
OML 100	30,000	48,000	NIL
OML 101	12,000	4,800	7,200
OML 102	6,000	1,200	4,800
OML 103	18,000	24,000	NIL
	66,000	78,000	12,000

Note:
Impairment is assessable individually, well by well, in aggregate or on group of property basis. If impairment were done on individual basis, a provision of N12 million would be made. However, no provision would be made for group or aggregate bases of assessment since group assessed value is higher than cost. Prudence concept is applied here.

3.3.5 Joint Production of Oil and Gas

DD & A is computed based on the equivalent units of production in barrels, where oil and gas are jointly produced. The barrels are the cost unit for oil and are equivalent to 42 US gallons, while gas is measured in metric cubic feet (MCF). For the purpose of calculating equivalent units, it is a standard assumption that one barrel of oil contains six times as much energy as gas, hence the volume of gas is divided by 6 to arrive at equivalent barrels.

3.3.6 Revenue Method of Amortization

DD & A could also be computed based on the current prices (year-end) of the reserves and production. The revenue methods should eliminate distortion caused by the 6:1 conversion ratio by determining amortisation on the relative value of hydrocarbons.

ILLUSTRATION 5

Using the following data, compute full costs for 2004 DD&A using:

(i) Equivalent physical units of production; and

(ii) Revenue values of oil and gas

	N'000
Net capitalization costs	17,500
Future development costs	5,000
Estimated dismantlement and reclamation	
Costs, net of salvage	2,500
End of year total proved reserve:	
Oil 475,000 barrels	
Gas 450,000 MCF	
2004 production/revenue:	

Oil 25,000 bbls - N 7,500,000

Gas	60,000 MCF	-	N900,000

End of year price

Oil N6,000/bbl

Gas N500/MCF

SUGGESTED SOLUTION 5
EQUIVALENT PRODUCTION METHOD/EQUIVALENT QUANTITY PER BARREL

Oil		25,000 bbls
Gas	60,000/6	10,000 bbls
		35,000 EQB

End of the year total proved reserves:

Oil			475,000 bbls
Gas	450,000/6	=	75,000 bbls
			550,000 EQB

DD & A = (25,000,000 X 35,000)/(35,000+550,000) = N1,495,726

PRODUCTION VALUE METHOD

	N'000
Oil 25,000 bbls x N6,000	150,000
Gas 60,000 bbls x N500	30,000
	180,000

Total proved reserves current value:	N'000
Oil 475,000 bbls x N6,000	2,850,000
Gas 450,000 MCF x N500	225,000
	3,075,000

DD & A = 25,000,000 x [180,000,000/(180,000,000 + 3,075,000)]

= N24,580,090

Self assessment exercise
State the various classes in which Costs in oil and gas operations may be classified.

4.0 CONCLUSION

The peculiarity in agency/property companies' balance sheet is that freehold land held for re-sale is classified as stock under current assets. The Peculiarities in a farmer's account are mainly in the valuation of stock of arable plantation products and livestock.

5.0 SUMMARY

This unit deals with the peculiarities associated with accounting for specialized businesses of Estate agencies and property companies, farmers; oil and gas related companies.

6.0 TUTOR MARKED ASSIGNMENT

1. State the broad classification of oil and gas upstream activities operations cost.

2. What is one approach to valuation of stock of livestock?

7.0 REFERENCES/FURTHER READING

Institute of Chartered Accountant of Nigeria, Financial Accounting, Study Pack Lagos.

International Accounting Standard Board, International Accounting Standard.

Jennings, A. R., (2001), Financial Accounting, London, Letts Educational

Jennings, A. R., (2001), Financial Accounting, Solution Manual, London, Letts Educational

Nigerian Accounting Standard Board, Statement of Accounting Standard

MODULE 1: SPECIALIZED BUSINESSES AND ACCOUNTING STANDARDS

UNIT 2: ACCOUNTING FOR SPECIALIZED BUSINESSES 2

CONTENT

1.0 INTRODUCTION

In the previous unit, we were able to discuss accounting for some of the specialized businesses such as agency/property companies, farmers, oil and gas related companies. In this unit, we shall take a step further to discuss four other specialized businesses.

2.0 OBJECTIVES

After studying this unit, you should be able to:

1. To prepare accounts relating to solicitors.
2. To prepare accounts relating to provident funds.
3. To prepare accounts relating to voyage/shipment.
4. To prepare accounts relating to cooperative societies.

3.0 MAIN CONTENT

3.1 SOLICITOR's ACCOUNT

Fiduciary relationship exists between the solicitor and his clients. Consequently, a firm of solicitors is obliged to keep separate account of client's moneys and solicitor' own money.

3.1.1 Accounting books required

The solicitor must keep the following accounting books to record the transactions on behalf of his client's and his office operations.

(a) Cashbook (2 columns: client's bank account, office bank account).
(b) Bill delivered book.
(c) Petty cash or disbursement book.
(d) Client's ledger account- (2 columns- client's a/c; office a/c).
(e) Private ledger- account not included in client's ledger.

3.1.2 Accounting entries

The following entries should be made in solicitor's books when the stated transactions take place:

(a) When money is received from the client by the solicitor.
    DR Cash Book (client)

	CR	Client ledger (client)	with amount received
(b)	Solicitor advances money or makes remittances to his client.		
	DR	Client ledger (office)	
	CR	Cash book (office)	with the amount advanced
(c)	Client pays back money advanced.		
	DR	Cash book (office)	
	CR	Client ledger (office)	with the value of money paid
(d)	Transfer is made in the client's ledgers for money advanced.		
	DR	Client ledger (client)	
	CR	Client ledger (office)	with the value of money transferred
(e)	Solicitor incurs costs on behalf of client.		
	DR	Client ledger (office)	
	CR	Private ledger (cost account)	with cost incurred
(f)	Transfer is made on cost incurred on behalf of the client in the client's ledger.		
	DR	Client ledger (client)	with the maximum amount agreed to. It can be
	CR	Client ledger (office)	transferred between client and solicitor
(g)	Money is paid on behalf of client		
	DR	Client ledger (client)	
	CR	Cash book (client)	with amount paid

ILLUSTRATION 6

Mr George, a solicitor, carried out the following transactions during the month of October 2008:
October 10: paid N60,000 to Mr James, at the request of his client, Mr Da-Silva, on account of a debt due from Mr Da-Silva to James; the client having no money in the hand of solicitor.

October 20: Mr Da-Silva pays N240,000 to the solicitor to meet the N60,000 and to discharge the balance of debt due to Mr James.

October 25: Mr James received a cheque of N150,000 from the solicitor, being the balance of the debt due from Mr Da-Silva. The solicitor charged Mr Da-Silva N6,000 as costs which are agreed by the client and remits the balance to Mr James by cheque.

Required: post the above transactions in the necessary accounts, and records as it will appear in the books of Mr George.

Suggested Solution 6

CASHBOOK

Date	Particulars	office a/c	client a/c	Date	Particulars	Office a/c	client a/c
		N	N			N	N
20/10	Da-Silva		240,000	10/10	Da-Silva advance	60,000	
20/10	Da-Silva Trans	60,000		20/10	Da-Silva (transfer)		60,000
25/10	Da-Silva cost	6,000		25/10	Da-Silva to James		150,000
				25/10	Da-Silva – cost		6,000
				25/10	Da-Silva bal. Repd		24,000
					Bal. c/d	6,000	
		66,000	240,000			66,000	240,000
	Bal b/d	6,000					

Client's Ledger- MR. DA-SILVA

Date	Particulars	office a/c	client a/c	Date	Particulars	Office a/c	Client a/c
		N	N			N	N
10/10	Cash advance	60,000					
20/10	Cash transfer		60,000	20/10	Cash		240,000
25/10	cash to James		150,000	20/10	Cash (transfer)	60,000	
25/10	Cash – cost		6,000	25/10	Cash – cost	6,000	
25/10	Cash- bal. Repaid		24,000				
25/10	Bal. c/d	6,000					
		66,000	240,000			66,000	240,000
					Bal. c/d	6,000	

BILL DELIVERED BOOK

Date	No. Of Bill	Client	Particulars	Costs	Disbursement	Total
				N	N	N
25/10	1	Mr. Da-Silva	Various matters	6,000	-	6,000

Private Ledger Cost Account

	N		N
Bal. b/d	XX	Bill delivered	6,000
P & L A/C	6,000	Bal. c/d	XX
	6,000		6,000

SELF ASSESSMENT EXERCISE

What are the accounting books to be kept in the office of a solicitor?

3.2 PENSION/PROVIDENT FUND ACCOUNTING

3.2.1 Introduction

For detailed background and theoretical knowledge of pension and provident fund, you are advised to study Statement of Accounting Standards- SAS No. 8- Accounting for Employee's Retirement Benefits and Pension Reforms Act, 2004.

SAS 8 is effective 1991, consequently, all the accounting applications here are based on SAS No. 8, which requires a complete review to give effect to the provisions of the newly promulgated Pension Reforms Act (2004).

Companies and organizations operating pension or provident fund are obliged to appoint a Board of Trustees for the purpose of managing the fund. The accounting records expected to be kept are as follows:

In the Company's Books

1. Pension expenses account
2. Bank Account
3. Profit and loss account

In the Trustee's Book

1. Pension Fund Account
2. Bank Account
3. Investment Account
4. Revenue Account
5. Balance Sheet

3.2.2 Accounting Entries

In the Company's Books

(a) Dr P&L a/c

In the Trustee's Books

(a) Dr Bank a/c

Cr Pension Expenses a/c	Cr Pension fund a/c
With employer's contribution to pension fund	with money received from the company
(b) Dr Salaries & wages	(b) Dr Bank a/c
Cr Pension expenses a/c	Cr Pension fund a/c
With employees' contribution to pension fund	with contribution from employees & employers
(c) Dr Pension expenses a/c	(c) Dr Investment a/c (capital column)
Cr Bank a/c	Cr Bank a/c
With the money paid to the Pension Trustee	with purchase price of investment
(d)	(d) Dr Investment a/c
	Cr Pension fund a/c
	With total investment income
	(e) Dr Pension fund a/c
	Cr Bank a/c
	With total expenses incurred
	(f) Dr Bank a/c
	Cr investment a/c
	With interest/dividend received
	(g) Dr Pension fund a/c
	Cr Bank a/c
	With amount paid to pensioners

ILLUSTRATION 7

The Board of Directors of Daisy Ltd decided on 30 April, 7, to introduce a contributory pension scheme for its staff. The staff pension fund was constructed by a Trust Deed which provided for the payment of pensions from 1 July, 2007.

The following contributions are to be paid to the fund:

(a) 10% of staff monthly salaries are to be deducted and paid to the trustees every month.
(b) The company's contribution to the Trust Fund are:
(i). Five annual instalments of N400,000 per annum to cover the pension liability in respect of past services, the first instalments to be paid on July 1, 2007.
(ii) A sum equal to thrice the members' contributions are to be made at the same time members' contributions are paid over.

The Trustees received the first contribution from the company in respect of past services on 1 July, 2007. Members' contribution amounting to N60,000 for six months ended December 31, 2007, were received together with the monthly contributions due from the company as at when due. Trustees purchased the following investments.

Interest days

(a) 2 July 2007 4% N60,000 Ebonyi State Stock @ 88 Cum div 1 June & 1Dec
(b) 2 July 2007 3% N60,000 Lagos State Stock @ 69 Ex div 1 July & 1 Dec
(c) 3 Sept 2007 3% N60,000 Nasarawa State Stock @ 77 Cum div 1 April & Oct 1

The following payments were made:

Stamp duty and brokerage on investments (a) N1,560; (b) N1,260; (c) N540. The trustees resolved to make the appropriate interest apportionment on all investments held and to accrue for interest due. The trustees paid pension of N50,000 and incurred sundry expenses of N4,000 during the six months period ended December 31, 2007.

Required:

i. Write up investment accounts as they will appear in the Trustee's books.

ii. Prepare pension fund account for the six months ended 31 December 2007 and a balance sheet as at that date.

SUGGESTED SOLUTION 7

(1) INVESTMENT- 4% Ebonyi State Govt. stock

	Nom	Income	Capital		Nom	Income	Capital
	N	N	N		N	N	N
2/7/03 Bank purchases	60,000	**200**	**54,160**	1/12/03 Bank interest		1,200	
1/11/03 Pension/rev		1,200		31/12/03 Bal c/d	60,000	200	54,160
	60,000	1,400	54,160		60,000	1,400	54,160
Bal. b/d	60,000	200	54,160				

Workings:

N60,000 x 88 cum div. = 60,000 x 88/100 = 53,800 + 1,560(stamp duties & brokerage)

= N54,360 less N200(income) = **54,160**

4/100 x 60,000 x 1/12 =**N200**

INVESTMENT- 3% Lagos State Government Stock

	Nom	Income	Capital		Nom	Income	Capital
	N	N	N		N	N	N
2/7/03 Bank purchases	60,000		42,660				
2/7/03 Adj. Ex-div			150	2/7/03 Adj. Ex-div		150	
2/7/03 Pension/rev		900		31/12/03 Bal. c/d	60,000	750	42,810
	60,000	900	42,810		60,000	900	42,810
1/1/04 Bal. b/d	60,000	750	42,810				

Workings:

N60,000 @69 cum div. = 60,000 x 69/100 = N41,400 + 1,260(stamp duties & brokerage)

= N42,660

INVESTMENT – 3% Nasarawa State Government Stock

	Nom	Income	Capital		Nom	Income	Capital
	N	N	N		N	N	N
3/9/03 Bank Purchases	20,000	250	15,690	1/10/03 Bank Interest		300	
Pension/rev		200		31/12/03 Bal. c/d	20,000	150	15,690
	20,000	450	15,690		20,000	450	15,690
1/1/04 Bal. b/d	20,000	150	15,690				

Workings:

N20,000 @ 77 cum div. = 20,000 x 77/100 = 15,400 + 540 = 15,940 less N250 (Income)

20,000 x 2/100 x 2/12 = N250

Bank A/c

		N		N
1/7/03	Pension Fund	400,000	Investment- 4% Ebonyi	54,360
31/12/03	Pension Fund- Employees	60,000	- 3% Lagos	42,660
	Employers	180,000	- 3% Nasarawa	15,940
	Investment Income – 4% Ebonyi	1,200	Pension Fund – Expenses	4,000
	3% Nasarawa	300	Pension Paid	50,000
			Bal. c/d	474,540
		641,500		641,500
	Bal. b/d	474,540		

Pension Sheet as at 31 December, 2007

			N
Long term investments - 4% Ebonyi Stock			54,160
3% Lagos stock	42,810		
3% Nasarawa Stock	15,690		
	112,660		
Accrued interest			1,100
Bank balance			474,540
		588,300	
			588,300
Financed by:			
Pension Fund			588,300

Self assessment exercise

What is the accounting records expected to be kept by companies or organizations operating pension?

3.3 VOYAGE/SHIPPING ACCOUNTS

3.3.1 Introduction

Shipping companies are expected to maintain a separate voyage account for each vessel to ascertain profit/loss account of a trading concern.

All expenses relating to a voyage (for example, stores, wages, insurance, commission brokerage, fuel and repairs) are debited to the voyage account. All earnings, passage money, freight and mail money (if any) are credited to voyage account. The balance on the voyage account represents the profit or loss made on the voyage and is transferred to the general profit and loss account.

ILLUSTRATION 8

SS Olokun was chartered on 1 March 2008, by Ocean View Shipping Agency Ltd from Awaye Lines Limited. It sets on a voyage on that date as follows:

Accra to Apapa with general cargo at N2,300 per ton. The charter stipulates for an address commission to the chatterers of 2% on freight, payable on signing the bill of lading together with a brokerage of 5% to the charters' agents, of which, one fifth is repayable to the vessel.

Conakry to Port Harcourt is at N1,700 per ton. Address commission of 2% on freight payable to charterers and brokerage of one-third of 5% payable to charters' agent on signing charter. The vessel was insured by Cornerstone Insurance Plc on 1 January 2008, for one year at N3 million and managing owner's Articles of Association fixed remuneration at 1.5% of gross freight charges.

The following are relevant extracts from the shipping company's account:

Freight of 15,000 tons of rice to Apapa and 17,500 tons of rubber to Port Harcourt:

	N
Wages for the year	9,600,000
Wharfage at Port-Harcourt	1,750,000
Captain disbursement- Port-Harcourt	325,000
Wharfage at Apapa	320,000
Agents' disbursements – Apapa	75,000
Captain's disbursements – Apapa	150,000
Stores Account	560,000
Port charges, etc. Accra	1,350,000
Captain's Accounts for Labour wages	750,000
Fuel	711,000
Stevedores at Conakry	420,000
Provisions at Conakry	164,000
Repairs on voyage	125,000
Captain's expenses- Conakry	100,000
Agents' Account for Port charges exclusive of	
Address commission & brokerage	175,000

The voyage terminated on 30 November 2008. You are required to prepare a voyage account (provide expenses to the nearest month).

SUGGESTED SOLUTION 8

OCEANIC VIEW SHIPPING AGENCY LTD
VOYAGE ACCOUNT FOR THE PERIOD 1/3/04 TO 30/11/04

	N	N
Outward (Accra to Apapa) 15,000 x 2,300		34,500,000
Inward (Conakry to Port-Harcourt) 17,500 x 1,700		<u>29,750,000</u>

		64,250,000
Stores	560,000	
Port charges	1,350,000	
Captain accounts	750,000	
Fuel	711,000	
Stevedores	420,000	
Provisions to Conakry	164,000	
Repairs	125,000	
Captains expenses (Conakry)	100,000	
Agents account	175,000	
Wages (9/12 x N9,600,000)	7,200,000	
Wharfage (Port-Harcourt)	1,750,000	
Captains (Port-Harcourt)	325,000	
Wharfage (Apapa)	320,000	
Agents etc.	75,000	
Insurance (9/12 x N3,000,000)	2,250,000	
Captains- Apapa	150,000	
Outward- brokerage 5% x N34,500,000 x 4/5	1,380,000	
- Commission 2% x N34,500,000	690,000	
Inward - brokerage 5% x N29,750,000 x 1/3	495,833	
- Commission 2% x N29,750,000	595,000	
Managing owner 1.5% x N64,250,000	963,750	
		(20,549,583)
Profit on the voyage		43,700,417

Self assessment exercise

Solve the question in the illustration without looking at the solution and compare your result to the solution in the illustration.

3.4 ACCOUNTS OF COOPERATIVE SOCIETIES

3.4.1 Introduction

Groups of individuals in employment, trade, commerce or industry, come together to form a co-operative society with a view to investing their resources for the benefits of the members.

The society is guided by its constitution and by-laws and must be registered with the Director of Co-operative Societies of the State of its operations.

The Funds of a cooperative society are usually generated from the contributions from members through direct monthly contributions and agreed deductions from members' salaries, in case of employees. The fund is then lent to its members for a stated purpose at an interest rate that is usually below the market rate.

Contributions from members could be in form of subscriptions to the society's share capital, members' savings or education fund.

The Society's funds are invested in shares of limited liability companies, short-term deposits, or commodities for sale to its members, to generate income for the society.

ILLUSTRATION 9

ONITSHA CO-OPERATIVE THRIFT AND CREDIT SOCIETY LIMITED
TRIAL BALANCE AS AT 31 DECEMBER 2008 IS AS FOLLOWS:

	DR	CR
	N	N
Fixed assets (net of depreciation)	196,770	
Stocks of recharge cards	168,045	
Investment- short-term deposits	4,382,510	
Quoted 721,145		
Members' indebtedness: loans	19,018,339	
Others	1,618,326	
Bank and cash balances	601,962	
Accrued expenses		403,500
Share capital		657,559
Share premium		101,524
Members' savings		23,045,316
Reserve fund		1,087,710
Education fund		184,182
Interest income:		
On members' fund		1,448,402
On investment		817,719
Profit on sale of commodities		463,930
Entrance fees		3,000
Loan forms and processing fees		51,000
Sundry income		1,013
Staff salaries and expenses	259,610	
Transport expenses	35,975	
Telephone expenses	3,320	
Committee meeting expenses	79,900	
Printing and stationery	39,425	
Bank charges and commissions	232,625	
General repairs and maintenance	31,290	

Audit fees	20,000	
Executive committee honoraria	103,500	
AGM expenses	280,000	
Depreciation charge	6,583	
Transfer to reserve fund	423,209	
Transfer to education fund	42,321	
	28,264,855	28,264,855

After appropriation to reserve and education fund, the Executive Committee proposed to pay #1,227,000 as dividends to members and transfer the balance to general reserve.

Required:

Prepare the Society' reserve account for the year ended 31 December, 2008 and a balance sheet as at that date.

SUGGESTED SOLUTION 9

ONITSHA CO-OPERATIVE TRIFT AND CREDIT SOCIETY LIMITED
REVENUE ACCOUNT FOR THE YEAR ENDED 31 DECEMBER 2008 INCOME

	#	#
Interest on members' loans		1,448,402
Investment income		817,719
Profit on sale of commodities		463,930
Entrance fees		3,000
Loans forms and processing fees		51,000
Sundry income		1,013
TOTAL INCOME		2,785,064
CHARGES:		
Staff salaries and expenses	259,610	
Transport expenses	35,975	
Telephone	3,320	
Committee meeting expenses	79,900	
Printing and stationery	39,425	
Bank charges and commissions	232,625	
General repairs and maintenance	31,290	
Audit fees	20,000	
Executive committee honoraria	103,500	
AGM Expenses	280,000	
Depreciation	6,583	
TOTAL CHARGES		(1,092,228)
SURPLUS FOR THE YEAR		1,692,836
APPROPRIATIONS:		
Transfer to reserve fund	423,209	
Transfer to education fund	42,321	
Proposed dividend	1,227,000	
		1,692,530
Balance transferred to general reserve		306

ONITSHA CO-OPERATIVE TRIFT AND CREDIT SOCIETY LIMITED
BALANCE SHEET AS AT 31 DECEMBER 2008

ASSETS	#	#
Fixed assets		196,770

Investments - short-term deposits		4,382,510	
Quoted shares	721,145	5,103,655	
Stocks of recharge cards			168,045
Members indebtedness- on loans		19,018,339	
Others	1,618,326	20,636,665	
Bank and cash balances			601,962
TOTAL ASSETS			26,707,097
LIABILITIES AND FUNDS:			
Current liabilities:			
Accrued expenses		403,500	
Proposed dividend		1,227,000	
			1,630,500
Members' funds:			
Share capital		657,559	
Share premium		101,524	
Members savings		23,045,316	
Reserves fund		1,087,710	
Education fund		184,182	
General reserve		306	
TOTAL FUNDS			25,076,597
TOTAL LIABILITIES AND FUNDS			26,707,097

SELF ASSESSMENT EXERCISE

How is the fund of a cooperative generated?

4.0 CONCLUSION

In this unit, the conclusion is that the officers of the society are obliged to prepare and lay before its members, the audited financial statements of the society at a properly convened Annual General Meeting at which issues relating to the activities of the society in the year under review and dividends payable to members are discussed. The account prepared by the society must include a balance sheet and a revenue account with relevant notes on the accounts.

5.0 SUMMARY

This unit deals with the peculiarities associated with accounting for specialised business of solicitor's account, provident fund accounting, voyage/shipping accounts and accounts of cooperative societies.

6.0 TUTOR MARKED ASSIGNMENT

1. State one accounting record that a solicitor is expected to maintain in respect of clients' monies.
2. State one account that should be maintained by the Board of Trustees of a Pension or Provident Fund.
3. State one guiding principle of a Co-operative Society.

7.0 REFERENCES/FURTHER READING

Aborode, R. (2004), A Practical Approach to Advanced Financial Accounting, Lagos, El-TODA Venture Ltd

Igben, R. O., (2004), Financial Accounting made Simple, Lagos, El-TODA Ventures Ltd, Volume 2.

Institute of Chartered Accountants of Nigeria, Financial Accounting, Study Pack, Lagos.

MODULE 1: SPECIALIZED BUSINESSES AND ACCOUNTING STANDARDS

UNIT 3: GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (GAAP)

CONTENT

1.0 INTRODUCTION

In this unit, you will learn of the Generally Accepted Accounting Principles (GAAP) as the conventions, rules, procedures and broad guidelines adopted in the preparation and presentation of financial statements in a given jurisdiction, e.g. Nigeria.

GAAP include broad ideas of measurement and classifications, as well as detailed rules and procedures used by accountants in preparing and presenting accounting reports. The rules followed by accountants in the preparation of financial statements are contained in the accounting standards issued by the standard-setting body in a given jurisdiction. In Nigeria, such standards are issued by the Nigeria Accounting Standards Board (NASB).

2.0 OBJECTIVES

After studying this unit, you should be able to:

1. Explain the meaning and purpose of GAAP.
2. State the sources of GAAP in Nigeria.
3. Discuss what constitutes International GAAP.
4. Explain the basic accounting principles and concepts in Nigeria GAAP.

3.0 MAIN CONTENT

3.1 PURPOSE OF GAAP

Adherence to generally accepted accounting principles serves five important purposes. These are:

(a) It increases the ability of users of financial statements to understand the accounting reports issued by different reporting entities.

(b) It provides reasonable degree of comparison between financial reports presented by entities since they adopt a standard framework of guidelines.

(c) It increases the confidence of investors, markets, and indeed the general public, that the financial statements issued by a reporting entity, faithfully represents its transactions.

(d) Preparers of financial statements have a set of guidelines which can be readily referred to in accounting and reporting their financial transactions.
(e) External auditors need GAAP to guide them in reporting on the truth and fairness or otherwise of the financial transactions of different entities.

SELF ASSESSMENT EXERCISE
What are the purposes of GAAP?

3.2 SOURCES OF GAAP IN NIGERIA
The sources of GAAP in Nigeria include:
(a) Companies and Allied Matters Act, CAP 20, LFN 2004.
(b) Insurance Act, 2003
(c) Banks and Other Financial Institutions Act 1991.
(d) National Insurance Commission Act 2003.
(e) Prudential guidelines issued by the Central Bank of Nigeria.
(f) Security and Exchange Commission and Stock Exchange rules and regulations.
(g) Accounting Standards issued by the Nigerian Accounting Standard Board (NASB).
(h) Accounting Standards issued by the International Accounting Standards Board constitute a secondary source of GAAP in Nigeria.
(i) Pension Reforms Act, 2004

SELF ASSESMENT EXERCISE
List the sources of GAAP in Nigeria.

3.3 INTERNATIONAL GAAP
In the previous sections of this chapter, we have interpreted GAAP as generally accepted accounting principles. GAAP could also be interpreted as generally accepted accounting practice. Some authors have argued that the term "principle" gives GAAP an unjustified measure of permanent since the concept changes in response to new developments in the business and economic environment.

The word "practice" perhaps better reflects the fact that accounting practice alters in response to changes in different social-economic environments, GAAP, therefore, goes beyond mere principles as they encompass contemporary accounting practices that are permissible within an accounting environment. By extension, international GAAP encompasses contemporary accounting practices that are "regarded as permissible by the accounting profession and regulators internationally" (Bonham, et al 2008).

The Accounting Standards issued by the International Accounting Standards Board (IASB) constitute the source of international GAAP.

SELF ASSESSMENT EXERCISE
What is the source of International GAAP?

3.4 FACTORS THAT DETERMINE THE ACCEPTABILITY OF AN ACCOUNTING PRACTICE

The following factors, outlined by Bonham et al (2008), members of Ernst & Young Global, provide useful guide in determining whether an accounting practice should be acceptable in a country's GAAP, as well as international GAAP.

(a) Is the practice addressed in accounting standards or other official pronouncement?
(b) Is the practice addressed in accounting standards that deal with similar and related issues?
(c) If the practice is not addressed in accounting standards, is it dealt with in the standards of another country that could reasonably be considered to offer authoritative guidance?
(d) Is the practice consistent with the needs of users and the objectives of financial reporting?
(e) Does the practice have authoritative support in the accounting literature?
(f) Is the practice consistent with the underlying conceptual framework document?
(g) Does the practice meet basic criteria as to the quality of information required for financial statements to be useful to users?
(h) Does the practice fairly reflect the economic substance of the transaction involved?
(i) Is the practice consistent with the fundamental concept of 'fair presentation?'
(j) Are other companies in similar situation generally applying the practice?

SELF ASSESSMENT EXERCISE
State the factors that determine the acceptability of an accounting practice.

3.5 ACCOUNTING CONCEPTS
These are generally accepted principles used in the preparation of financial statements and are rarely disclosed because of their general acceptability. They are:

(a) Entity concept: This principle assumes that a company or corporation is a separate entity on its own; it can sue and be sued in a court of law.
(b) Going concern: The concept assumes that an organization will continue to operate for the foreseeable future. The balance sheet and profit and loss account assume no intention to liquidate or curtail its scale of operations.
(c) Realization concept: This concept recognizes revenue as soon as it is capable of objective measurement and the value of asset is reasonably certain.
(d) Matching concept: Under this concept, revenue or income and costs in a period are matched and dealt with in the profit and loss account of the period they relate.
(e) Double entry principle/concept: This concept assumes that every transaction should have two entries. In other words, where there is a debit entry, there has to be a corresponding credit entry for proper accountability.
(f) Consistency concept: This means that every like item within each accounting period should be treated the same way. This allows for easy comparison of accounts of an entity over a period of time.
(g) Prudence concept: This assumes that income is actually realized, not estimated. That is, revenue and profit should not be anticipated but recognized only when realized in cash or other assets. Prudence and realization concepts, are basic concepts in determining profit made.
(h) Periodicity: This concept assumes that transactions should be separated into particular periods for easy matching of revenue with expenses.

(i) Historical cost: This assumes that items should be stated at their original cost of purchase rather than realisable value.

SELF ASSESSMENT EXERCISE
Mention and briefly explain five accounting concepts.

3.6 ACCOUNTING METHOD AND POLICY
Accounting Method
This is the medium through which accounting concepts are applied to financial transactions in the preparation of financial statements.

The methods adopted and applied by an organization in applying the fundamental accounting principles to its financial transactions are called the Accounting Bases. There are two bases used in the preparation of financial statements. They are

(a) The accrual basis ;
(b) The cash basis

Accounting Policy
Every organization or corporation has a policy used in the preparation of its accounts. Accounting policies are, therefore, the basic rules, principles, conventions and procedures adopted in the preparation and presentation of financial statements.

Disclosure of Accounting Policies
Accounting policies adopted by an organization or corporation in the preparation and presentation of financial statements are disclosed under one heading to provide an overview.

Use of Accounting Policies
Policies adopted by an organization are based on personal judgement and the suitability of presenting a true and fair view of the result of an organization. Therefore, there is a need for management to be careful and rational in their choice of accounting policies.

There are principles that should be used as a guide. These are:
(a) Substance over form: This principle states that generally the legal form of every transaction is a basis for recording its commercial status in the books of accounts, but there are instances whereby the legal status differs from the commercial status. In such instances, the commercial status shall be recognized rather than the legal form. For example, in a finance lease agreement, the commercial status is recognized by including the assets acquired as part of the fixed assets of the lessee, despite the fact that legal title remains with the lessor.
(b) Objectivity: This principle states that an accountant should be fair and unbiased in the process of recording, collating, summarizing, analysing and interpreting financial transactions. This implies that accountants should be fair to all users of financial information and also treat transactions without emotion.
(c) Materiality: The principle holds that only items of material values are accorded strict accounting treatment: that is, items with significant values.
(d) Prudence: Revenue and profits are not to be anticipated but recognized only when realized while known losses should be adequately provided for.

(e) Fairness: this is a product of the objectivity principle. It emphasizes the need for accountants not to be influenced by any user, but to prepare accounts based on acceptable principles.

Where fundamental accounting concepts are followed in the preparation of accounts, disclosure of such concepts is not necessary unless there is a departure from the fundamental accounting concepts.

However, when selecting accounting policies, rational judgement should be used: thus, the principles of substance over form, objectivity, fairness, and materiality can conveniently allow prudence to govern.

A reporting enterprise should disclose the basis used in the preparation of accounts if it is significant for the understanding and interpretation of a financial statement. The policies should also be disclosed as an integral part of the financial statements.

Accounting policies should be used consistently to facilitate comparison except where a different policy will better enhance or reflect net profit or loss of current or subsequent periods.

When there is a change in accounting policy, the nature, justification and the effect on current year's profit or loss should be disclosed. Also, cumulative effect of the change on profit or loss of prior periods should be adjusted in the retained earnings.

ILLUSTRATION OF ACCOUNTING POLICIES

Basis of Accounting

Financial statements are prepared under the historical cost convention, except for some fixed assets which are included at their professional valuation.

Consolidation

Group profit and loss account and balance sheet include the accounts of the company and all the subsidiaries and the company's share of profit after tax, less losses of associated companies.

Goodwill

Any excess of the cost of acquisition over the fair values of the net assets is recognised as an asset in the balance sheet as goodwill arising on acquisition.

Investments

Investments in subsidiary and associated companies are stated at the lower of cost or the company's share of their net tangible asset value at the year end.

Fixed Assets

Land and buildings are stated at their professional valuation plus additions at cost. Other fixed assets are stated at cost.

Depreciation

Depreciation on a fixed asset is calculated to write-off the cost or valuation on a straight line basis over its expected useful life.

Stock and Work-In-Progress

Stocks are stated at the lower of cost and net realizable value after making adequate provision for obsolescence and damaged items. In the case of goods manufactured by the company, cost consists of direct labour, material and appropriate proportion of factory overhead.

Turnover

Turnover represents the net value of goods and service invoiced or sold to third party, net of value added tax (VAT).

Contract in Progress

These are stated at the values of independence engineers' certificate for work done but in respect of which payments were not received at the year end, plus estimated values made by officials of the company of the realizable value of work done not yet certified.

Foreign Currency Conversion

Transactions in foreign currencies are converted into naira at the prevailing rate ruling at the date the relevant invoices are received, while assets and liabilities denominated in foreign currencies are translated at the prevailing rate ruling on the balance sheet date.

Deferred Taxation

Provision is made for deferred taxation by the liability method to take account of all timing differences between accounting treatment of certain items and their corresponding treatment for income tax purposes.

SELF ASSESSMENT EXERCISE

What are the two bases used in preparing financial statements?

4.0 CONCLUSION

There are many alternative postulates, assumptions, principles and methods that could be used in preparing the financial statements of a reporting entity. These alternative methods impact on the financial position and operational results of corporate entities differently. To ensure a degree of comparison of financial reports, there should be minimum uniform standards and guidelines of financial accounting that different entities have to follow in financial reporting. These standards are referred to as Generally Accepted Accounting Principles (GAAP).

5.0 SUMMARY

This unit has explained the meaning and sources of GAAP in Nigeria and globally. It also looked at the purpose of GAAP and the basic accounting concepts used in Nigeria.

6.0 TUTOR MARKED ASSIGNMENT

1. In accounting, there are generally accepted accounting principles. Identify one of such principles.
2. Define accounting policies.
3. State one accounting concept.
4. Accounting policies used in an organization depends on personal judgment. State the concept that should be used as guide when selecting accounting policies.
5. What is the main advantage of historical cost concept?

7.0 REFERENCES/FURTHER READING

Institute of Chartered Accountant of Nigeria, Financial Accounting, Study Pack Lagos.

International Accounting Standard Board, International Accounting Standard.

Jennings, A. R., (2001), Financial Accounting, London, Letts Educational

Jennings, A. R., (2001), Financial Accounting, Solution Manual, London, Letts Educational

Nigerian Accounting Standard Board, Statement of Accounting Standard

MODULE 1: SPECIALIZED BUSINESSES AND ACCOUNTING STANDARDS

UNIT 4: DEVELOPMENT OF ACCOUNTING STANDARDS

CONTENT

1.0 INTRODUCTION

In order to make any society work there must be order in that society. That order might not be self evolving. The people of that society must have to put that order in place so that everyone could follow it in achieving the goal of that society. Similarly, in any profession, there are bodies set up to ensure that members of that profession carrying out their professional activities according to stated rules and guide. These rules or standards are the deliberate effort by some to ensure that everyone in practising such profession is doing it according to laid down rules and standards. In this unit, let us discuss the body responsible locally for ensuring the development of accounting rules and standards in Nigeria.

2.0 OBJECTIVES

After studying this unit, you should be able to:

1. Describe the brief history of the Nigerian Accounting Standards Board.
2. State the reasons for establishing the NASB.
3. State the composition of the governing Council of the NASB.
4. State the functions of the NASB.
5. Outline the powers of the NASB.
6. Describe the stages of the NASB Due Process

3.0 MAIN CONTENT

3.1 BRIEF HISTORY OF THE NIGERIAN ACCOUNTING STANDARDS BOARD

The Nigerian Accounting Standards Board (NASB) was establish in September, 1982 with the responsibility of developing accounting standards to be observed in the preparation and presentation of financial statements in Nigeria. Its first legal authority was the provision of section 335(1) of the Companies and Allied Matters Act, 1990, which requires that financial statements prepared in Nigeria shall comply with the "Statement of Accounting Standards" issued by the Nigerian Accounting Standards Board. Currently, the full legal authority of the NASB is provided by the Nigerian Accounting Standards Board Act, 2003 which contains a wide range of provisions on the establishment, finances and powers of the Board.

SELF ASSESSMENT EXERCISE
Describe a brief history of the Nigerian Accounting Standard Board.

3.2 REASONS FOR ESTABLISHING THE NASB
The reasons for setting up the NASB, as explained by Godson Nnadi, its chief executive are to:

(i) Narrow the areas of differences in practices so that financial statements that are presented to users are structurally uniform and meaningful;

(ii) Produce accounting information that reflect Nigeria's economic environment while at the same time satisfying the anticipated needs of users of the information; and

(iii) Introduce measures which will enhance the reliability and velocity of information reported in financial statements.

SELF ASSESSMENT EXERCISE
State the reasons for setting up the Nigerian Accounting Standard Board.

3.3 COMPOSITION OF THE GOVERNING COUNCIL OF THE NASB
Under section 2 of the NASB Act 2003, the Governing Council of the NASB shall consist of the following:

(a) A chairman who shall be a professional accountant with considerable professional experience in accounting practices.

(b) Two representatives each of the following

  (i) Institute of Chartered Accountants of Nigeria, and

  (ii) Association of National Accountants of Nigeria

(c) A representative each of the following:

  (i) Federal Ministry of Commerce
  (ii) Federal Ministry of Finance
  (iii) Central Bank of Nigeria
  (iv) Corporate Affairs Commission
  (v) Federal Inland Revenue Service
  (vi) Nigeria Deposit Insurance Corporation
  (vii) Securities and Exchange Commission
  (viii) Auditor-General for the Federation
  (ix) Accountant-General of the Federation
  (x) Chartered Institute of Taxation of Nigeria
  (xi) Nigeria Accounting Teachers Association; and
  (xii) Nigeria Association of Chambers of Commerce, Industries, Mines and Agriculture

(d) The executive Secretary of the Board

SELF ASSESSMENT EXERCISE
State the composition of the governing Council of the Nigerian Accounting Standard Board.

3.4 FUNCTIONS OF THE BOARD

Section 6 of the NASB Act 2003, requires the Board to perform the following functions:

(a) Develop and publish in the public interest, accounting standards to be observed in the preparation of financial statements.
(b) Promote the general acceptance and adoption of such standards by the preparers and users of financial statements.
(c) Promote and enforce compliance with the accounting standards developed or reviewed by the Board.
(d) Review from time to time notices of non-compliance with its standards from the preparer, user or auditor of accounts.
(e) Receive from time to time, the accounting standards developed in line with the prevalent social, economic and political environment.
(f) Receive copies of all qualified audit reports together with detailed explanations for such qualifications from the auditors of the accounts within a period of sixty days from the date of such qualification.
(g) Advise the supervising Minister on the making of regulations under Section 356 of CAMA 2004.
(h) Advise the Federal Government on matters relating to accounting standards.
(i) Perform such other duties which in the opinion of the Council are necessary or expedient to ensure the efficient performance of the functions of the Board under the Act.

SELF ASSESSMENT EXERCISE

Outline the functions of the Nigerian Accounting Standard Board.

3.5 POWERS OF THE BOARD

Section 7 of the Act empowers the Board to:

(a) Identify accounting issues which require standardization and establish the order of priority for addressing them.
(b) Determine the scope and objectives of each standard.
(c) Prescribe the methods and procedure for the production of standards.
(d) Prescribe the time table for the production of each standard.
(e) Approve discussion papers, exposure drafts and standards.
(f) Enforce and approve enforcement of compliance with accounting standards in Nigeria.
(g) Exercise such powers as are necessary or expedient for giving effect to the provisions of the Act.

SELF ASSESSMENT EXERCISE

What are the powers of the Board?

3.6 NASB DUE PROCESS

The development of a new and proposed accounting standard involves a long process which ensures that all interested parties are given the opportunity to express their views. This standard setting process is called Due Process and it can take more than two years in some cases. The stages involved in the production of a ***Statement of Accounting Standard*** (SAS) are outlined below:

(a) The first stage in the development of an accounting standard is the ***selection of a topic*** for standardization. Such topic can be suggested by any individual or organization.

(b) The next stage is the selection of a ***steering committee*** of experts, comprising mainly of lending authorities in that area. This committee usually includes an accountant in practice, representative of the affected industry, representative of the Federal Inland Revenue Service Board, and academia, and at least one person representing the business community who may be affected by the proposed standard (Nnadi, 2006).

(c) The Steering Committee directs the NASB secretariat in drafting or (re-drafting) of the ***point outline*** which details the aspects of the topic to be covered.

(d) When the steering is satisfied with the points outlined, it is submitted to the Council for approval.

(e) Upon the approval of the points outlined by the Council, the steering committee directs the Secretariat in the preparation of a ***draft exposure draft***. After consideration of the draft exposure draft by the steering committee, it is recommended to the Council for approval as exposure draft.

(f) The Council usually meets for two working days to meticulously examine the exposure draft submitted to it. If two-thirds of the members present at the technical session vote in favour of its publication, then the document becomes an ***exposure draft***.

(g) Each Exposure Draft is exposed for about three months. During this period, recipients of the document are expected to comment in writing and the NASB may conduct a ***public hearing*** where necessary.

(h) Based on comments received from the public, the Exposure Draft may be amended. If an amended exposure draft is approved by three-quarters of council members present at its meetings, it becomes an ***accounting standard***.

SELF ASSESSMENT EXERCISE

Describe the stages involved in the development of statement of accounting standard.

4.0 CONCLUSION

It is important you know that the Nigerian Accounting Standards Board being a local accounting body in Nigeria also relates with the trend of accounting development at the international environment, thereby making local conceptualization of accounting procedures to be in conformity with international accounting standards. We shall be discussing the International Accounting Standards Board in the next unit.

5.0 SUMMARY

In this unit, we discussed a brief history of the Nigerian Accounting Standards Board and state the reasons for establishing the Board. In addition, other issues, such as composition of the governing council of the NASB, functions of the Board, powers of the Board, and the NASB due process were discussed.

6.0 Tutor Marked Assignment

1. State one member of the Nigerian Accounting Standards Board
2. What legislation empowers the NASB to enforce the compliance with any Statement of Accounting Standard?
3. One argument in favour of Statements of Accounting Standards is that they conform with existing ________ and ________ requirements.
4. The Nigerian Accounting Standards Board was established in year _______

7.0 REFERENCES/FURTHER READING

Institute of Chartered Accountant of Nigeria, Financial Accounting, Study Pack Lagos.

International Accounting Standard Board, International Accounting Standard.

Jennings, A. R., (2001), Financial Accounting, London, Letts Educational

Jennings, A. R., (2001), Financial Accounting, Solution Manual, London, Letts Educational

Nigerian Accounting Standard Board, Statement of Accounting Standard

MODULE 1: SPECIALIZED BUSINESSES AND ACCOUNTING STANDARDS

UNIT 5: THE INTERNATIONAL ACCOUNTING STANDARDS BOARD (IASB)

CONTENT

1.0 INTRODUCTION

In previous the unit, we discussed issues concerning the Nigeria Accounting Standards Board. A step further is to discuss the international Accounting Standards Board. The International Accounting Standard board is set up in order to facilitate the harmonization of accounting standards all over the world. This provides a platform for local accounting systems to relate with global interests in accounting practice.

2.0 OBJECTIVES

After studying this unit, you should be able to:

1. Describe a brief history that led to the establishment of the IASB.
2. State the objectives of the IASB.
3. State the features of the IASB structure.
4. Outline the stages of the IASB due process.
5. Outline some of the argument for and against accounting standards generally.

3.0 MAIN CONTENT

3.1 BRIEF HISTORY OF THE INTERNATIONAL ACCOUNTING STANDARDS BOARD

In 1973, the International Accounting Standards Committee (IASC) was established to develop and issue accounting standards that should guide the preparation and presentation of financial statements, globally. The IAS was in existence until 2001 by which time it had issued forty-one International Accounting Standards (IASs). Because of differences in interpreting the accounting standards issued by the IASC, a new body called ***Standard Interpretation Committee*** (SIC) was established by the IASC in 1997. As at 2001, the SIC had issued 32 interpretations, some of which are still applicable to financial statements issued today.

In 2001, there were fundamental changes in the global standard setting body which resulted in the establishment of a new body called International Accounting Standards Board (IASB), to take over the responsibilities of the IASC with effect from 1st April, 2001. The IASB now issues International

Financial Reporting Standards (IFRS) in place of International Accounting Standards (IAS) issued by the IASC.

SELF ASSESSMENT EXERCISE
Describe the brief history of the International accounting Standard Board.

3.2 OBJECTIVES OF THE IASB
Article 2 of the IASB constitution sets out the objectives of the IASC foundation, as follows:

(a) To develop, in the public interest, a single set of high quality, understandable and enforceable global accounting standards that require high quality, transparent and comparable information in financial statements and other financial reporting to help participants in world' capital markets and other users make economic decisions;
(b) To promote the use and rigorous application of those standards;
(c) To fulfil the objectives associated with (a) and (b) above, to take account of, as appropriate, the special needs of small and medium-sized entities and emerging economics; and
(d) To bring about convergence of national accounting standards and international financial reporting standards to high quality resolutions.

SELF ASSESSMENT EXERCISE
What are the objectives of the International Accounting Standard Committee?

3.3 STRUCTURE OF THE IASB
In accordance with Article 18 of its Constitution, "The International Accounting Standards Board is an independent, privately-funded accounting standard-setter based in London, U.K. The Board members come from nine countries and have a variety of functional backgrounds".

The IASB structure has the following main features.

(a) Trustees. The trustees are not involved in the standard process of the IASB, but have responsibility for strategic operational issues such as budgets, operational procedures of the IASB and appointment of members of the Board IFRIC and SAC.
(b) The Board. The Board consists of 12 full-time members and 2 part-time members who are appointed by the Trustees, based on their technical skills and other experience. These members are responsible for the standard setting activities of the IASB.
(c) Standards Advisory Council (SAC). The SAC provides a forum for the IASB to consult with a range of individuals and organizations affected by the IASB's work. The SAC also advises the IASB on a wide range of issues including the IASB's agenda and IASB's project priorities and time table.
(d) International Financial Reporting Interpretations Committee (IFRIC). The IFRIC assists the IASB in improving financial reporting by providing timely guidance and interpretation of international financial reporting standards.

SELF ASSESSMENT EXERCISE
What are the features of the International Accounting Standard Board?

3.4 THE IASB DUE PROCESS
As with SASs, the development of IFRSs follows a due process which comprises the following six stages, according to the IASB's Due Process Handbook.

Stage 1: Setting the agenda;

Stage 2: Project planning;

Stage 3: Development and publication of a discussion paper;

Stage 4: Development and publication of an exposure draft;

Stage 5: Development and publication of an IFRS;

Stage 6: Procedures after an IFRS is issued.

SELF ASSESSMENT EXERCISE
Outline the due process of the International Accounting Standard Board.

3.5 ARGUMENTS FOR AND AGAINST STANDARDS
Arguments for are:

(a) They give accountants and auditors some protection from those who may try to pressurize them into using improper methods and. Therefore, ensure their independence.
(b) They ensure that all stakeholders make contributions into the standard formulation and as such enriches the quality;
(c) They usually conform with international accounting standards;
(d) They usually conform with all existing law and regulation requirements; for example CAMA 2004, BOFIA 1991, Insurance Act 2003;
(e) The Standards are reviewed periodically to conform with the latest economic and social developments; and
(f) The enactment of the NASB Act, 2003, gives it power to enforce compliance with standard.

Arguments against may be discussed, as follows:

(a) They inhibit initiative as decisions have already been made;
(b) They rarely take account of peculiarities of the individual businesses, and
(c) Standards may be ‘watered-down’, due to exposure to interested parties or intended users.

SELF ASSESSMENT EXERCISE
What are the arguments against and for accounting standards?

4.0 CONCLUSION
The IASC or the accountancy profession does not have the power to enforce international agreement or to require compliance with international accounting standards. The success of IASC’s effort is dependent upon recognition and support for its work from many different interested groups acting within the limits of their own jurisdiction. Recognition of IASC’s work comes from groups such as the international bodies representing financial institutions, financial executives, trade unions, employers, stock exchanges, lawyers, securities commissions and financial analysts involved in the Board and consultative group. Others include the United Nations (UN), the Organization for Economic Cooperation and Development (OECD) and the International Federation of Accountants.

5.0 SUMMARY
In this unit, we discussed International Accounting Standards Board. We discussed issues relating to how the International Accounting Standards Board evolved. Similarly, other issues such as objectives

of the IASB, features of the IASB structure, the IASB due process, and the argument for and against accounting standards were discussed.

6.0 TUTOR MARKED ASSIGNMENT

1. In what year was the Standards Interpretations Committee established?
2. What is the first stage of the IASB due process?

7.0 REFERENCES/FURTHER READING

Institute of Chartered Accountant of Nigeria, Financial Accounting, Study Pack Lagos.

International Accounting Standard Board, International Accounting Standard.

Nigerian Accounting Standard Board, Statement of Accounting Standard

MODULE 1: SPECIALIZED BUSINESSES AND ACCOUNTING STANDARDS

UNIT 6: CONTENTS AND APPLICATION OF ACCOUNTING STANDARDS

CONTENT

1.0 INTRODUCTION

In this unit, we shall be looking at a list of Accounting Standards issued by the Nigerian Accounting Standards Board and the international Accounting Standards Committee/Board. The Statement of Accounting Standard No. 10: Banks and Non-Bank Financial Institutions (Part 1), seeks to provide a guide for accounting policies and accounting methods that should be followed by banks in the preparation and presentation of their financial statements. Such guide is necessary to ensure healthy reporting practices and reliable financial information in the banking sector.

2.0 OBJECTIVES

After studying this unit, you should be able to:

1. List the Accounting Standards issued by NASB.
2. List the Accounting standards issued by the IASB.
3. Describe Accounting Standards on banks and non-banks financial institutions as stated in SAS 10.

3.0 MAIN CONTENT

3.1 LIST OF ACCOUNTING STANDARDS ISSUED BY THE NASB

As discussed in the previous units, the Nigeria Accounting Standards Board is mandated by the NASB Act 2003, to issue Statement of Accounting Standards (SAS) from time to time, to guide accounting practice in Nigeria. The accounting standards so far issued by the NASB, as stated in the Body's Handbook for 2008/2009, are listed below.

SAS No.	Title
1	Disclosure of Accounting Policies
2	Information to be Disclosed in Financial Statements
3	Property, Plants and Equipment

4	Stocks
5	Construction Contracts
6	Extra-ordinary Items and Prior Year Adjustments
7	Foreign Currency Conversion and Translation
8	Accounting for Employees' Retirement Benefits
9	Accounting for Depreciation
10	Banks and Non-Bank Financial Institutions (Part 1)
11	Leases
12	Accounting for Deferred Taxes (superseded by SAS 19)
13	Accounting for Investments
14	Petroleum Industry: Upstream Activities
15	Banks and Non-Bank Financial Institutions (Part 2)
16	Accounting for Insurance Business
17	Petroleum Industry: Downstream Activities
18	Cash Flow Statements
19	Accounting for Taxes
20	Abridged Financial Statements
21	Earnings Per Share
22	Research and Development Cost
23	Provisions, Contingent Liabilities and Contingent Assets
24	Segment Reporting
25	Telecommunication Activities
26	Business Combinations
27	Consolidated and Separate Financial Statements
28	Investments in Associates
29	Interests in Joint Ventures
30	Interim Financial Reporting

SELF ASSESSMENT EXERCISE

Outline twenty accounting standard titles you know.

3.2 LIST OF ACCOUNTING STANDARDS ISSUED BY INTERNATIONAL ACCOUNTING STANDARDS COMMITTEE/BOARD (IASC/IASB)

International Financial Reporting Standards (IFRSs)

IFRS 1	First-time Adoption of International Financial Reporting Standards
IFRS 2	Share-based Payments
IFRS 3	Business Combinations
IFRS 4	Insurance Contracts
IFRS 5	Non-current Assets Held for Sale and Discontinued Operations
IFRS 6	Exploration for and Evaluation of Mineral Resources
IFRS 7	Financial Instruments: Disclosures
IFRS 8	Operating Segments

International Accounting Standards (IASs)

IAS 1	Presentation of Financial Statements
IAS 2	Inventories
IAS 7	Statement of Cash Flows
IAS 8	Accounting Policies, Changes in Accounting Estimates and Errors

IAS 10 Events after the Reporting Period
IAS 11 Construction Contracts
IAS 12 Income Taxes
IAS 16 Property, Plant and Equipment
IAS 17 Leases
IAS 18 Revenue
IAS 19 Employee Benefits
IAS 20 Accounting for Government Grants and Disclosure of Government Assistance
IAS 21 The Effect of Changes in Foreign Exchange Rates
IAS 23 Borrowing Costs
IAS 24 Related Party Disclosures
IAS 26 Accounting and Reporting by Retirement Benefit Plans
IAS 27 Consolidated and Separate Financial Statements
IAS 28 Investment in Associates
IAS 29 Financial Reporting in Hyperinflationary Economies
IAS 31 Interests in Joint Venture
IAS 32 Financial instruments: Presentation
IAS 33 Earnings per Share
IAS 34 Interim Financial Reporting
IAS 36 Impairment of Assets
IAS 37 Provisions, Contingent liabilities and Contingent Assets
IAS 38 Intangible Assets
IAS 39 Financial Instrument: Recognition and Measurement
IAS 40 Investment Property
IAS 41 Agriculture

Current Valid Interpretations issued by IASB, IFIC (International Financial Reporting Interpreting Committee, and SIC (Standards International Committee).

IFRIC 1 Changes in existing Decommissioning, Restoration and Similar liabilities
IFRIC 2 Members' Shares in Co-operative Entities and Similar Instruments
IFRIC 4 Determining whether an Arrangement contains a Lease
IFRIC 5 Rights to Interest Arising from Decommissioning, Restoration and Environmental Rehabilitation Funds
IFRIC 6 Liabilities arising from Participating in a Specific Market-Waste Electrical and Electronic Equipment
IFRIC 7 Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies
IFRIC 8 Scope of IFRS 2
IFRIC 9 Reassessment of Embedded Derivatives
IFRIC 10 Interim Financial Reporting and Impairment
IFRIC 11 IFRS 2- Group and Treasury Share Transactions
IFRIC 12 Service Concession Arrangements
IFRIC 13 Customer Loyalty Programmes
IFRIC 14 IAS 19- The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interactions
IFRIC 15 Agreements for the Construction of Real Estate
IFRIC 16 Hedges of a Net Investment in a Foreign Operation
IFRIC 17 Distributions of Non-Cash Assets to Owners
SIC-7 Introduction of the Euro
SIC-10 Government Assistance- No Specific Relation to Operating Activities
SIC-12 Consolidation- Special Purpose Entities
SIC-13 Jointly Controlled Entities- Non Monetary Contributions by Venturers

SIC-15	Operating Leases- Incentives
SIC-21	Income Taxes- Recovery of Re-valued Non Depreciable Assets
SIC-25	Income Taxes- changes in the Tax Status of a Entity or its shareholders
SIC-27	Evaluating the Substance of Transactions involving the legal Form of a Lease
SIC-29	Serving Concession Arrangements: Disclosures
SIC-31	Revenue- Barter Transactions involving Advertising Services
SIC-32	Intangible Assets-Web Site Costs

The IASs, IFRSs, SICs and IFRICs stated above were obtained from International Financial Reporting Standards 2009. The only official printed edition of the "Consolidated Text" of the IASB's authoritative pronouncements.

IFRSs and SASs presented simultaneously

International Financial Reporting Standards (IFRSs)	Relating Statement of Accounting Standards (SASs)
IFRS 1 First-time Adoption of International Financial Reporting Standards	None
IFRS 2 Share-based Payments	None
IFRS 3 Business Combinations	SAS 26
IFRS 4 Insurance Contracts	SAS 16
IFRS 5 Non-current Assets held for Sale and Discontinued Operations	None
IFRS 6 Exploration for and Evaluation of Mineral Resources	SAS 14
IFRS 7 Financial Instruments: Disclosures	SAS 10 and 15**
IFRS 8 Operating Segments	SAS 24
International Accounting Standards (SASs)	
IAS 1 Presentation of Financial Statements	SAS 1 and 2
IAS 2 Inventories	SAS 4
IAS 7 Statement of Cash Flows	SAS 18
IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors	SAS 6**
IAS 10 Events after the Reporting Period	None
IAS 11 Construction Contracts	SAS 5
IAS 12 Income Taxes	SAS 19
IAS 16 Property, Plant and Equipment	SAS 3
IAS 17 Leases	SAS 11
IAS 18 Revenue	None
IAS 19 Employee Benefits	SAS 8
IAS 20 Accounting for Government Grants and Disclosure of Government Assistance	None
IAS 21 The Effects of Changes in foreign Exchange Rates	SAS 7
IAS 23 Borrowing Costs	None
IAS 24 Related Party Disclosures	None
IAS 26 Accounting and Reporting by Retirement Benefit Plans	SAS 8
IAS 27 Consolidated and Separate Financial Statements	SAS 27
IAS 28 Investment in Associates	SAS 28
IAS 29 Financial Reporting in Hyperinflationary Economies	None yet
IAS 31 Interests in Joint venture	SAS 29

IAS 32 Financial Instruments: Presentation	SAS 10 and 15**
IAS 33 Earnings per Share	SAS 21
IAS 34 Interim Financial Reporting	SAS 30
IAS 36 Impairment of Assets	SAS 9**
IAS 37 Provisions, Contingent liabilities and Contingent Assets	SAS 23
IAS 38 Intangible Assets	
IAS 39 Financial Instrument: Recognition and Measurement	SAS 10 and 15**
IAS 40 Investment Property	SAS 13
IAS 41 Agriculture	SAS 4**

***** Only partially related***

SELF ASSESSMENT EXERCISE

What is the title of IFRS 7 AND SAS 10?

3.3 SAS 10: ACCOUNTING FOR BANKS AND NON-BANK FINANCIAL INSTITUTIONS (PART 1)

The Statement (Part1), focuses on three main areas, relating to accounting practices of banks, namely:

(a) Income recognition;
(b) Loss recognition; and
(c) Balance Sheet Classification

Some of the major provisions of SAS No. 10 are presented below:

Accounting Policies

(a) A bank should articulate and disclose as an integral part of its financial statements, all the significant accounting policies adopted in the preparation of its financial statements.
(b) The accounting policies should be prominently disclosed under one caption rather than as notes to individual items in the financial statements.

Income Recognition

(a) On loans, drafts and other risk assets, interest income should be recognised so as to record a constant yield on the outstanding principal, over the life of the credit at the interest rate applicable to the facility.
(b) For discount products, on which interest is often settled upfront or in arrears, the discount should be over the life of the product so as to give a constant yield on the outstanding principal.
(c) Credit-related fee income, where material and its collectability is not in doubt, should be deferred and amortized over the life of the related credit in proportion to the outstanding credit risk. Credit related fee income should be regarded as material in all situations where in aggregate, they constitute at least 10% of the projected average annual yield over the life of the facility to which they relate. Related direct expenses should be deducted from the fees before deferral.
(d) In situation where credit-related fee income is not material as defined above, the fees may be recognized at once, provided all associated costs are expensed in the same period.
(e) Non-credit related fee income should be recognized as earned. Fees earned over a long period of time or in stages, and which are not contingent upon the occurrence of a future event, should be recognized when the related service is performed, or on the completion of

contracted stages. Fees relating to a transaction, in which some portion of related credit risk is retained, should be treated as above.

(f) Lease rental income should be recognised in a systematic manner so as to record a constant yield on the lessor's net investment in the lease over its terms. If the lease contains an interest rate variation clause, the yield should be adjusted in the appropriate period.

(g) Profits or losses arising on sale of loans or discounts without recourse to the seller, should be recognized by the seller, when the transaction is completed.

(h) Profit arising on sale of loans or discount with recourse to the seller, should be amortized by the seller over the remaining life. Losses should be recognized as soon as they can be reasonably estimated.

Loss recognition

Banks should make provision for all losses as soon as they can be reasonably estimated. Losses can arise on any asset considered doubtful of being realized in full and can include loan loss provisions against diminution in the value of other assets and loss contingencies.

Loan loss

(a) Banks should make provision for loan loss after a thorough and systematic review of all its credit risks, including loans and advances, leases and off-balance sheet engagements. The precise time at which a provision should be made against a credit risk, is a matter of judgment, especially in the case of revolving facilities such as overdrafts. Each bank should develop a formal procedure for identifying non-performing facilities and evaluating loan losses and a systematic method of making provisions for loan losses. Each bank should consider other indications that a loss may arise on a credit risk since for example, loan may be doubtful of recovery even if it is performing in accordance with its terms.

(b) Loan loss provisions are as provided below

Fixed facilities

Indications that a fixed facility is non-performing include a situation in which interest and/or principal repayments are in arrears of the facility terms.

In those cases:

(a) Interest overdue by more than 90 days (or such shorter period as may be specified by regulatory authorities) should be suspended and recognized on a cash basis.

(b) Principal repayment which is overdue by more than 120 days (or such shorter period as may be specified by regulatory authorities) should be fully provisioned and recoveries recognized on cash basis.

(c) When individual principal repayment are subject to provision, banks should make provision against the outstanding principal repayments not yet due as follows:

No. Of days for which Principal is overdue	Minimum percentage provision required for principal not due
180 days	50%
360 days	100%

Where regulatory authorities stipulate shorter periods or higher percentages than indicated above, such shorter periods or higher percentage should be followed.

(d) Where the facility is secured by a perfect fixed legal charge over, or by title to, tangible property, the principal provision could cease once the outstanding principal is less than a specified proportion of the estimated net realisable value of the security as follows:

(i) Where the principal repayment is overdue by more than one year, the outstanding Principal not provided should not exceed 50% of the estimated net realizable value of security.
(ii) Where the principal repayment is overdue by more than two years, there should be no outstanding portion not provided of the credit facility irrespective of the estimated net realizable value of security held.
(iii) In both (i) and (ii) above, where regulatory authorities stipulate shorter periods of lower percentages, such shorter or lower percentage should be followed.

(e) Where a facility is secured by a floating charge or an unperfected or equitable charge over tangible property, it should be treated as an unsecured credit and no account taken of any security held in determining the provision for loan loss.

Revolving and Overdraft facilities

(a) Normally, the first indication that a revolving or overdraft facility may be non-performing is when the turnover on the account is considerably lower than anticipated when the facility was arranged or when interest is charged which take the facilities above its limit.
In these circumstances:
(i) A revolving facility should be classified as non-performing and unpaid interest suspended once a period of 90days (or shorter period as may be specified by regulatory authorities) elapses after the facility limit is exceeded.
(ii) Where credit limits are not exceeded, each bank should have a systematic method for the identification of non-performing revolving credits. Once classified as non-performing, all unpaid interest on the facility should be suspended.
(iii) Once a facility is classified as non-performing, provision against principal and unpaid interest should be made in accordance with a systematic method to reduce the outstanding principal to the estimated net realisable value of any security held (following the criteria earlier specified over a specified period).

(b) In the case of revolving and overdraft facilities, where a loan rescheduling is agreed with a customer, the rescheduling should be treated as a new facility but provisioning should continue until it is clear that the rescheduling is working. Interest previously suspended and, provisions against principal previously made, should be recognized on a cash basis.

Facilities performing in arrears

In many cases, short time cash flow difficulties result in a customer temporarily falling behind its facility terms. In these cases, provision should be made in accordance with the principles set out above. Once the facilities begin to perform, interest previously suspended and provisions against principle previously made should be recognized on cash basis.

General provisioning

Banks should make general loan loss provision of at least 1% of their risk assets not specifically provided for, in addition to specific provisions, to provide against the unidentified losses which are known to exist in any portfolio, using a systematic method, which should be consistently followed from period to period.

Investment securities

Long-term investment in marketable securities should be stated at net realisable value. Original cost should be disclosed.

Short-term investments in marketable securities should be stated at net realisable value. Original cost should be disclosed.

Investment in securities for which there is no active market, should be stated at lower of cost and net realisable value.

ILLUSTRATIVE EXAMPLE

Please refer to ACC311 course material for illustrations on the accounts of banks.

SELF ASSESSMENT EXERCISE

Outline the three main areas of the Statement (Part1) relating to accounting practices of banks.

4.0 CONCLUSION

The syllabus requires students to study detailed contents and application from SAS 10 to SAS issued to date and to discuss IASs/IFRSs not covered by current suite of SASs issued by the NASB. The correlated presentation of SASs and IASs above clearly shows us the IASs and IFRSs to be included in our discussion of accounting standards in this unit and subsequent units. You are advised to avail yourself the opportunity of getting Accounting Standards Handbook published by the NASB and visit the IASB website to obtain comprehensive coverage of the standards, since a single unit in this course material cannot by any stretch of imagination cover all the aspects of the accounting standards listed. What is, therefore, presented in the following sections, in terms of contents of SASs and IASs, is a theoretical and practical guide on Nigerian Accounting Standards.

Equally worthy of mention is the fact that some of the standards discussed in this unit have been illustrated earlier on. In such cases, in the subsection entitled illustrative examples, you will be referred to the units where the related illustrative examples have been given. In the other cases where the standards have not been illustrated in other units of this course material, illustrations are given as such topics are discussed.

5.0 SUMMARY

In this unit, we stated a list of Accounting Standards issued by the Nigerian Accounting Standard Board and the International Accounting Standard Board/Committee. In addition, we described the content of SAS 10 as it relates to bank and non-bank financial institutions.

6.0 Tutor Marked Assignment

1. SAS 12 represents ________
2. SAS 19 represents ________
3. The corresponding standard of SAS 21 is ______
4. The SAS 10 (Part 1) focuses on three areas, what are they?

7.0 REFERENCES/FURTHER READING

Institute of Chartered Accountant of Nigeria, Financial Accounting, Study Pack Lagos.

International Accounting Standard Board, International Accounting Standard.

Nigerian Accounting Standard Board, Statement of Accounting Standard

MODULE 2: ACCOUNTING FOR PETROLEUM ACTIVITIES AND FINANCIAL INSTITUTIONS

Unit 1: Leases and Accounting for Investment

Unit 2: Accounting in the Petroleum Industry: Upstream Activities and Accounting by Banks and Non-banks Financial Institutions

Unit 3: Accounting for Insurance Business and Accounting in the Petroleum Industry: Downstream

UNIT 1: LEASES AND ACCOUNTING FOR INVESTMENT

CONTENT

1.0 INTRODUCTION

In this unit, we shall be discussing leases and accounting for investment as provided in the Accounting Standards. The Statement of Accounting Standard 11 on Leases was issued to achieve the following primary objectives:

(a) To ensure that published financial statements contain sufficient information about lease transactions, to make it possible for users of such statements to determine the effects of lease commitments, on the present and future operations of the reporting enterprises; and
(b) To ensure uniform disclosure of terms and classes in financial statements.

The Statement of Accounting Standard 13 on accounting for investment focuses on three main forms of investments, namely;

(a) Short-term investments (current investment);

(ii) Long-term investments; and

(iii) Investment properties

2.0 OBJECTIVES

After studying this unit, you should be able to:

1. Define lease according to the provision of the Accounting Standard.
2. Familiarize yourself with some of the provisions of Statement of Accounting Standard 11.

3. Define investments according to the Accounting Standard.
4. Familiarize yourself with some of the provision of Statement Accounting Standard 13

3.0 MAIN CONTENT

3.1 Definitions of Leases by the Standard

The following terms are as defined by the Standard:

(a) A lease is a contractual agreement between an owner (the lessor) and another party (the lessee) which conveys to the lessee, the right to use the leased asset for an agreed period of time in return for a consideration, usually periodic payments called rents.

(b) Operating lease is one in which the lessor, while giving the lessee the use of the leased property, retains practically all the risks, obligations and rewards of ownership, for example, early obsolescence and appreciation.

(c) Finance or capital lease is one in which ownership risks and rewards are transferred to the lessee, who is obligated to pay such costs as insurance, maintenance and similar charges on the property. Usually, the agreement is non-cancellable and the lessee has the option to buy the property for a nominal amount upon the expiration of the lease.

Other variants of finance or capital leases are:

(i) Leveraged lease is a three-party lease involving a lender and lessee. The lender supplies, in most cases, the greater part of the purchase price of the leased asset.

(ii) sales-typed lease is one where the offeror or dealer (lessor) transfers substantially all the ownership risks and benefits of the property to the lessee and at the inception of the lease, the fair value of leased asset is greater than its carrying amount in the books of the lessor resulting in a profit or loss to the lessor (who is often not a manufacturer or dealer).

(iv) Direct finance lease is one which transfers substantially all the ownership risks, and benefits of the property to the lessee and at the inception of the lease, the fair value of leased assets is the same as its carrying amount to the lessor (often not a manufacturer or dealer).

SELF ASSESSMENT EXERCISE

What is a lease?

3.2 Some of the Provisions of Statement of Accounting Standard 11

(a) A reporting enterprise should state, in the appropriate section of its financial statements, its accounting policy with respect to leases.

(b) A reporting enterprise should, at the inception, of a lease, classify it as either a finance lease or as a finance lease or an operating lease.

(c) A lease qualifies as a finance lease if the following conditions are met.

(i) Lease is non-cancellable, and

(ii) Any of the following is applicable:

- The lease term covers substantially (80% or more) the estimated useful life of the asset or,
- The net present value of the lease as its inception, using the minimum lease payment payments and the fair value of the leased asset or,
- The lease has a purchase option which is likely to be exercised

(d) A lease which does not qualify as a finance lease as specified above should be treated as an operating lease.

Finance leases

(a) The reporting enterprise should account for a finance lease by recording the lease as an acquisition of an asset and the incurrence of a liability.

(b) Where lease right is capitalised by the lessee as in (a) above, the following should be determined:

(I) The initial value of the leased asset and the corresponding liability;

(II) The amortisation rate or amount; and

(III) The amount by which the lease liability is to be reduced.

(c) At the beginning of the lease term, the lessee should record the initial assets and liability at amounts equal to the fair value of the leased asset less the present value of an unguaranteed or partially guaranteed residual value which would accrue to the lessor at the end of the term of the lease. The discount factor to apply in calculating the present value of the unguaranteed residual value accruing to the lessor is the interest rate implicit in the lease.

(d) Where the lessee cannot determine the fair value of the leased asset at the inception of the lease or is unable to make a reasonably estimate of the residual value of the lease without which the interest rate implicit in the lease could not be computed, the initial asset and liability should be recorded at amounts equal to the present value of the minimum lease payments using the lessee's incremental borrowing rate as the discounting factor.

(e) The leased asset should be depreciated or the rights under the leased assets should be amortized in a manner consistent with the depreciation policy on the lessee's own assets.

(f) The minimum lease payment in respect of each accounting period should be allocated between finance charge and the reduction of the outstanding lease liability. The finance charge should be determined by applying the rate implicit in the lease to the outstanding liability at the beginning of the period. The 'sum of the years digit' may be used as an approximation.

(g) Contingent rentals should be written off in the period in which they are incurred.

Operating Leases

The rental expenses should be charged into the income account on systematic basis, in line with the time pattern of the user's benefit, not on the basis of the rental payments made by the user.

Accounting for leases in the financial statements of the lessor

Finance leases

(b) An asset under a finance lease should be recorded in the financial statements of the lessor, not as property, plant and equipment, but as an investment in a lease.

(c) At the inception of the lease, the lessor should recognize in the accounts simultaneously:

(i) Gross investment in the lease; and

(ii) Unearned finance income from the lease.

(d) The unearned finance income should be deferred and allocated to income of the lessor over the lease term based on a pattern reflecting a constant periodic rate of return on the lessor's net investment outstanding.

(e) Contingent rentals should be recognized in the accounts of the period to which they relate.

(f) Initial direct costs that are identifiable with direct financing of the lease should be taken to the income statement in the period in which the costs were incurred.

(g) In sales type lease, the manufacturer or dealer-lessor should take to the income statement, the difference between the fair value of the asset at the inception of the lease and its carrying amount.
(h) Investment in leases should be reviewed periodically for recoverability in the same manner as other receivables, but with regard to the security, if any, held by the lessor, for example, recourse to the leased asset.
(i) Where a reappraisal is made of the residual value of the asset and this shows a diminution, the resulting loss should be charged to the income statement. Gross investment in the lease should similarly be written down.

Operating leases

(a) Where the lessor classifies a lease agreement as an operating lease, it should be accounted for by the lessor as an item of property, plant and equipment. Accordingly, the periodic rentals that are receivable should be treated as rental income.
(b) The depreciation of a leased asset by the lessor should be on the basis of the lessor's normal depreciation policy for that class of assets leased out.
(c) The initial direct costs associated with the operating lease should be charged as incurred to the income statement.

SELF ASSESSMENT EXERCISE
Outline the treatment of finance lease in accounting for leases in the financial statements of the lessor.

3.3 Accounting for sale and lease back transactions
(a) Where in a sale and lease-back transaction, an asset is sold at a price equal to or greater than the current market value and it is leased back for a term approximately the useful life of the asset and for payments that are sufficient to cover the new owner's investment plus a reasonable return thereon, the transaction should be classified as a finance lease by the seller-lessee.
(b) If a sale and lease-back qualifies as a finance lease, the profit generated by the seller lessee should be deferred and amortized systematically over the useful life of the asset.
(c) Where a sale and lease-back qualifies as an operating lease, that is, when it does not meet the conditions of a finance lease, the profit generated by the seller-lessee should be deferred and amortised in proportion to the rental payments over the term of the lease.
(d) Where the market value of the asset is less than the carrying amount on the date of the sale and leaseback transaction, the difference should be charged immediately to the income statement of the seller-lessee. Similarly, costs associated with the transaction, for example, legal and professional fees should be charged to the income statement.

Disclosures in Financial Statements of Lessee
In addition to the disclosure requirements of SAS 2 information to be disclosed in financial statements and SAS 3-Accounting for property, plant and equipment, the following disclosures should be made:

(a) The amount and the major classes of assets being leased at the balance sheet date, liabilities and at the same time, differentiating between current and long-term portions of the liabilities.
(b) Commitments for minimum lease payments with a term in excess of one year, in summary, stating the amount and the yearly future payment due.
(c) Any significant restrictions, renewal or purchase options, contingent rentals and other contingencies arising from leases.

Disclosures in Financial Statements of a Lessor
The following disclosures should be made in the financial statements of the lessor:
(a) The gross investment in leases classified as finance leases, the related deferred income and the unguaranteed residual values of the leased assets be disclosed at the balance sheet date;
(b) The net investment in leases, should be broken into current and non-current portions.
(c) The basis or bases used to allocate income; and
(d) For assets under operating lease, the amount of assets under each category and the accumulated depreciation at the balance sheet date.

ILLUSTRATIVE EXAMPLES

For illustrations on lease accounting, please refer to ACC311 and the implementation guide on lease accounting issued by the NASB.

SELF ASSESSMENT EXERCISE
Outline the disclosures made in the financial statement of the lessee.

3.4 Basic Definitions of Investment
(a) Investments are assets by an enterprise for purpose of capital appreciation or income generation without activities in the form of production, trade, or provision of services.
(b) Short-term Investments are investments which are readily realisable and intended to be held for not more than one year.
(c) Long-term Investments are investments other than short-term investment.
(d) An Investment Property is an investment in land or building held primarily for generating income or capital appreciation and not occupied substantially for use, or in the operations of, the investing enterprises. A property is deemed to be substantially occupied if the owner of another enterprise in the same group occupies more than 15% of the lettable space.

SELF ASSESSMENT EXERCISE
What is an investment property?

3.5 Some Provisions of Statement of Accounting Standard 13
A reporting enterprise should classify its investments into short-term investments, long-term investments, and investment properties.

Short-term Investments
(a) Short-term investments should be valued at the lower cost and market value. The carrying amount should be determined on an item basis.

(b) The amount by which cost exceeds market value (unrealised loss) should be charged to the income statement for the period.
(c) Realised gains and losses on disposal of short-term investment should be taken to the income statement for the period of disposal.

Long-term Investments

(a) Long-term investments should be carried at cost or at a revalued amount.
(b) When there has been a permanent decline in the value of an investment, the carrying amount of the investment should be written down to recognise the loss. Such a reduction should be charged to the income statement. Reduction in carrying amount may be reserved when there is an increase, other than temporary, in the value of the investment, or if the reasons for the reduction no longer exist.
(c) An increase in carrying amount from the revaluation of long-term investments should be credited to owner's equity as revaluation surplus. To the extent that a decrease in carrying amount offsets a previous increase, for the same investment that has been credited to revaluation surplus and not subsequently reserved or utilized, it should be charged against that revaluation surplus rather than income.
(d) An increase on revaluation which is directly related to a previous decrease in carrying amount for the same investment that was charged to income, should be credited to the extent that it offsets the previously recorded decrease.
(e) When a reporting enterprise receives dividends that represent a distribution of earnings retained in the business prior to acquisition of stock in an investee company, such dividends should be treated as deduction from the cost of the investment.
(f) When a reporting enterprise receives interest on dated stock which includes interest accrued before the date of purchase, the relevant amount should be credited to acquisition cost and the portion of interest relating to post-acquisition period, should be credited to income statement.
(g) When an investment has been written down as earlier stated above, the new carrying amount is deemed to be the new basis for subsequent accounting purposes.
(h) Any discount or premium arising on acquisition of debt securities should be amortised over the period to maturity so that earnings from the investment would reflect a constant yield based on acquisition cost. The amortised discount or premium should be credited or charged to income as though it were added to or subtracted from the carrying amount of the security. The resulting carrying amount should then be regarded as cost.

Investment Properties

(a) Every enterprise should have a policy on accounting for investment properties either in accordance with SAS No. 3 and SAS No. 9 or in accordance with this Standard as stated below.
(b) Investment properties should be carried in the balance sheet at their market value and revalue periodically on a systematic basis at least once three years.
(c) Investment properties should not be subject to periodic charges for depreciation.
(d) A decrease in carrying amount of an investment property should be treated in the manner specified earlier. An increase in carrying amount should be treated in accordance with the provisions earlier provided.

ILLUSTRATIVE EXAMPLES

Aspects of the requirements of this unit have been illustrated in ACC311.

SELF ASSESSMENT EXERCISE

What is the provision of SAS 13 in respect of long-term investment?

4.0 CONCLUSION

In conclusion of this unit, we would state that Leasing is a process by which a firm can obtain the use of a certain fixed assets for which it must pay a series of contractual, periodic, tax deductible payments.

The lessee is the receiver of the services or the assets under the lease contract and the lessor is the owner of the assets. The relationship between the tenant and the landlord is called a tenancy, and can be for a fixed or an indefinite period of time (called the term of the lease). The consideration for the lease is called rent.

Investment is the commitment of money or capital to purchase financial instruments or other assets in order to gain profitable returns in the form of interest, income, or appreciation of the value of the instrument. Investment is related to saving or deferring consumption.

5.0 SUMMARY

In this unit, we discussed leases and accounting for investment according to the provision of Statement of Accounting Standard 11 and 13. We discussed such issues as definitions of leases, some provision of SAS 11, accounting for sale and lease back transactions, basic definition of investment and some provisions of Statement of Accounting Standard 13.

6.0 TUTOR MARKED ASSIGNMENT

1. Short-term investments should be valued at what?
2. The amount by which cost exceeds market value (unrealised loss) should be charged to what?
3. Realised gains and losses on disposal of short-term investment should be taken to which account?
4. Long-term investments should be carried at what amount?
5. When there has been a permanent decline in the value of an investment, the carrying amount of the investment should be what?

7.0 REFERENCE/FURTHER READING

Institute of Chartered Accountant of Nigeria, Financial Accounting, Study Pack Lagos.

International Accounting Standard Board, International Accounting Standard.

Jennings, A. R., (2001), Financial Accounting, London, Letts Educational

Jennings, A. R., (2001), Financial Accounting, Solution Manual, London, Letts Educational

Nigerian Accounting Standard Board, Statement of Accounting Standard

MODULE 2: ACCOUNTING FOR PETROLEUM ACTIVITIES AND FINANCIAL INSTITUTIONS

UNIT 2: ACCOUNTING IN THE PETROLEUM INDUSTRY: UPSTREAM ACTIVITIES AND ACCOUNTING BY BANKS AND NON-BANKS FINANCIAL INSTITUTIONS (PART 2)

CONTENT

1.0 INTRODUCTION

In this unit, we shall be looking at two accounting standards which are Statement of Accounting Standard 14 (SAS 14): Accounting in the Petroleum Industry: Upstream Activities and Statement of Accounting Standard 15 (SAS 15): Accounting by Banks and Non-Banks Financial Institutions (Part 2).

The petroleum industry is very central in the Nigerian economy as petroleum is the main source of revenue for the Nation. The industry plays a major role in facilitating the economic development of the nation.

Activities of the industry can be divided into two broad categories: upstream and downstream. Upstream activities involve the acquisition of mineral interest in properties, exploration (including prospecting), development and production of crude oil and gas. Downstream activities involve transporting, refining, and marketing of oil, gas and derivatives. SAS 14 deals with accounting and reporting for upstream activities. It does not cover the downstream activities.

The Statement of Accounting Standard 15 seeks to provide a guide for accounting policies and accounting methods that are to be followed by Non-Bank Financial Institutions, such as:

(a) Financial Houses/Companies;

(ii) Bureaux De Change;

(iii) Mortgage Institutions;
(iv) Discount houses;
(v) Stock Broking Firms; and

(vi) Other Capital Market Operators

2.0 OBJECTIVES

After studying this unit, you should be able to:

1. Define the terms used in the Statement of Accounting Standard;

2. Outline the provisions of Statement of Accounting Standard 14 and 15

3.0 MAIN CONTENT

3.1 DEFINITIONS OF TERMS USED IN STATEMENT OF ACCOUNTING STANDARD 14

The following terms are used in this Statement with the meanings specified:

(a) Abandonment is the process of giving up further exploration activities in a well or field in which oil or gas has been found in commercial quantity. This does not include capped (plugged) wells. It can also relate to the giving up of production wells or field at the end of their productive lives.

(b) Acquisition costs are costs of acquiring concession rights in a lease area.

(c) Amortisation is used generically to mean the depreciation of tangible costs, depletion of mineral acquisition costs and intangible costs.

(d) Appraisal well is a well drilled to ascertain the commercial potentials of a reservoir discovered from explanatory activities.

(e) Barrel is a standard of measurement in the oil industry. One barrel equals 42 U.S gallons (35 imperial gallons) at standard conditions.

(f) Bottom hole agreement refers to an agreement in which cash consideration or property is given to another party for his use in drilling a well on property in which the payer has no mineral rights, in exchange for technical information from the drilling of the well.

(g) Carried interest is a working interest arrangement involving two or more parties, in which a carrying party or the assignee finances the exploration and development activities in consideration for a reward out of future production (if any) and if necessary from the carried party's or the assignor's share of such future production. The assignor is usually the carried party while the assignee is the carrying party. A production sharing contract (PSC) is a form of carried interest.

(h) Casing Point is the point at which the drill has reached its objectives depth, in which case, determination can be made as to its productivity or otherwise.

(i) Ceiling test is a test to determine whether the recorded capitalised exploration, appraisal and development costs are recoverable from proved reserves.

(j) Commercial quantity is the quantity of oil or gas in reservoir that can be produced economically at current prices using existing technology. The Petroleum Act 1969, however, defines commercial quantity as daily production of 10,000 barrels of crude oil.

(k) Completion is the process of bringing an oil or gas well into production. The process begins only after the well has reached the depth where oil or gas is thought to exist, and generally involves installation of casing pipes, perforation of the casing pipes and acidizing and fracturing operations.

(l) Concession is a right granted to a company by the federal government on behalf of the Federation to explore and produce oil and gas within a given area. In Nigeria, this involves the granting of oil exploration license, oil prospecting license or oil mining lease.

(m) Conservation refers to the preservation or restoration of a drilling site to its natural state after drilling. It may also be related to economy and avoidance of waste drilling.

(n) Cost pool is a centre comprising of a defined geographical area used under the full cost method of accounting as a basis for accumulating depreciable capitalised exploration, appraisal and development expenditure. Cost pools are usually not smaller in size than a country except where warranted by major differences in economic, fiscal or other factors in that country.

(o) Development costs are additional capital costs incurred, following a decision to develop a reservoir.
(p) Discovery well is an exploratory (wildcat) well that finds a new deposit of oil or gas.
(q) Discovery value is the estimated value of oil and/or gas at the date of discovery.
(r) Dry hole (also referred to as a duster or wet hole) is a well that either finds no oil or gas or too little to make it commercially viable.
(s) Dry hole agreement is similar to bottom hole agreement except that money or property contributions are made to another party only in the event that the well reaches an agreed depth and is found to be non-productive.
(t) Exploration and appraisal costs are costs incurred in the search for oil and gas deposits after obtaining a license but before a decision are taken to develop a reservoir.
(u) Exploration project area is acreage usually larger than a field where initial findings efforts such as geological and geophysical surveys are undertaken.
(v) Exploration well is a well drilled to ascertain whether or not oil or gas exists in a field.
(w) Farm is referred to the transfer of all part of oil and gas interest in consideration for an agreement by the transferee (farmee), to meet certain oil exploration and development costs which would otherwise have been undertaken by the owner (farmor). See farm out.
(x) Farm out is a sharing of oil exploration and development activities and costs, whereby a company with a concession, either because it has more potential oil acreage that it can handle or wishes to share risks, invites others to explore all or portions of the tract in return for a share of whatever oil is found. See farm in.
(y) Federal Government refers to the Federal Government of Nigeria.
(z) Federation means the Federal Government, State Government, the Capital Territory and Local Governments.
(aa) Field is a given area or region, usually comprising a number or reservoirs in which oil and gas reserves exist.

(ab) Impairment is the possible diminution in the value of unproved properties of an exploration and production company arising from events or circumstances outside its control.

(ac) Joint Venture is a contractual arrangement whereby two or more parties undertake an economic activity which is subject to contractually agreed basis of sharing of control.

(ad) Oil Exploration License (OEL) is a license granted to a company under the Petroleum Act of 1969 to explore for petroleum and does not confer an exclusive right over the area of the licence. This usually has a one year term.

(ae) Oil Mining Lease (OML) means a licence granted to a company under the Petroleum Act, 1969, for the purpose of winning petroleum, or any assignment of such lease. This usually has a term of between twenty and thirty years.

(af) Oil Prospecting Licence (OPL) means a licence granted to a company under the petroleum Act, 1969, for the purpose of winning petroleum, or any assignment of such licence. The term is usually between three and five years.

(ag) Operator is the party that conducts the operations under a joint venture. This may include the drilling of a well and/or the production of oil from tract or field under an agreed contract.

(ah) Pre-licence costs are costs incurred in the period prior to the acquisition of a legal right to explore for oil and gas in a particular location. Such costs include the geological and geophysical analysis of these data.

(ai) Production costs (operating or lifting costs) are the current costs incurred in oil and gas production activities.

(aj) Property includes leases, reservations, royalty rights and similar rights.

(ak) Proved developed reserves represent oil and gas reserves that can be expected to be recovered from existing wells and facilities using existing technology.

(al) Proved reserves represent estimated quantity of oil and gas that can be recovered from known reservoirs using existing technology.

(am) Proved underdeveloped reserves include all proved oil and gas reserves that do not qualify to be described as proved developed reserves.

(an) Reservoir is a natural formation of porous and permeable spaces in the earth' crust containing accumulation of oil and gas. Each distinct reservoir is confined by impermeable rocks or barriers which help to trap oil and gas.

(ao) Stratigraphic test well is well drilled to obtain information about the geological conditions of an exploration area.

(ap) Wildcat well is any well drilled in unproven territory.

(aq) Work over is a remedial operation required to restore oil flow from a well to its maximum production capacity or enhance its production capacity following a decline in production.

SELF ASSESSMENT EXERCISE
Define abandonment and a bottom hole agreement.

3.2 PROVISIONS OF STATEMENT OF ACCOUNTING STANDARD 14
The provisions of SAS 14 include the following:
ACCOUNTING POLICY

(a) All companies engaged in oil and gas exploration, development and production activities, shall state in their financial statements, the policy for accounting for costs incurred and the manner of disposing of capitalised costs in respect of such activities. In addition, the policy on accounting for restoration and abandonment cost and the total restoration and abandonment costs, should be disclosed in their financial statements, even if already included in cost of sales.
(b) A company may use either the "full cost" method or the "successful efforts" method. The method used should be consistently applied and disclosed.

Classification of Costs
Oil and gas producing activities involve special types of cost, which should be classified as follows:

(a) Mineral rights acquisition cost;
(b) Exploration and drilling cost;
(c) Development cost;
(d) Production costs;
(e) Support equipment and facilities costs; and
(f) General costs

FULL COST METHOD
Initial treatment of cost

Costs incurred on mineral rights acquisition, exploration, appraisal and development activities should be capitalised.

Amortisation of capital costs
All capitalised costs incurred in a cost centre should be depreciated on the unit of production basis, using proved reserves. The determination of the capitalised cost to be amortised should be on a country-wide basis.

Ceiling test
(a) Ceiling tests should be conducted at least annually at balance sheet date on a country wide basis. Such tests should use discounted values for revenue, costs, estimated future taxes, and estimated future development costs.
(b) The price used for the test should be that ruling at the balance sheet date, while the reserve used should be proved reserves. Where the accounts are prepared in U.S dollars, the discount rate to be used for estimating future cash flow shall be ten percent. Where accounts are prepared in Naira, the CBN rediscount rate should be used.
(c) If the net discounted revenue is lower than the capitalised costs the difference should be written off.

SUCCESSFUL EFFORT METHOD
Initial treatment of costs
(a) Cost incurred prior to acquisition of mineral rights and other exploration activities not specifically directed to an identifiable structure, should be expensed in the period they are incurred.
(b) All costs, incurred on mineral rights acquisition, exploration, appraisal and development activities should be capitalised initially on the basis of wells, field or exploration cost centres, pending determination. Such costs, should be written off when it is determined that the well is dry.

Retention period pending determination
If further appraisal of concession is planned, cost of exploration and appraisal activities may be carried forward pending determination of proved reserves in commercial quantities for a period of:

(a) Not more than 3 years following completion of drilling in an offshore area where major development costs may need to be incurred, or
(b) For a maximum of 2 years in an onshore area.

Amortisation of capitalised costs

(a) Mineral rights acquisition costs which have been allocated should be amortised over the remaining life of the licence. Net book value not depreciated mineral rights acquisitions, should be reviewed annually for impairment on well-by well basis. Any impairment discovered should be written off.

Amortisation of exploration and drilling costs incurred within each well, field or property, should be on a unit-of-production basis using proved developed reserves.

Cost of Providing Amenities for Communities
Cost of providing amenities for communities in areas of operation should be written off as incurred.

Conveyances
Recognition of gains or losses under conveyance should be as follows:

(b) If the entire interest in an unproved property for which impairment is recorded on an individual basis is sold, gain or loss should be recorded to the extent of difference between the proceeds and net book value.

(c) If the entire interest in an unproved property for which impairment is recorded on a group basis is sold, no gain or loss is recognised unless the proceeds exceed the original cost of the lease.

(d) If a portion of interest in an unproved property for which individual impairment is recorded is sold, and the proceeds exceed the total carrying value should be recognised as a gain.

(e) If a portion of interest in an unproved property for which group impairment is recorded is sold and the proceeds exceed the total cost of the property, the excess of the proceeds over net book value of the group should be recognised as a gain.

(f) If the entire interest in an unproved property on which amortisation is individually computed is sold, the difference between the proceeds and a proportionate share of each cost and amortisation provision (net book value) should be recognised as a again or loss.

(g) If a portion of interest in an unproved property on which amortisation is individually computed is sold, the difference between the proceeds and a proportionate share of each cost and amortisation provision (book value) should be recognised as a gain or loss.

(h) If an unproved property on which impairment has been recorded on an individual basis is surrendered of the rights released, the book value of the property should be expensed.

(i) If an unproved property on which impairment has been recorded on a group basis is surrendered or the rights released, the book value of the property should be charged to the accumulated impairment account and no loss should be recognised.

Carried Interests
The carrying party should record the total cost incurred in respect of the carried interest as capital expenditure. Disclosure should be made of the carrying arrangements, including the amount of carried expenditure to date.

Farmouts and similar arrangements

(a) The farmor should not record any expenditure made on its behalf by the farmee. Any capitalised costs previously incurred by the farmor in relation to the whole interest should be re-designated as relating to the partial interest retained.

(b) Where cash reimbursement of past costs takes place, the farmor should credit any proceeds to the accounts, whether capital or expense, in which such costs were originally recorded.

(c) The farmee should record all of its expenditure relating to the arrangement, both in respect of its own interest and that retained by the farmor as and when the costs are incurred.

Utilization and Redetermination
No gain or loss should be recognised on an unitization arrangement except where cash received exceeds costs.

Where there is re-determination of interest, the resulting adjustment of the unit members' shares of production and costs should be accounted for on a prospective basis, rather than way of prior period re-statement.

Joint Venture

(a) The operator of a joint venture should maintain a separate set of books dedicated solely to recording the transactions relating to the venture.
(b) Each partner should account for its proportionate share of the costs, production, assets and liabilities of the joint venture in line with its accounting policy.

Over lifts and under lifts
One of the following methods should be used to account for under lifts and over lifts:

(a) Both under lifts and over lifts should be accrued for, under lifts should be included as stock, at the lower of cost or market value while over lifts, should be valued at year end at spot price.
(b) Invoiced sales should be adjusted to exclude over lifts at year end spot price and to include under lifts, at the lower of cost or net realizable value.

Restoration and Abandonment

(a) Companies should make provisions for restoration and abandonment costs less estimated salvage values, based on the best available estimate by:
    (i) a charge against income on system basis over the full productive lives of the facilities concerned, so that the accumulated provision will cover the cost of restoration and abandonment, or
    (ii) recognised the eventual liability at the outset, the corresponding debit, should be treated as a capital cost to be depreciated or as deferred expenses to be amortized, using the unit-of-production basis.
(b) Restoration and Abandonment costs should be deducted in arriving at estimated future net revenues for ceiling test calculations.

Farmout
If the consideration for the farmout includes an arrangement for the farmee to bear subsequent, which would otherwise, fall to the retained interest of the farmor, the farmor should disclose the amount of such expenditure incurred by the farmee in aggregate during the accounting period, to provide an indication of the consideration received from the farmout.

ILLUSTRATIVE EXAMPLES
For illustrations on accounting for upstream activities, please refer to unit 1 of this course material.

3.3 Provision of SAS 15: ACCOUNTING BY BANKS AND NON-BANK FINANCIAL INSTITUTIONS (PART

II)

The provision of SAS 15 includes the following:

Accounting Policies

(a) Non-Bank Financial Institution (NBFIs) should articulate and disclose, as an integral part of their financial statements, all the significant accounting policies adopted in the preparation of their financial statements.

(b) The accounting policies should be prominently disclosed, under one caption, rather than as notes to individual items in the financial statements.

Income recognition

(a) Each significant item of revenue should be separately reported by a Non-Bank Financial Institution to enable the users of its financial statements to assess the contribution of that particular source of revenue.

(b) Income from loans, lease rentals, factoring, and other transactions for which collectability is not in doubt, should be recognised in the accounts as earned.

(c) Interest on loans should be assumed to be earned in the proportion to the outstanding principal, over the period of facility. However, when the collectability of a loan is in doubt, further income should be recognised only after the principal due and already-recognised interest are paid or when a request for rollover has been agreed and relevant conditions met.

(d) Credit-related fee income, where material to the transaction and its collectability not in doubt, should be deferred and amortised over the life of the credit in proportion to outstanding credit risk. Credit-related fee income should be regarded as material where in aggregate, it constitutes at least 10% of the projected average annual yield and should be deducted from the fees before deferral.

(e) Non-credit related fee income should be recognised as and when earned. Fees earned over a long period of time or stages, for example, issuing house fees, which are not contingent upon the occurrence of future events, and for which collectability is not in doubt, should be recognised when the related services are performed or on the completion of contracted stages.

(f) For a transaction where success is doubtful and income contingent on completion, income should not be recognised until it is reasonably certain that the transaction will be completed.

Loss Recognition

(a) NBFIs that have loan portfolios should analyse and classify them between performing and non-performing.

(b) Each NBFI should estimate and make general and specific provisions against loan losses in the manner set out in paragraphs 74 and 75, after a thorough and systematic review of all its credit risks, including loans, leases and off-balance sheet engagements.

(c) For mortgage transactions, provisions should take due account of the long-term nature of the loans and the security available, if a repayment becomes overdue for three months. Where principal repayment is overdue by more than one year, the outstanding unprovided principal should not exceed 50% of the estimated net realisable value of the security. Where principal repayment is overdue by more than two years. There should be no outstanding unprovided portion of the credit facility, irrespective of the estimated net realisable value of security held.

(d) For all other NBFIs transactions:
(i) where lending is related to a specific transaction, and there is evidence that the transaction will not be successful, provisions should be made immediately in full against interest and principal outstanding, net of collateral realised or in possession and in the process of realisation.
(ii) where lending is not related to a specific transaction or evidence on the status of the transaction is not readily available, and success of the transaction is doubtful, the following minimum guidelines should be followed:
    - Interest overdue by more than 30 days, should be suspended and recognised on a cash basis.
    - Principal repayments which are overdue by more than 90 days, should be fully provided for and recoveries recognised on a cash basis.
    - When individual principal repayments have been overdue for more than 180 days, NBFIs should make full provision against the outstanding principal repayments not yet due.

DISCLOSURES

Accounting Policies

In addition to the disclosure requirements of SAS 2- Information to be Disclosed in Financial Statements, NBFIs should also disclose the following:

(a) The methods and bases by which provisions for loan or securities are made.
(b) The nature of off-balance sheet engagements and the method used to recognise income or loss thereon.

Income Statement

The disclosures in the Income Statement and the Notes to the Financial Statements, should include but not necessarily be limited to, the following income and expense captions, where material;

(a) Income
(i)Interest and discount income
(ii) lease finance income
(iii) fees for services rendered;
(iv) foreign exchange income;
(v) commission income; and
(vi) investment income
(b) Expenses
(i) interest expense;
(ii) loan loss expense;
(iii) commission expense;
(iv) general and administrative expenses;
(v) diminution in asset values;

The above captions should be further analysed across lines of businesses where material.

Balance sheet

NBFIs should group their assets and liabilities in the balance sheet according to their nature, liquidity and maturity. The disclosures in the balance sheet and the Notes to the financial statements should include but not necessarily be limited to, the following assets and liabilities captions:

(a) Assets
 (i) Cash;
 (ii) Short-term fund and short-term investment;
 (iii) Due from banks/due from non-bank financial institutions;
 (iv) Bills discounted;
 (v) Investments;
 (vi) Loans and advances;
 (vii) Advance under finance leases;
 (viii) Other assets; and
 (ix) Fixed assets
(b) Liabilities
 (i) depositors' funds, current accounts or clients' fund;
 (ii) due to bank/due from bank financial institutions;
 (iii) taxation payable;
 (iv) dividend payable;
 (v) other or sundry liabilities; and
 (vi) long-term loans
(c) Discount Houses
 Discount houses should make full disclosure of:
 (i) securities, analysed into treasury bills and certificates, other government securities and private sector securities; and
 (ii) deposits, split between call and term deposits, with their maturity profiles.
(d) Finance Houses
 Finance Houses should disclose:
 (i) total value of placements with other finance houses, with analysis of the period to maturity/period from maturity;
 (ii) schedule of sectoral allocation of risk assets, such as trade finance; and
 (iii) breakdown of items that constitute "other assets" and "other liabilities".
(e) Bureaux De Change
 Bureaux de change should treat their foreign currencies as stocks. The stocks of foreign currencies held at the balance sheet date should be valued at the lower of cost and market value. The following disclosures should be made by Bureaux de change;
 (i) quantity and naira equivalent of the different foreign currencies traded in during the period; and
 (ii) value of foreign currency stock held and conversion rates used at the balance sheet date.
(f) Mortgage Institutions
 The following disclosures should be made by Mortgage Institutions.
 (i) total liabilities to National Housing Fund
 (ii) total value of mortgage assets and movement thereon, showing:
 - Assets brought forward;
 - Additions during the year;

- Disposal and realisations during the year; and
- Balance carried forward.

(iii) other sources of funds apart from share capital and national housing fund.

(iv) classification of mortgage loans receivable and mortgage backed securities into those held for sale and those held for long-term investments. Detailed breakdown of serving rights acquired during the year stating:

- The amount capitalised;
- The method of amortised; and
- The amount amortised.

ILLUSTRATIVE EXAMPLES
For illustrations on the accounts of banks, please refer to ACC311.

SELF ASSESSMENT EXERCISE
Outline the classification of costs.

4.0 CONCLUSION
In conclusion, it can be stated that petroleum accounting for the oil & gas Industry provides in-depth understanding of the different accounting principles and procedures prevalent in the petroleum industry. It highlights the importance of various contract and fiscal policies on accounting procedures. In addition, it relates net income as contained in financial statements to overall project investment profitability. It emphasizes in particular, the fiscal and accounting framework of the petroleum industry.

A non-bank financial institution (NBFI) is a financial institution that does not have a full banking license or is not supervised by a national or international banking regulatory agency. NBFIs facilitate bank-related financial services, such as investment, risk pooling, contractual savings, and market brokering.

5.0 Summary
In this unit, we discussed SAS 14 and SAS 15. We looked the definition of terms in accounting for petroleum: up-streams and the provision of SAS 14. Similarly, the provision of SAS 15 was discussed.

6.0 Tutor Marked Assignment
1. What is a natural formation of porous and permeable spaces in the earth' crust containing accumulation of oil and gas?
2. ________ test well is well drilled to obtain information about the geological conditions of an exploration area.
3. ________ well is any well drilled in unproven territory.
4. ________ is a remedial operation required to restore oil flow from a well to its maximum production capacity or enhance its production capacity following a decline in production.

7.0 REFERENCE/FURTHER READING
Institute of Chartered Accountant of Nigeria, Financial Accounting, Study Pack Lagos.

International Accounting Standard Board, International Accounting Standard.

Jennings, A. R., (2001), Financial Accounting, London, Letts Educational

Jennings, A. R., (2001), Financial Accounting, Solution Manual, London, Letts Educational

Nigerian Accounting Standard Board, Statement of Accounting Standard

MODULE 2: ACCOUNTING FOR PETROLEUM ACTIVITIES AND FINANCIAL INSTITUTIONS

UNIT 3: ACCOUNTING FOR INSURANCE BUSINESS AND ACCOUNTING IN THE PETROLEUM INDUSTRY: DOWN STREAM

CONTENT

1.0 INTRODUCTION

In this unit, we shall be discussing two Statements of Accounting Standards which are SAS 16: Accounting for Insurance Business and SAS 17: Accounting in the Petroleum Industry: Downstream Activities.

The Statement of Accounting Standard 16 provides guidelines for the preparation and presentation of financial statements of insurance businesses in Nigeria.

The Statement of Accounting Standard 17 provides the rules governing the accounting and reporting of downstream activities in Nigeria.

We shall discuss details of their various provisions in their various subunits in this unit of the course material.

2.0 OBJECTIVES

After studying this unit, you should be able to:

1. State the provisions of the Statement of Accounting Standard 16
2. State the provisions of the Statement of Accounting Standard 17

3.0 MAIN CONTENT

3.1 PROVISIONS OF STATEMENT OF ACCOUNTING STANDARD 16

Accounting Policies

(a) An insurance company should articulate and disclose as an integral part of its financial statements, all the significant accounting policies adopted in the preparation of its financial statements.

(b) The accounting policies should be prominently disclosed under one caption rather than as notes to individual items in the financial statements.

Basis of Accounting

General insurers should adopt the normal basis of accounting. Where it is not possible to determine underwriting results with reasonable certainty until the following accounting period, the deferred annual basis be adopted. The accounting basis or bases adopted should be disclosed. Where the deferred annual basis is used, the classes of business involved and the extent of the time deferral for profit should also be disclosed.

Premium Recognition

(a) Premium revenue should be recognised from date of attachment of risk.
(b) Premium revenue should be assumed to be earned evenly over the period of risk. Where there is a marked variation in the pattern of risks within the risk period, premium revenue should be accounted for in accordance with the pattern of risk exposure.
(c) All written premiums relating to risk for a period not falling within the accounting period, should be carried forward as provision for unearned premium.

Expenses

(a) General insurers should classify their expenses under the following captions:
    (I) Underwriting;
    (II) Claims
    (III) Investments; and
    (IV) Management
(b) Underwriting expenses should be subdivided into maintenance and acquisition expenses.
(c) Maintenance expenses should be charged to the revenue account in the year in which they are incurred.
(d) The portion of acquisition expenses relating to unearned premiums should be deferred. Deferred acquisition expenses should be determined separately for each class of business.
(e) Such deferred acquisition expenses should be calculated by applying to the acquisition expenses, the ratio of unearned premium provision to written premium.
(f) The movement in deferred acquisition expenses between two accounting periods should be expensed in the revenue account.
(g) Claims and claims handling expenses incurred during the reporting period should be charged to the revenue account.
(h) Adequate provision should be made for settlement of claims incurred but not reported by end of the accounting period. Any amount recoverable through salvage or subrogation should be used to reduce recoverable through salvage or subrogation should be used to reduce claims incurred.
(i) Investment and management expenses should be charged to the profit and loss account in the year in which they are incurred.

Unexpired risks

(a) Unexpired risks provision should be determined based on the underwriting experience of each class of business.
(b) Provision should be made for unexpired risks where the total of anticipated claims and related expenses exceeds the related unearned premiums.

Financial statements

The financial statements of general insurers should include a revenue account for each class of insurance business undertaken.

Disclosures

In addition to the disclosure requirements of SAS No. 2 – information to be disclosed in the Financial statements- General Insurers should disclose the following:

Revenue Account
The revenue account referred to, should disclose the following:
Income
(a) Direct premiums;
(b) Inward reinsurance premiums;
(c) Gross written premiums;
(d) Net written premiums;
(e) Decrease in provision for unexpired risks; and
(f) Commission received.

Deductions from Income
(a) Outward reinsurance premiums; and
(b) Increase in provision for unexpired risks.

Expenses
(a) Direct claims paid;
(b) Inward reinsurance claims paid;
(c) Increase in provision for outstanding claims

Underwriting Expenses
(a) Acquisition; and
(b) Maintenance.

Outward reinsurance expenses should be reported separately as a deduction from premium revenue, while reinsurance and other recoveries should be reported separately as a deduction from claims expenses.

Profit and Loss Account
The disclosure in the profit and loss account and notes to the financial statements should include the following income and expenses captions (unless they have been disclosed in the revenue account):

Income
(a) Gross written premiums;
(b) Outward reinsurance premiums;
(c) Earned premiums;
(d) Investment income (net);
(e) Commissions received; and
(f) Other income.

Expenses
(a) Underwriting expenses;
(b) Claims incurred;
(c) Management expenses; and
(d) Provisions for bad and doubtful debts

Balance Sheet
General insurers should arrange their balance sheet items in order of liquidity. The disclosure in the balance sheet and notes to the financial statements should include the following asset and liability caption:

Assets
(a) Cash;
(b) Short term investments;
(c) Debtors;
(d) Deferred acquisition expenses;
(e) Long term investments;
(f) Statutory deposit; and
(g) Fixed assets.

Liabilities
(a) Creditors and accruals; and
(b) Insurance fund (including provisions for unearned premiums, outstanding claims and unexpired risks).

Shareholders' Fund
(a) Authorised share capital.
(b) Called-up share capital.
(c) Statutory contingency reserves.
(d) Capital reserves.
(e) General reserves.

Life Assurance Business

Basis of Accounting

Life assurance business should be accounted for on the fund accounting basis.

Premium Recognition

Premium revenue should be recognised and credited to the fund account when due for payment from policy-holders. There should be no allocation of premium revenue between reporting periods.

Receipts from deposit administration and other businesses of saving nature should not be treated as revenues but liabilities. Interest accruing to the life assurers from investment of such deposits should be recognised in the profit and loss account in the period in which they are earned, while interest paid to depositors should be recognised as an expense.

Claims
All claims due or notified in an accounting period should be charged to the fund in that period.

Expenses
All incurred expenses should be charged to the fund at the end of the accounting period.

Policy Liabilities

Policy liabilities should be as determined by the actuarial valuation.

Valuation Surplus/deficiency
A valuation surplus should be shared between the "with-profit" policy-holders and shareholders in accordance with the advice of the actuary and subject to the provisions as set out in paragraph 45.

A valuation deficiency should be transferred to the profit and loss account.

Financial Statements
The financial statements of a life assurer should include a life revenue account only if it has other classes of insurance business.

Disclosures
In addition to the disclosure requirements of SAS No. 2 – information to be Disclosed in the Financial statements, - a life assurer should disclose the following:

Revenue Account
Income
(a) Direct premiums;
(b) Inward reinsurance premiums;
(c) Gross written premiums;
(d) Net written premiums;
(e) Commissions received.

Deduction from Income

Outward reinsurance premiums;

Claims Incurred
(a) Direct claims;
(b) Inward reinsurance claims;
(c) Reinsurance recoveries; and
(d) Surrenders.

Underwriting Expenses
(a) Acquisition; and
(b) Maintenance.

Profit and Loss Account
The disclosure in the profit and loss account and notes to the financial statements should include the following income and expense captions (unless they have been disclosed in the revenue account):

Income
(a) Gross written premiums;
(b) Earned written premiums;
(c) Earned premiums;
(d) Investment income (net);
(e) Commission received;
(f) Shareholders' portion of life assurance surplus/deficit; and
(g) Other income

Deduction from income

Outward reinsurance premiums.

Expenses:

(a) Claims incurred;
(b) Underwriting expenses
(c) Management expenses; and
(d) Provision for bad and doubtful debts.

Balance Sheet
Life assurance should arrange their balance sheet item in order of liquidity. The disclosure in the balance sheet and notes to the financial statements should include the following:

(a) Cash;
(b) Short term investments;
(c) Debtors;
(d) Loans to policy-holders;
(e) Long term investments;
(f) Statutory deposit; and
(g) Fixed assets

Liabilities

(a) Creditors and accruals;
(b) Outstanding claims;
(c) Insurance fund; and
(d) Deposit administration

Shareholders' Fund

(a) Called-up share capital;
(b) Statutory contingency reserves;
(c) General reserves; and
(d) Retained earnings/accumulated losses.

An insurer carrying on both life and general businesses should follow the same disclosure requirements set out above. In addition, its financial statements should include a separate balance sheet for life business.

ILLUSTRATIVE EXAMPLES
Accounting for insurance business has been illustrated in ACC311 of your study materials.

Self assessment exercise
How is the unexpired risk provision determined?

3.2: STATEMENT OF ACCOUNTING STANDARD 17: ACCOUNTING IN THE PETROLEUM INDUSTRY: DOWNSTREAM ACTIVITIES

Accounting Policies

(a) All companies engaged in the petroleum industry should state in their financial statements all significant accounting policies adopted in the preparation of the statements.

(b) The accounting policies should be prominently disclosed under one caption rather than as note to individual items in the financial statements.

REFINING AND PETROCHEMICAL OPERATIONS:

Catalysts

Cost of short life catalyst should be expensed in the year in which they are incurred while cost of long life catalysts should be capitalized and written off over the life of the refinery. Where long life catalysts are regenerated, the costs of regeneration should be capitalized and amortised over the life of the regeneration.

Turn-around Maintenance

Turn-around maintenance costs should be capitalized and amortised over the expected period before the next turn-around maintenance is due.

Stand-by Equipment

Stand-by equipment should be depreciated over the expected useful life of a similar equipment in use.

Depreciation of Plant and Equipment

The costs of refining or petrochemical plants and equipment should be depreciated on a straight line basis over the useful life of the assets or, if operating at normal levels of production, on the basis of expected throughout. The method used should be disclosed and consistently applied.

Debottlenecking, Major Plant Rehabilitation and Replacement of Major Components

Where major plant rehabilitation, debottlenecking or replacement of major components result in a significant and identifiable increase in output or betterment of the plants, its cost should be capitalised and amortised over the period over which the benefit is expected to last. In any other case, it should be expensed as incurred.

MARKETING AND DISTRIBUTION OPERATIONS

Bridging costs

Bridging costs which are recoverable from government through NNPC, should be set up as claims receivable. Where they remain outstanding for an unreasonable length of time, adequate provision should be made for them. Claims not recovered within two years should be fully provided for.

ATK Overbilling claims should be set up as a receivable. Where they remain unpaid for an unreasonable length of time, they should be provided for. Claims not recovered within two years should be fully provided for.

Liquefied Natural Gas Operation- Take or Pay Contracts

(a) Where a purchaser is unable to take his entitlement under a take or pay contract, with a right of make-up, the purchase should treat the amount paid as a receivable. Conversely, the supplier should treat the advance received as deferred revenue. The deferred revenue should be recognised when the make-up right is exercised by the purchaser.

(b) Where a supplier is unable to deliver the quantity contracted, the amount received from the purchaser should be treated as a liability by the supplier while the purchaser should treat the amount paid as a repayment.

Disclosures

In addition to the disclosure requirements of SAS No. 2- Information to be disclosed in the Financial Statements, companies operating in the downstream sector of the petroleum industry should disclose the following as they relate to their activities:

(a) Refining and Petrochemical Companies
  (i) processing fees from third parties;
  (ii) any amount of turn-around maintenance capitalised and/or expensed, split into material costs and labour costs;
  (iii) debottlenecking costs incurred, capitalized or expensed;
  (iv) the cost of research and development;
  (v) basis for valuation of products and intermediates;
  (vi) for an integrated plant, revenue earned for each class of activities.

(b) Marketing and Distribution Companies
  (i) bridging claims and related provision made; and
  (ii) ATK overbilling claims and related provision made.

(c) Liquefied Natural Gas Companies
  Details of take or pay contracts not yet fulfilled and the related deferred revenue or repayment.

Packaging Companies and Non-core Businesses

The operating results of packaging factories and other non-core businesses owned by companies operating in the downstream sector of the petroleum industry should be separately disclosed.

Transfer Pricing

The transfer pricing methods adopted should be disclosed.

ILLUSTRATION 10

On 31st December 20x6, Divine Petroleum Resources Ltd, incurred N27 million in the turn-around maintenance (ATM) of its refinery in Port Harcourt. The next turn around maintenance is expected in January 20x9. You are expected to show how this transaction would be treated by the company in its financial statements for the year ended 31 December 20x7.

Suggested Solution 10

The cost incurred in the turn-around maintenance would be capitalised and amortised over three years in accordance with SAS 17 para. 47.
Annual amortization would be 27/3 = N9m
Extracts of financial statements of the company at 31st December 20x7, will appear as follows:
Income statement
Amortisation of the cost of TAM N9m
Balance Sheet
Tangible assets

TAM less amortisation N18

SELF ASSESSMENT EXERCISE
How is stand-by equipment treated?

4.0 CONCLUSION
We are increasingly living in a global economy—with trade and inbound and outbound investment a fact of life. It's no wonder, capital markets have long advocated for globally recognized accounting standards.

Until recently, that common accounting language has been a missing link. Now, policymakers, lawmakers and regulators are working alongside standard-setters to provide a single set of high-quality, global accounting principles.

Accounting for international petroleum operations is very complex and involves different accounting methods being used according to the specific purpose. Internationally, the United States was the first country to issue accounting standards specifically for oil and gas producers.

5.0 SUMMARY
In this unit, we discussed the Statements of Accounting Standard 16 and 17. Basically, the unit focuses on the provision of the Standard as it relates to issues in insurance business and petroleum industry, downstream activities.

6.0 TUTOR MARKED ASSIGNMENT
1. Underwriting expenses should be subdivided into __________ and acquisition expenses.
2. Maintenance expenses should be charged to the ___________ account in the year in which they are incurred.
3. The portion of acquisition expenses relating to ___________ should be deferred.
4. Stand-by equipment should be depreciated over the _________ of similar equipment in use.
5. The costs of refining or petrochemical plants and equipment should be depreciated on a __________ over the useful life of the assets or, if operating at normal levels of production, on the basis of _________.
6. Where major plant rehabilitation, debottlenecking or replacement of major components result in a significant and identifiable increase in output or betterment of the plants, its cost should be ___________over the period over which the benefit is expected to last.

7.0 REFERENCES/FURTHER READING
Institute of Chartered Accountant of Nigeria, Financial Accounting, Study Pack Lagos.

International Accounting Standard Board, International Accounting Standard.

Nigerian Accounting Standard Board, Statement of Accounting Standard

MODULE 3: FINANCIAL REPORTING 1

Unit 1: Statement of Cash flow, Accounting for Taxes and Abridged Financial Statements

Unit 2: Earnings per Share, Research and Development, and Provisions, Contingent Liabilities and Contingent assets

Unit 3: Segment Reporting and Telecommunication Activities

UNIT 1: STATEMENT OF CASH FLOW, ACCOUNTING FOR TAXES AND ABRIDGED FINANCIAL STATEMENTS

CONTENT

1.0 INTRODUCTION

In this unit, we shall be discussing Statement of Accounting Standard 18, 19 and 20.

In financial accounting, a **cash flow statement**, also known as ***statement of cash flows*** or ***funds flow statement***, is a financial statement that shows how changes in balance sheet accounts and income affect cash and cash equivalents, and breaks the analysis down to operating, investing, and financing activities. Essentially, the cash flow statement is concerned with the flow of cash in and cash out of the business. The statement captures both the current operating results and the accompanying changes in the balance sheet. As an analytical tool, the statement of cash flows is useful in determining the short-term viability of a company, particularly its ability to pay bills.

The Statement of Accounting standard 19 discusses the computation and presentation of the different taxes imposed on business companies, such as, company income tax, petroleum profits tax, value added tax, and capital gains tax. It also covers education tax and deferred taxes.

Under section 355 of the Companies and Allied Matters Act, Cap. C20 LFN 2004, companies are allowed to publish abridged financial statements if they wish. The Act, however, does not specify any minimum disclosure requirement of such statements. Statement of Accounting Standard 20 has filled the gap by specifying the minimum contents of such financial statements.

2.0 OBJECTIVES

After studying this unit, you should be able to:

1. State some of the provisions concerning issues in the Statement of Accounting Standard 18.
2. Define the terms used in the Statement of Accounting Standard 19.
3. State some of the provisions concerning issues in the Statement of Accounting Standard 19.
4. Compute the amount related to the deferred taxes.
5. State some of the provisions concerning issues in the Statement of Accounting Standard 20.

3.0 MAIN CONTENT

3.1 SOME PROVISIONS OF STATEMENT OF ACCOUNTING STANDARD 18: STATEMENT OF CASH FLOW

A statement of cash flows provides information about cash receipts and payments of an enterprise over a given period. It indicates the pattern of cash generation and utilization. It reveals how cash is generated from operations or through new capital raised and how payments are made for taxes, dividends, new investments and debts. It is designed to shed light on an enterprise's financial strength.

Definition

The following terms are used in this statement with the meanings specified:

(a) Cash comprises cash on hand and demand deposits denominated in naira and foreign currencies.

(b) Cash equivalents are short-term, highly liquid investments that are readily convertible to known amount of cash and which are subject to an insignificant risk of charges in value.

(c) Cash flows are inflows and outflows of cash and cash equivalents.

Preparation and Format

(a) A reporting enterprise should prepare a statement of cash flows in line with the provisions of this standard as an integral part of its financial statements.

(b) The statement of cash flows should include all cash inflows and outflows of the enterprise during a reporting period. It should however, exclude cash flows arising from the purchase and liquidation of cash equivalents.

(c) An enterprise should report its cash flows according to the activity which gave rise to them and the cash flows should be grouped under the broad headings of operating activities, investing activities and financing activities.

(d) An enterprise should use either the direct or indirect method in preparing its statement of cash flows. However, the direct method is preferred.

(e) The statement of cash flows should report gross cash flows except in the instances where net cash flows would be more relevant and meaningful,

(i) where the enterprise is, in substance, holding or disbursing cash on behalf of its customer; and

(ii) where turnover of investments and loans is rapid and the total volume of transactions is large.

Interest paid and received

(a) Interest paid should be classified as cash flow from financing activities while interest received should be classified as cash flow from investing activities. The interest element of finance lease rental payments should be shown separately by the lessee.
(b) Interest received or paid should be reported gross of taxes. Interest capitalised should also be reported in the statement of cash flows.

Dividends Paid and Received

(a) Dividends received should be classified as cash flows from investing activities except in cases where the investor-company has significant control over the investee-company and holds at least 20 percent of the equity. In such cases, dividends received should be classified as cash flows from operating activities.
(b) Dividends paid and other distributions to owners should be classified as cash flows from financing activities.

Foreign Currency Cash Flows

Cash flows resulting from currency transactions should be translated using the rates applicable at the time they occur. A weighted average exchange rate for a period should be used for translation if the result is substantially the same as if the rates applicable at the dates of the cash flows were used.

Taxation

(a) The total amount of income taxes paid should be classified as operating cash outflows and should be separately disclosed.
(b) The net amount paid or received with respect to value added tax and other sales taxes should be shown separately as cash flows from operating activities.
(c) Taxes paid or refunds received in respect of capital profits such as capital gains tax should be reported in line with the underlying transactions giving rise to them.

Exceptional and Extraordinary Items

Cash flows in respect of exceptional items whose effects are included in the profit and loss account, should be reported under appropriate headings- operating, investing and financing activities- according to the nature of each item. There should be sufficient disclosure of the nature of each item, by way of note to the financial statements.

Acquisition and Disposal of Entities

The cash flow of effects of acquisitions and disposals of subsidiaries and other business units should be classified as investing activities and presented separately in the statement of cash flows. The details required should be presented in aggregate for all entities acquired or disposed off during the financial year.

Major Non-Cash Transactions

Non-cash transactions of a reporting entity should not be incorporated in the statement of cash flows. However, such transactions should be disclosed in the notes to the financial statements in a way that provides all the relevant information about their cash flow implications

Cash flows to be highlighted

The following, however classified, shall be disclosed separately in the statement of cash flows:

(a) Interest received;

(b) Dividends received;
(c) Interest paid;
(d) Dividend paid; and
(e) Income taxes paid.

Reporting Cash Flows of Financial Institutions
Financial institutions should prepare a statement of cash flows as part of their financial statements. However, such organization should report cash flows from operations on a net basis. For instance, rather than reporting the gross amount of fresh loans and loan repayments, the net increase or decrease in loans should be reported.

Reconciliations
Where necessary, an enterprise should show by way of note, a reconciliation of the amounts in its statements of cash flows with equivalent items reported in the profit and loss account and the balance sheet. It should also show by way of note a reconciliation of cash flows from operating activities to operating profit or loss after income tax as reported in the profit and loss account. Finally, the statement of cash flows should include a reconciliation of the increase and decrease in cash and cash equivalents during the reporting period with the operating and closing balances.

ILLUSTRATIVR EXAMPLES
For illustrations on the preparation of cash flow statements, please refer to ACC 311 of your course material.

SELF ASSESSMENT EXERCISE
What is cash and cash equivalent?

3.2 DEFINITIONS OF TERMS USED IN STATEMENT OF ACCOUNTING STANDARD 19

The following terms are used in this statement with the meanings specified:
(a) Accounting profit/loss: This is the aggregate profit and loss for the period as reported in the income statement including exceptional and extraordinary items.
(b) Capital gains: These are gains arising on the disposal of a chargeable asset.
(c) Deferred tax: This is tax (liabilities or assets) attributable to timing differences.
(d) Deferred tax assets: These are the amount of taxes recoverable in future periods which are attributable to the following:
(i) deductible temporary difference such as unused capital allowance;
(ii) carry forwards of unused tax losses; and
(iii) carry forwards of unused tax credits.
(e) Deferred tax liabilities: These are the taxes payable in future accounting periods attributable to timing differences.
(f) Input tax (VAT): This is the tax paid on goods and services purchased.
(g) Input tax credit: This is the credit provided on incurring qualifying capital expenditure by a taxpayer. It serves as a credit against the tax payable by such taxpayer in the relevant year.
(h) Output tax (VAT): This is the tax collected by a taxable person from other parties for goods and services supplied.
(i) Permanent differences: These are differences between taxable and accounting income for a period, that are not expected to reserve in subsequent periods.

(j) Tax expense/tax income: This is the total of current and deferred taxes charged against or credited to the income of the accounting period.

(k) Temporary differences: These are the differences between the amount an asset or a liability is carried in the balance sheet and its tax base.

Temporary differences may be either:

(i) taxable differences, that will result in taxable amount in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled; or

(ii) deductible differences that will result in amount that are deductible in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled.

(l) The tax based of an asset or liability: This is the amount attributed to that asset or liability for tax purpose.

(m) Timing difference: These are differences between the accounting income and taxable income which arise because the periods in which some items of revenue and expense are received or take place are included in taxable income. Such differences originate in one period and are expected to reverse in one or other subsequent periods. While all timing differences are temporary differences, not all temporary differences that arise when:

(i) the carrying amount of an asset or liability on initial recognition differs from its tax base;

(ii) non-monetary asset and liability are restated under financial reporting in an inflationary environment; and

(iii) the non-monetary assets and liabilities of a foreign operation that is integral to the operations of the reporting entity are translated at historical exchange rates.

(n) Value-added tax (VAT): This is a tax payable on supply of taxable goods and services. The tax crystallizes as goods and services pass from one person to another in the production and distribution chain.

(o) Withholding tax: This is an advance payment of tax on income by deduction at source.

SELF ASSESSMENT EXERCISE

What do you understand by temporary difference?

3.3 SOME PROVISIONS OF STATEMENT OF ACCOUNTING STANDARD 19: ACCOUNTING FOR TAXES

Deferred Taxes

(a) Deferred taxes should be computed using the liability method.

(b) Only the timing differences that are expected to reverse during the period allowed by the tax law should be considered in computing deferred taxes for treatment either as an asset or as a charge to the deferred tax account.

(c) Full provision should be made for deferred taxes.

(d) Deferred taxes relating to ordinary activities should be shown as part of the tax on profit or loss resulting from ordinary activities.

(e) Deferred tax relating to extraordinary activities should be shown as part of the tax on extraordinary activities.

Capital Gains Tax (CGT)

(a) CGT should be included in the tax expense for the period.

(b) Where CGT relates to a disposal treated as an extraordinary item, it should be stated as deduction from the item.

Withholding Tax

The tax credit should be used as set-off against income tax payable. Where the tax credit is considered irrecoverable, it should be written off as part of the tax charge for the year.

Value added tax (VAT) and payment of foreign taxes

For the accounting treatment of VAT and payment of foreign tax, please refer to the standard.

Disclosure Requirements

Tax should be recognised as an expense (income) and included in the profit and loss account for the accounting period as a separate line item. The following components of tax expense (income) should be disclosed by way of notes:

(a) Company income tax;
(b) Petroleum profits tax;
(c) Capital gains tax;
(d) Education tax;
(e) Deferred tax; and
(f) Taxes on extraordinary items and prior year adjustment (income or expenses) should be deducted from or added to the related items and disclosed by way of notes.

Deferred taxes, other than those relating to extraordinary items or prior year adjustments, should be shown separately from the items and disclosed by way of notes. Deferred taxes figures should be presented in the balance sheet separately. In the case of liability, they should be shown between long-term and current liabilities and, in the case of assets, between fixed and current assets. Tax assets and liabilities should be disclosed separately in the balance sheet. Movements in these accounts should be shown by way of notes as follows:

(a) Current Taxes
  (i) balances at the beginning of the period;
  (ii) tax charge or credit for the period;
  (iii) payments made during the period;
  (iv) tax credits received during the period; and
  (v) balance at the end of the period.

(b) Deferred Taxes

  (i) balance at the beginning of the period;

  (ii) current year provision (reversal); and

  (iii) balance at the end of the period.

The tax effect relating to the increase in the carrying value of a revalued asset should be determined and charged or credited directly to equity.

(c) Capital Gains Tax

Where provision is not made for capital gains tax because of roll over relief, the fact of non-provision and the amount of capital gains tax involved should be disclosed.

ILLUSTRATION 11

a. The following is the summary of the fixed assets of Niger ltd for the years, 20X4 to 20X8 and the residual values of the assets in those years.

FIXED ASSETS SCHEDULE
(Total Fixed Assets)

	20X4	20X5	20X6	20X7	20X8
	N'000	N'000	N'000	N'000	N'000
Cost at 1st January	1,400	1,800	2,500	2,150	3,450
Addition	700	1,200	-	1,300	-
Disposals	(300)	(500)	(350)	-	-
Cost at 31st December	1,800	2,500	2,150	3,450	3,450
Depreciation at					
1st January	250	350	530	680	1,490
Charge for the year	350	520	450	810	350
Disposals	(150)	(340)	(300)	-	-
Depreciation at 31st	450	530	680	1,490	1,840
NBV	1,350	1,970	1,470	1,960	1,610

b. Tax Computation Schedule
(Summary of all assets)

	20X4	20X5	20X6	20X7	20X8
	N'000	N'000	N'000	N'000	N'000
Residual value b/f	980	900	1,180	960	1,760
Additions during the year	700	1,200	-	1,300	-
Disposal during the year	(180)	(240)	(100)	-	-
	1,500	1,860	1,080	2,260	1,760
Allowances:					
Initial	(310)	(450)	-	(350)	-

Annual	(290)	(230)	(120)	(150)	(190)
Residual value at end of year	900	1,180	960	1,760	1,570

You are required to:

Using only the information given above, compute the deferred taxation for the years 20X4 to 20X8 and the amounts to be charged to the profit and loss account for the years. Assume an average tax rate of 30%.

SUGGESTED SOLUTION 11

COMPUTATION OF DEFERRED TAX FOR THE YEAR 20X4 – 20X8

	20X4	20X5	20X6	20X7	20X8
	N’000	N’000	N’000	N’000	N’000
Net book value of asset at end of year	1,350	1,970	1,470	1,960	1,610
Residual value of asset at end of year	900	1,180	960	1,760	1,570
Balancing charge	450	790	510	200	40
Deferred tax at 30%	135	237	153	60	12
To be charged to profit & loss account	135	102	(84)	(93)	(48)

SELF ASSESSMENT EXERCISE

Outline the provision of the Statement of Accounting Standard 19 in respect of deferred tax.

3.4 SOME PROVISION OF THE STATEMENT OF ACCOUNTING STANDARD 20: ABRIDGED FINANCIAL STATEMENTS

Summary of the Provisions of SAS 20 are as follows.

(a) A company need not publish abridged financial statements. If it does, however, such financial statements should comply with this standard.

(b) Abridged financial statements should carry a declaration that:

(i) they are abridged financial statements;

(ii) the financial statements and specific disclosures included in them have been derived from the full financial statements of the company;

(iii) the abridged financial statements cannot be expected to provide as full an understanding of the financial performance, financial position, and financial and investing activities of the organization as full financial statements; and

(iv) copies of the full financial statements can be obtained from the registrar of the company.

(c) A company whose financial statements for a period are qualified by its auditors, should not published abridged financial statements for that period.

(d) Abridged financial statements must include the following, as in the full financial statements:

(i) accounting policies;

(ii)profit and loss account for the financial year;
(iii) balance sheet as at the end of the financial year;
(iv) Statement of cash flow for the financial year;
(v) notes in relation to exceptional and extraordinary items;
(vi) five-year financial summary; and
(vii) Any other information necessary to ensure that the abridged financial statements are consistent with the full accounts and reports for the year.

(e) Other information to be included in an abridged financial statements are:
(i) notice of annual general meeting;
(ii) names of directors during the year and their shareholdings;
(iii) report of audit committee which should confirm that the auditors' report is unqualified.
(iv) financial highlights (result at a glance); and
(v) dividends paid or proposed and date of payment.

Disclosures Requirements

(a) The following items should be disclosed:
(i) material events occurring after the balance sheet date; and
(ii) where there is a change in accounting policy or estimates from those used in the preceding financial year which has a material effect in the current financial year or is expected to have a material effect in a subsequent financial year, the information about such change in accordance with SAS No. 6: On Extraordinary items and Prior Year Adjustments.

(b) Where a company is a parent company, this statement applies to the consolidated financial statements of the company, and the accompanying notes, and does not require that the parent company's own financial information be provided.

(c) Comparative information
Information for the preceding corresponding financial year which corresponds to the disclosures made in accordance with this standard for current financial year must be disclosed.

SELF ASSESSMENT EXERCISE

What should be disclosed in abridged financial statement?

4.0 CONCLUSION

Complementing the balance sheet and income statement, the cash flow statement (CFS), a mandatory part of a company's financial reports since 1987, records the amounts of cash and cash equivalents entering and leaving a company. The CFS allows investors to understand how a company's operations are running, where its money is coming from, and how it is being spent.

Government are expected to maintain economic stability, full employment, reduce income inequality & promote growth and development. Tax system should be such that it meets the requirements of growing state activities.

Where a company elects to file abridged financial statements with the Companies Registration Office, the information required to be disclosed in the notes to those abridged financial statements is prescribed in section 12 of the Companies Amendment Act 1986.

However, notwithstanding the provisions of section 12, the overriding consideration above all others is that the abridged financial statements are required to give a 'true and fair view' of the state of the company's affairs. Accordingly, in order to ensure that the financial statements give a true and fair view of the state of the company's affairs, it will, under certain circumstances, be necessary for companies to provide disclosure over and above that required by section 12 in the notes to their abridged financial statements.

5.0 SUMMARY

In this unit, we discussed the Statement of Accounting Standard 18, 19 and 20. We looked at the definitions of terms in some of the Standards and state some of the provisions contained in the Standard. We also looked at the computation for deferred tax.

6.0 TUTOR MARKED ASSIGNMENT

1. A company, whose financial statements for a period are qualified by its auditors, should not publish ________ for that period.
2. _________ are short-term, highly liquid investments that are readily convertible to known amount of cash and which are subject to an insignificant risk of charges in value.
3. Cash flows are inflows and outflows of cash and __________.

7.0 REFERENCES/FURTHER READING

Institute of Chartered Accountant of Nigeria, Financial Accounting, Study Pack Lagos.

International Accounting Standard Board, International Accounting Standard.

Nigerian Accounting Standard Board, Statement of Accounting Standard

MODULE 3: FINANCIAL REPORTING 1

UNIT 2: EARNINGS PER SHARE, RESEARCH AND DEVELOPMENT, AND PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS

CONTENT

1.0 INTRODUCTION

In this unit, we shall be discussing Statement of Accounting Standard 21: Earning per Share, Statement of Accounting Standard 22: Research and Development, and Statement of Accounting Standard 23: Provisions, Contingent Liabilities and Contingent Assets.

Earnings per share (EPS) are one of the important ratios used by existing and potential investors to assess businesses. EPS is so important that the NASB and the IASB have singled it out for standardisation. The significance of this ratio stems from its usefulness in calculating price/earnings ratio, and the basis for comparison between companies and relevant periods.

Research refers to the original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding. Development is the application of research findings or other knowledge to a plan or design for the production of new or substantial improved materials, devices, products, processes, systems or services prior to the commencement of commercial production or use. If it is possible to distinguish the research phase from the development phase of an internal project, the entity treats the expenditure on that project as if it were incurred on the research phase only.

Activities of many organizations cut across different classes of businesses and geographical boundaries of their businesses, where such businesses are significantly affected by the different classes or geographical boundaries.

Financial statements are means of communicating information on the resources, obligations, and performance of a reporting entity. Therefore, the information contained therein, should enable users to understand the risks and conditions which have affected or may affect the performance and financial position of the entity.

2.0 OBJECTIVES

After studying this unit, you should be able to:

1. Define the terms used in Statement of Accounting Standard 21.
2. Compute earnings per share.
3. State some of the provisions in Statement of Accounting Standard 22
4. State some of the provisions in Statement of Accounting Standard 23

3.0 MAIN CONTENT

3.1 DEFINITIONS OF TERMS USED IN THE STATEMENT OF ACCOUNTING STANDARD 21: Earnings per Share

The following terms are used in this statement with the meanings specified:

(a) Adjusted Earnings Per Share
This refers to the figure carried in a financial statement as earnings per year for previous years after recalculating the EPS of such years, using the outstanding shares of the company as at the latest balance sheet date as a common denominator all the years.

(b) Basic Earnings per Share
Basic earnings per share is the amount of earnings per share based on the weighted average number of shares outstanding during the reporting period.

(c) Bonus Shares
A bonus share is a share in respect of which purchase consideration is satisfied by capitalising existing reserves, which already belong to the shareholders. It is the formal recognition of the increase in the capital invested by those shareholders. It is also referred to as a stock dividend.

(d) Convertible securities
Convertible securities are financial instruments that confer holders with the right to receive a determinable number of ordinary shares or other securities in satisfaction of their claim at determinable future dates or period.

(e) Diluted Earnings Per Share
Diluted earnings per share are the amount of earnings per share after adjusting for the effect of all potential ordinary shares.

(f) Options and Warrants
An option is the right to deal in the security of an entity at a fixed price during a specific period of time. An option can either be a call option or a put option:
(i) a call option is a right given by one party to another to buy a security at a fixed price during a specific period of time.
(ii) a put option is a right given by one party to another to sell a security at a fixed price during a specific period of time. A warrant is a certificate by a company, which gives its holders the right to purchase its shares at fixed price within a specific period of time. Warrants are prohibited in Nigeria by Section 149(1) of the CAMA, Cap. C20 LFN, 2004.

(g) Ordinary Shares
An ordinary share represents a unit of the ownership interest in a company, which entitles its holder to participate in the earnings, dividends and assets of the company after other interests have been settled.

(h) Potential Ordinary Shares
A potential ordinary share is a financial instrument or any other contract, which could:
(i) be converted into an ordinary share; or
(ii) result in the calling of, or subscription for, ordinary share capital at a fixed price within a specified period of time.

(i) Preference Shares
A preference share is an equity instrument that has claim to a company's earnings, dividends and assets before the ordinary share but after the debt obligations and could be redeemed without a court order or the dissolution of the company either by winding up or liquidation.

(j) Publicly Traded Shares
A publicly traded share is a share of company which can be transferred without the prior consent of its directors and may or may not be listed on a recognised stock exchange or other public securities market.

(k) Rights Issue
A right issue is a privileged issue of the securities of a company, at a price, to its existing shareholders on the basis of their existing shareholdings.

(l) Share Consolidation
Share consolidation, also called reverse split, take place when the number of the outstanding shares in a company is reduced by increasing the par (normal) value of each share.

(m) Share Split:
Share split takes place when the number of the outstanding shares in a company is increased by reducing the par value of each share.

SELF ASSESSMENT EXERCISE
What is the difference between ordinary shares and preference shares?

3.2 COMPUTATION OF EARNINGS PER SHARE

(a) In calculating earnings per share, an enterprise should not include extraordinary items before arriving at profit after tax.
(b) Potential ordinary shares should be treated as dilutive when, and only when, their conversion to ordinary shares would decrease net profit per share from continuing ordinary operations.
(c) The amount of net profit attributable to preference shareholders including preference dividend for the period should be deducted from the net profit (or added to the net loss) in calculating the net profit or net loss for the period attributable to ordinary shareholders.
(d) In order to determine earnings for EPS calculation, the full dividend for the year on cumulative preference shares, should be deducted (the net amount) from the net profit or added to the net loss, whether or not it has been earned or declared, while only the actual dividend paid or proposed on non-cumulative preference shares should be deducted from the net profit.
(e) A weighted average number of shares outstanding during the period should be used as a denominator for the earnings per share calculation. Shares issued during the year included in the weighted average number of shares should reflect the date the consideration was received.

(f) In calculating diluted earnings per share, the number of shares should be determined as the total of the following:
(i) the weighted average number of ordinary shares.
(ii) potential ordinary shares of the entity outstanding as at the beginning of the financial year that remain outstanding as at the reporting date that are dilutive.
(iii) potential ordinary shares issued during the financial year that are dilutive, weighted by reference to the number of days from the date of issue of those potential ordinary shares to the reporting date of issue of those potential ordinary shares to the reporting date as a proportion of the total number of days in the financial year.
(iv) potential ordinary shares outstanding during the financial year that are dilutive and have been converted or have lapsed or cancelled during the year, weighted by reference to the number of days from the beginning of the financial year to the date of conversion lapse or cancellation.

ILLUSTRATION 12
Eggon Plc has a capital structure made up of:

	N
2,000,000 ordinary shares of N2:00 each	4,000,000
Retained Earnings	8,500,000
10% debentures	2,500,000
	15,000,000

In the last three months, the market value of the company's shares has remained at N5:00 per share. Its current year's profit after tax is N10,000,000. Eggon Plc has decided to pay 25% stock dividend to its shareholders from the current year's profit.

You required to show the effect of this on:

(i) the market price of the company's share; and

(ii) the earnings per share

SUGGESTED SOLUTION 12
(i) effect of the stock dividend on the market price of the company's share will be:

Current market price per share is N5:00

Total market value of the shares is 2,000,000 x N5:00 (i.e. N10,000,000)

25% stock dividend = 25% of N10,000,000 = N2,500,000

= N2,500,000/2, that is 1,250,000 new shares at N2:00 per share

With stock dividends, the total number of shares becomes 3,250,000. Since the total market value is N10,000,000, the market price per share will be N10,000,000/3,250,000 per share i.e. N3:08 per share.

Market price per share is expected to reduce to N3:08

(ii) Effect on earnings per share will be as follows:

EPS prior to stock dividend = N10,000,000/2,000,000 = N5:00 per share

EPS after stock dividend will be: 7,500,000/3,250,000 = N2:31

That is, EPS has fallen from N5:00 to N2:31

SELF ASSESSMENT EXERCISE
Outline how you compute earnings per share.

3.3 SOME PROVISIONS OF THE STATEMENT OF ACCOUNTING STANDARD 22: RESEARCH AND DEVELOPMENT

Cost of elements should be separated into:
- (a) Research costs; and
- (b) Development cost.

Research costs include:
- (a) The costs (including VAT) of materials and services consumed in research activity;
- (b) Specific labour costs attributive to research activity;
- (c) The cost of software and equipment acquired for research purposes;
- (d) The cost of borrowed rights;
- (e) The cost of information or technical services;
- (f) The depreciation charge for equipment and facilities to the extent that they are used for research activities;
- (g) The amortization charge for other assets, such as patents and licences, to the extent that they are related to research; and
- (h) Shared costs only in terms of benefits to the parties sharing the costs or costs agreed by the same parties for research based on requests.

Development costs include:
- (a) The cost of evaluating products or process alternatives;
- (b) The cost of design, construction, and testing of pre-production or pre-use prototypes and models;
- (c) The cost of design of tools, jigs, moulds, and dies involving new technology;
- (d) The cost of design, construction, and operation of a pilot plant that is not of a scale economically feasible for production; and
- (e) The cost of design, construction and testing of a chosen alternative for new or improved materials, devices, products, processes, systems or services.

If it is not possible to distinguish the research phase from the development phase of an internal project, the entity shall treat the expenditure on the product as if it were incurred in the research phase only.

Accounting Treatment of Research and Development Costs

(a) Research and development costs shall be separated into research costs and development costs. The amount of research costs shall be expensed in the period in which they are incurred and development costs should be deferred to the extent that they meet the criteria for deferral.
(b) For an entity to defer development costs, the following criteria must be satisfied:
(i) the product or process is clearly defined and the costs attributable to the product or process can be separately identified and measured reliability;
(ii) the technical feasibility of the product or process has been demonstrated;
(iii) the management of the entity has indicated its intention to produce and market, or use, the product or process;
(iv) adequate resources exist, or are reasonably expected to be available, to complete the project and market the product or process.
(v) the current and future cost to be deferred are material; and
(vi) there is a reasonable indication that current costs, future research and development costs to be incurred, together with unamortized deferred costs in relation to that project, are expected beyond any reasonable doubt to be recoverable.
(c) A reporting entity shall state its accounting policy with respect to research and development costs. Where an accounting policy of deferral of development costs is adopted, it shall be applied to all such projects that meet the criteria.
(d) Where development costs of a project are deferred, they shall be allocated on a systematic basis to future accounting periods by reference to either the scale or use of the product or process or to the period over which the product or process is expected to be sold or used.
(e) Where development costs are deferred, the amortization shall not exceed five years from the inception of the benefits;
(f) The deferred development costs of a project shall be reviewed at the end of each accounting period, and the following steps taken;
(i) when the criteria are no longer met, the unamortized balance shall be written off as an expense immediately;
(ii) when the other criteria for deferral continue to be met but that amount of unamortized balance of the deferred development costs and other relevant costs exceed the expected future revenues or benefits relate thereto, such excess shall be charged as expense immediately; and
(iii) if for any reason, research and/or development activities are suspended or postponed on account of lack of resources, time or other contingencies, the unamortized balance shall be written off immediately.

Accounting Treatment of Grants Received in Relation to Research and Development

(a) Where a grant is received or receivable in relation to research and development cost which have been charged to the profit and loss account during the period or in a prior financial year, the grant shall be credited to the profit and loss account;
(b) Where a grant is received or receivable in relation to development costs which have been deferred, the grant shall be deducted from the unamortized balance; and
(c) Development costs which did not previously meet the criteria for deferral and were charged to the profit and loss account shall not be written back in the light of subsequent events.

DISCLOSURE REQUIREMENTS

In addition to the disclosure requirements of SAS 2, the financial statements of an entity shall disclose:

(a) The accounting policies adopted for research and development costs;
(b) The amount of research costs and development recognised as an expense in the period;
(c) The amortization methods used as regards development costs;
(d) The useful lives or amortization rates used; and
(e) A reconciliation of the unamortized development costs at the beginning and end of the period, showing:
    (i) development costs recognised as an asset;
    (ii) development costs recognised as an expense;
    (iii) development costs allocated to other asset accounts; and
(f) The grants received in respect of research and development, the amount received or receivable and the source(s).

ILLUSTRATION 13

Major Oil Plc is about to acquire another oil company, Peanut Oil Limited, for N700 million. The consideration includes a purchase of four years' profits. You are also given the following information:

PEANUTS OIL LIMITED

FINANCIAL SUMMARIES

	2004	2005	2006	2007	2008
	N'm	N'm	N'm	N'm	N'm
Sales	-	70	142	194	270
Expenses	(75)	(72)	(108)	(121)	(130)
Net profit/(loss)	(75)	(2)	34	73	140
Fixed Assets	270	274	302	310	300
Current Assets	35	29	35	100	220
	305	303	337	410	520

In 2004, Peanuts Ltd spent N12 million in obtaining licence to prospect for oil in Nigeria for an initial period of 20 years. In 2006, the company formulated a brand of engine oil for N24 million to lead the market. Industry analyst predicted that this brand of engine oil would remain dominant for 10 years. The licensing and brand development costs were written off in the year of expenditure.

You are required to:

(a) Advise on the treatment of licensing and development costs in the accounts and draft a suitable accounting policy for the two items.
(b) Assess the offer of N700 million for the company by Major Oil Plc.

SUGGESTED SOLUTION 13

(a) It is not proper to write off licensing and brand development costs in the year of expenditure.
The proper treatment should be to write off licensing costs over 20 years and brand development cost over 10 years.
(i) Accounting Policies
Licensing fees
These are written off over the expected useful life of the licence on a straight line basis.

(ii) Research and Development

Research costs are written off in the year of expenditure and development costs are amortized over the estimated useful life of the product.

(b) Assessment of the offer of N700 million:
Since licensing fees and brand development costs should be spread over their useful lives, the accounts should be reconstructed.
(i) licensing fees written off over 20 years
N12 m /20 = N600,000 per annum
(ii) brand development costs written off over 10 years
24/10 = N2,400,000 per annum

PEANUTS OIL LIMITED
FINANCIAL SUMMARIES

	2004	2005	2006	2007	2008
	N'm	N'm	N'm	N'm	N'm
Net profit	(75)	(2)	34	73	140
Add back	-	12	-	24	-
Less	(0.6)	(0.6)	(3)	(3)	(3)
	(75.6)	(2.6)	31	70	137

Value of intangible assets
License = 12m – (0.6 x 5) = N9m
Brand developments = (24m – N2.4m x 3) = N16.8
Total = N9m + N16.8m = N25.8m
Therefore net assets in 2008 becomes

Net assets	520m
Added intangible assets	25.8m
Adjusted net assets	N545.8m

Four years purchase of goodwill
Average profit = (75.6 + (2.6) + 31 + 70 + 137/5 = N31.96m

Four years purchase = N31.96 x 4 = N127.84m
Therefore fair purchase consideration = net assets + goodwill
That is = N(545.8m + 127.84m) = N673.64m
It is therefore, not a fair bargain if Peanuts Oil limited could be acquired for only N700m.
The present value of the company is N26.36 million lower than the purchase consideration.

SELF ASSESSMENT EXERCISE
What is included in research cost?

3.4 SOME PROVISIONS OF THE STATEMENT OF ACCOUNTING STANDARD 23: PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS

Meaning of Provisions
Provisions are liabilities that have arisen or are likely to arise in respect of a previous or current financial year. Such liabilities are charges against incomes and they often have substantial effect on an entity's financial position and performance.
Due to the uncertainties surrounding the timing of events that may give rise to provisions and actual amount of liabilities involved, there is need to ensure uniformity and completeness in the manner in which such provisions are recognised and measured in financial statements. It is also of utmost important that sufficient information is provided in the financial statements to enable users understand their nature, timing and amounts.

Relationship between Provisions and Contingent Liabilities
All provisions are usually contingent since they are uncertain in timing or amount. The term, "contingent", is used for liabilities as well as for assets, whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity. The term, "contingent liability", is used for liabilities, that do not meet the recognition criteria of a "provision".

CONTINGENT LIABILITIES
A contingent liability is either a possible obligation arising from past events, whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the entity's control, or a present obligation that arises from past events that it is probable a transfer of economic benefit will be required to settle the obligation or because the amount of the obligation cannot be measured with sufficient reliability.
A provision shall be recognised when:
(a) An entity has a present obligation (legal or constructive) as a result of past event;
(b) If it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and
(c) A reliable estimate can be made of the amount of the obligation.

If these conditions are not met, no provision shall be recognised.

The amount recognised as a provision shall be the best estimate of the expenditure required to settle the present obligation at the balance sheet date.

The risks and uncertainties that inevitably surround many events and circumstances shall be taken into account in arriving at the best estimate of the provision.

Where the effect of the time value of money is material, the amount of a provision shall be the present value of the expenditure expected to settle the obligation.

Contingent Liabilities
A contingent liability is

(a) A possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one more uncertain future events not wholly within the control of the entity; or
(b) A present obligation that arises from past events but is not recognised because the amount of the obligation cannot be measured with sufficient reliability or it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation.

Contingent liabilities should not be provided for in the accounts. If it is probable that transfer of economic benefits will be required to settle that obligation and the amount of the obligation can be measured with sufficient liabilities, a disclosure should be made in the financial statements.

Contingent Assets
A contingent asset is a possible asset that arises from past event(s) and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity.

An entity should not recognise a contingent asset in its financial statements. If it is probable that future economic benefits will flow, the entity and the amount can be measured with sufficient reliability, a disclosure should be made in the financial statements.

Onerous Contract
(a) If an entity has a contract that is onerous, the present obligation under the contract should be recognised and measured as a provision.
(b) A constructive organization to restructure arise only when an entity:
(i) has a detailed formal plan for the restructuring, identifying at least;
- The business or part of the business concerned;
- The principal locations affected;
- The location, function and approximate number of employees
- Who will be compensated for terminating their services;
- The expenditure that will be undertaken; and
- When the plan will be implemented; and

(ii) has raised a valid expectation in those affected.

SELF ASSESSMENT EXERCISE
What is the difference between provisions and contingent liabilities?

4.0 CONCLUSION

In conclusion, we would state that earnings per share are generally considered to be the single most important variable in determining a share's price. It is also a major component used to calculate the price-to-earnings valuation ratio.

The term 'research and development' is used to cover a wide range of activities, including those in the services sector. Classification of expenditure is often dependent on the type of business and its organisation. However, it is generally possible to recognise three broad categories of activity, namely pure research, applied research and development.

5.0 SUMMARY

In this unit, we discussed Statement of Accounting Standard 21: Earning per Share, Statement of Accounting Standard 22: Research and Development, and Statement of Accounting Standard 23: Provisions, Contingent liabilities and Contingent Assets.

Basic earnings per share is the amount of earnings per share based on the weighted average number of shares outstanding during the reporting period.

A contingent liability is either a possible obligation arising from past events, whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the entity’s control, or a present obligation that arises from past events that it is probable a transfer of economic benefit will be required to settle the obligation or because the amount of the obligation cannot be measured with sufficient reliability.

A contingent asset is a possible asset that arises from past event(s) and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity.

6.0 TUTOR MARKED ASSIGNMENT

1. In calculating earnings per share, an enterprise should not include _________ before arriving at profit after tax.
2. Where development costs of a project are deferred, they shall be allocated on _________ to future accounting periods.
3. What is a possible asset that arises from past event(s) and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity?
4. What could be either a possible obligation arising from past events, whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events?

7.0 REFERENCES/FURTHER READING

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MODULE 3: FINANCIAL REPORTING 1

UNIT 3: SEGMENT REPORTING AND TELECOMMUNICATION ACTIVITIES

CONTENT

1.0 INTRODUCTION

In this unit, we shall discuss Statement of Accounting Standard 24: Segment Reporting and Statement of Accounting Standard 25: Telecommunication Activities.

Business segment means a distinguishable component of an entity, where such component is engaged in providing a product or service, or a group of related products or services that is subject to risks and returns that are different from those of components operating in other economic environments.

The substantial amount of resources deployed in the telecommunications industry and the peculiarity of its operations necessitates the development of an accounting standard to ensure uniformity in the reporting pattern of entities engaged in it.

2.0 OBJECTIVES

After studying the unit, you should be able to:

1. Identify reportable segment according to Statement of Accounting Standard 24.
2. Compute the present value of the de-commissioning cost.
3. Compute the liability at the end of each year and changes in liability.
4. Calculate the depreciation charges on the equipment.
5. Prepare fixed asset schedule.

3.0 MAIN CONTENT

3.1 SOME PROVISIONS OF STATEMENT OF ACCOUNTING STANDARD 24: SEGMENT REPORTING

Scope

This statement applies to all entities that carry on different classes of businesses or operate in different geographical areas.

Identification of Business Segments

In determining business segments, a reporting entity would need to consider factors which include:

(a) Existing profit centres;

(b) The nature of the product or service;
(c) The nature of the production process;
(d) Markets and marketing methods; and
(e) The nature of the regulatory environment, for example, bank, insurance, oil and gas, public utilities, etc.

Organizational groupings such as divisions, subsidiaries, or branches, are ordinarily created according to management requirements. Such groupings often correspond with the determinable segments of the entity, thus facilitating segment reporting. Where this is not the case, segment reporting may require reclassification of data.

It is relevant to consider the interrelationships among an entity's activities. For example, it may be potentially misleading to report as separate business segment, parts of an entity's activities that are significantly integrated or interdependent.

Identification of Geographical Segments
Operations of a reporting entity will only classify as operations of a geographical segment if they extend beyond facilitating export sales or services from the reporting entity's domestic operations. If the product were substantially manufactured, assembled or acquired in the overseas county, the activities would be classified as geographical segment.

Factors that are usually considered in identifying geographical segments include:
(a) Similarity of economic and political conditions;
(b) Relationships between operations in different geographical areas;
(c) Proximity of operations;
(d) Special risks associated with operations in a particular areas;
(e) Exchange control regulations; and
(f) The underlying currency risks.

Determining Material Business and Geographical Segments
After entity has been divided into business and geographical segments, it is necessary to decide whether particular segments are material and so warrant separate reporting. The materiality of a segment to the entity as a whole, can be measured in terms of its revenue, results, or assets employed. A segment would be considered material if one or more of the following conditions apply:

(a) Its revenue is 10 percent or more of the total revenue of all segments; or
(b) Its segment result, whether profit or loss, is 10 percent or more of the combined result of all segments in profit or the combined result or all segments in loss, whichever is the greater in absolute amount; or
(c) Its assets are 10 percent or more of the total assets of all segments; or
(d) Where it is required by regulatory authorities.

To provide an adequate insight into the entity's operations, it is necessary for the material segments to represent a substantial proportion of total operations. This is deemed to be the case where the total revenue from sales of all material segments to the segments outside customers, constitutes 75 percent or more of the entity's external revenue. Where this materiality test has not been met, the entity should identify more segments, even if the additional segments do not meet the ten percent threshold as specified above.

If an entity has two or more classes of businesses, or operations in two or more geographical segments which differ substantially from each other, it should define its classes of businesses and geographical segments in its financial statements, and it shall report with respect to each class of business and geographical segment, the following financial information:

(a) Revenue or turnover, distinguishing between:
    (i) revenue or turnover derived from external customers; and
    (ii) revenue or turnover derived from other segments;
(b) Result, before accounting for taxation, minority interests and extraordinary items; and
(c) Net assets.

A business or geographical segment shall be identified as a reportable segment if a majority of its revenue is earned from sales to external customers and:

(a) Its revenue is earned from sales to external customers and from transactions with other segments is 10 percent or more of the total revenue, external or internal, of all segments; or
(b) Its segment result, whether profit or loss, is 10 percent or more of the combined result of all segments in profit or loss, is 10 percent or more of the combined result of all segments in profit or the combined result of all segments in loss, whichever is greater in absolute amount; or
(c) Its assets are 10 percent or more of the total assets of all segments

Disclosure Requirements
The total of the amounts disclosed by segments should agree with the related total in the entity's financial statements. Otherwise, the reporting entity shall provide reconciliation between the two amounts. Reconciling items shall be properly identified and adequately disclosed.

Revenue from both external and internal sources shall be disclosed with the latter shown on the basis of internal transfer prices. Any change in the basis for such transfer prices shall also be disclosed.

Where inter-segment sales and transfers constitute a material part of the total revenue of the reportable segments, they shall be analyzed in segments and shown separately. The geographical analysis of inter-short-term investment or turnover shall be disclosed.

ILLUSTRATION 14
Polo Plc operates in five geographical segments and ten business segments. Data relating to the geographical segments for the year ended 31 December 200X9, are as follows:

	Aba	Gboko	Edo	Warri	Kano
	N'000	N'000	N'000	N'000	N'000
Total revenue from sales	6,000	2,000	8,000	9,000	7,000
Sales to external customers	4,000	1,200	3,500	6,000	4,000
Sales to other segments	2,000	800	4,500	3,000	3,000
Segment results	9,600	3,000	9,700	9,200	(6,000)

Assets	9,800	2,100	9,200	7,100	4,800

Identify the reportable geographical segment in accordance with SAS 24.

SUGGESTED SOLUTION 14

Step 1

The first step in determining a reportable segment is to identify the segments that earn majority of their revenue from sales to external customers.

Segment	% of sales to external customers	Qualify?
Aba	4,000/6,000 X 100 = 67%	Yes
Gboko	1,200/2,000 X 100 = 60%	Yes
Edo	3,500/8000 X 100 = 44%	No
Warri	6,000/9,000 X 100 = 67%	Yes
Kano	4,000/7,000 X 100 = 57%	Yes

Step 2 Apply the 10% Rule

The next step is to apply the 10% rule according to SAS 24.40

	N'000	N'000
Revenue test		
10% of total revenue: 10/100 X N32,000		3,200
Profit or loss test		
Higher of 10% of total profit and total loss:		
10% of total profit [0.1 x (9,600 + 3,000 + 9,700 + 9,200)]		3,150
10% of total loss (0.1 x 6,000)	600	
Asset test 10% x N33,000		3,300

Segments that meet the 10% rule are Aba, Warri and Kano.

Step 3: apply the 75% rule

The total revenue of the three reportable segments based on step 2 is N22 million (6m +9m + 7m). this is only 68% of the total revenue. Calculate as follows: 22/32 x 100.

SAS 24.22 requires that it the proportion of reportable segments' revenue is not up to 75%, more segments should be identified even though they do not meet the 10% rule.

Therefore, the reportable segments will include Gboko.

SELF ASSESSMENT EXERCISE
How do you determine a business segment?

3.2 SOME PROVISIONS OF STATEMENT OF ACCOUNTING STANDARD 25: TELECOMMUNICATION ACTIVITIES

FIXED ASSETS

De- commissioning Costs
The present value of management's best estimate (based on annual probability analysis) of the cost of de-commissioning and dismantling a site at the time of installation, shall be included in the cost of an item of property, plant and equipment. Any subsequent change to this estimate shall be added to, or deducted from, the item's cost. The carrying amount shall be added to, or deducted from, the item's cost. The carrying amount shall then be subsequently depreciated over its remaining useful life.

Over the passage of time, the corresponding liability shall be adjusted for the time value of money. Such increases in the liability shall be recognised as an interest expense in the profit and loss account of each period. The liability shall also be adjusted to record the effects of any reinstatements/disposal and the corresponding payments/realization of de-commissioning costs.

ILLUSTRATION 15
The management of NEWTEL Ltd has estimated that a de-commissioning cost of N665,500 will be incurred at the end of three years in respect of a new equipment installed on 1st January 20X5. The management has further estimated that a discount rate of 10% will give the present value of the de-commissioning cost at 1 January 20X5.

You are required to:

(a) Compute the present value of the de-commissioning cost to be included in the property, plant and equipment of NEWTEL Ltd on 1 January 20X5.
(b) Compute the liability at the end of each year and changes in liability to be recognised as an interest expense in profit or loss are required by SAS 25.

SUGGESTED SOLUTION 15
(a) Given a discount rate of 10% and a three year period, the present value of N665,500 would be 1/(1.1)3 x N665,500 = 1/1.331 x 665,500 = N500,000
Therefore, N500,000 will be included in the cost of equipment of NEWTEL Ltd on 1 January 20X5 and the carrying amount of the equipment will be depreciated over its useful life as required by SAS 25.
(b) SAS 25 also requires that the reporting entity should recognise a corresponding liability which should be adjusted for the time value of money. The increases in liability should be recognised as interest expenses in the income statement for each period.
One way to easily obtain the liability at the end of the year and the increases in liability, is to unwind the interest as follows:

	N
Liability at 1 January 20 x 5	500,000
Discount for 20 x 5 (10% x 500,000)	50,000

Liability at 31 December 20 x 5	550,000
Discount for 20 x 6 (10% x 550,000)	55,000
Liability at 31 December 20 x 6	605,000
Discount for 20 x 7 (10% x 605,000)	60,500
Liability at 31 December 20 x 7	665,500

Tutorial
Observe that the liability increases with the passage of time. SAS 25 requires that the increases should be recognised as interest expense in the profit and loss account of each period. Thus, the amount to be recognised as interest expense each year would be: 20X5, N50,000; 20X6, N55,000 and 20X7, N60,500.

Commencement of Depreciation of Network Assets
Depreciation of network assets shall commence when an asset is available for use, irrespective of whether it is actually used or not.

Component Accounting
Each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item shall be separately depreciated.

An entity shall allocate the amount initially recognised in respect of an item of property, plant and equipment to its significant parts and depreciate them separately.

A significant part of an item of property, plant and equipment that has a useful life and depreciation methods that are the same as those of another significant part of that same item, shall be grouped in determining the depreciation charge.

To the extent that an entity depreciates separately some parts of an item of property, plant and equipment. It also shall depreciate separately the reminder of the item. The remainder consists of the parts of the item that are individually not significant. If an entity has varying expectations of these parts, approximation techniques shall be applied to depreciate the remainder in a manner that faithfully represents the consumption pattern and/or useful life of the parts.

Stand-by equipment and strategic spares shall be depreciated over the expected useful life of similar equipment in use.

ILLUSTRATION 16
All peoples Network, a newly established telecommunication company in Nigeria, acquired special telecommunication equipment for N500 million on 1 January 20X7. The equipment has three major components, which for ease of reference, may be referred to as component A, component B, and component C. The estimated useful life of the entire component is 20 years, but component A will need to be replaced after 5 years, component B after 7 years and component C after 10 years. The cost price of N500 million included N20 million, N42 million and N50 million, for components A, B, and C, respectively.

You are required to calculate the depreciation charge on the equipment for 20X7.

SUGGESTED SOLUTION 16
SAS 25 requires separate depreciation charge for each major component of an item of property, plant and equipment. Therefore, the depreciation charge on the equipment will be calculated as follows:

		Nm
Component A	20m/5years	4
Component B	42m/7years	6
Component C	50m/10	5
The rest of the equipment N388/20years		19.4
		34.4

INTANGIBLES
Subscriber Acquisition costs relate exclusively to an explicit contract, they may be capitalized if and only if:

(a) The operator controls by means of an enforceable contract, future economic benefits as a result of the costs incurred;
(b) It is probable that those future economic benefits will eventuate; and
(c) The costs are specific to the particular contract and can be measured reliably.

Subscriber acquisition costs, other than those dealt with above, shall be expensed as incurred.

Capitalized acquisition costs shall be amortized over the specific period of the contract. If a contract for which subscriber acquisition costs have been capitalized is terminated early, then the net book value of the intangible asset shall be regarded as impaired.

Amortization of Licence Fee
Amortization of license fee may commence from either the date of issuance of licence or date of commercial launch. However, the amortization period shall not exceed expiration date of the licence and shall be calculated on the straight line basis over the estimated period.

If the recoverable amount of an asset, such as licence fee, is less than its carrying amount, the carrying amount of the asset shall be reduced to its recoverable amount. That reduction is an impairment loss.

An impairment loss shall be recognised immediately in the profit and loss account. After the recognition of an impairment loss, the amortization charge for the asset shall be adjusted in future periods to allocate the asset's revised carrying amount, less its residual value (if any), on a systematic basis over its remaining useful life.

Co-location Arrangements
A seller of a right to use capacity shall not report the transaction as sale of an asset, or of a component of a large asset, but as a rental income which is recognized on a straight line basis over the period of the Indefeasible Right to Use (IRU), unless:

(a) The purchaser's right of use is exclusive and irrevocable;

(b) The asset component is specific and separable (such that the buyer's exclusivity is guaranteed and the seller has not right to substitute other assets);
(c) The term of the contract is for a major part of the asset's useful life;
(d) The attributable cost or carrying value can be measured reliably; and
(e) No significant risks, as indicated in paragraph 30, are retained by the seller.

Interconnection Cost
Interconnection cost shall be calculated at the agreed regulated rate of the charges (gross) and recognised by the originating operator (who has an obligation to pay a terminating operator for terminating calls on its network) as incurred.

Exchange Transactions
An entity that sells capacity on its network to another entity, shall recognise the revenue (gross) as earned. Similarly, an entity that purchases capacity on the network of another entity, shall recognise the cost (gross) as incurred. Where there is exchange of airtime for any transaction of a financial nature, but without inflow or outflow of cash, such exchange shall be governed by a written agreement and accounted for by the transacting parties.

Where the exchange or reciprocal transactions entered into for capacity is such that the transacting parties had no current need and where the subject of the transaction will otherwise be saleable, non-accounting recognition shall be given.

Bundled Product
The revenue recognition criteria shall be applied separately to each transaction. However, in certain circumstances, where it is necessary to apply the recognition criteria to the separately identifiable components of a single transaction in order to reflect the substance of the transition, the bundled products shall be properly itemised and revenue recognition criteria shall apply to them separately. Where there is a discount on a bundled product, the discount shall be prorated and applied on all the elements of the bundled product's cost.

ILLUSTRATION 17

(a) A Telecommunication Service Provider (TSP) has three products named handsets, sim pack and air time. The price per unit for each product is N5,000, N2,000, N500, respectively.
The Telecommunication Service Provider in preparation for its first year anniversary of commencement of its operations, decided to bundle these products and offered the new product (i.e. bundled product) for N6,000.
Required:
(i) state how the discount offered the subscribers would be treated in the company's books in line with the provisions of SAS 25.
(ii) apply the above principle to the discount.
(b) Tellfone ltd is a Telecommunication Activities Service Provider registered with both NCC and CAC. Included in its items of fixed assets are the following:

	N'000
Masts	10,000
Switching Machine	3,750
Generator	1,000
Transformer	5,000

Stand-by equipments are:

Switching machine	2,750
Generator	1,000

The standby equipment were idle for the period as there was no breakdown of the asset in its four (4) years of operations. The company's policy is to depreciate equipment at the following rates.

Masts	10%
Switching machine	20%
Generator	25%
Transformer	10%

Masts, switching machine and transformer could be traded for N2 million, N0.5 million and N1 million, respectively after the expiration of the life span of the licence procured for 4 years.

Required:

Prepare the fixed assets schedule in line with the provisions of SAS 3 and SAS 25 to reflect impairment losses (if any).

SUGGESTED SOLUTION 17

(a) (i) Where there is a discount on a bundled product, the discount shall be pro-rated and applied on all the cost elements of the bundled products.

(ii) Products

	N
Handset	5,000
Sim pack	2,000
Air time (free)	500
	7,500
Bundled at	(6,000)
Discount	1,500

Discounted pro-rated viz:

Handset	5,000/7,500 = 2/3 x 1,500/1 =	1,000
Sim pack	2,000/7,500 = 40/150 x 1,500/1 =	400
Air time	500/7,500 = i/15 x 1,500/1 =	100
		1,500

Discounted prices to customers:

	Handset	Sim pack	Air time	Total
	N	N	N	N
Initial cost	5,000	2,000	500	7,500
Less pro-rated discount	1,000	400	100	1,500

Bundled prices	4,000	1,600	400	6,000

(b) TELLFONE LIMITED

Fixed assets schedule

		Transformer	Masts	Switching Machine	Generator	Total
		N'm	N'm	N'm	N'm	N'm
Cost		5	10	3.75	1.25	20.00
Standby equipment		-	-	2.75	1.00	3.75
Total	(i)	5	10	6.50	2.25	23.75
Depreciation rate %		10	10	20	25	-
Depreciation per year		0.5	1	1.3	0.5625	3.3625
Accumulated dep. for 4years		2	4	5.2	2.25	13.45
Residual values		1	2	0.5	-	3.5
Carrying amount	(ii)	3	6	5.7	2.25	16.95
Impairment losses	(i –ii)	2	4	0.8	nil	6.8

Disclosure requirements

In addition to the disclosure requirements of other applicable statements of Accounting Standards, entities engaged in telecommunications activities shall also disclose the following:

(a) Description of how revenues from various types of telecommunications activities are recognised;
(b) A description of how deferred revenue is calculated;
(c) A description of how any expired deferred revenue is treated in the financial statements;
(d) A description of how subscriber acquisition costs are treated in the financial statements;
(e) A description of the amortization methods used for intangible assets (including license fees);
(f) Free airtime given and the movement thereof;
(g) Treatment of dismantling, removal and site restoration costs; and
(h) The method, assumptions, external valuers involved (professional details), policy on frequency, nature of indices used for probability analysis by management in arriving at the present value of the best estimate of decommissioning costs.

ILLUSTRATION 18

On 31 December 20X9,Power Plc, acquired 12 million shares of the 15 million shares of Sweet Plc for N30 million. On that date, the acquirer, Sweet Plc, had retained earnings amounting to N4 million and the fair value of its net assets was N19 million. You are required to calculate the goodwill on acquisition in accordance with SAS 26.

SUGGESTED SOLUTION 18

Step 1

Calculate the proportion acquired.

Proportion of interest acquired by powder Plc is 80% obtained as follows: 12 million shares divided by 15 million shares multiplied by 100.

Step 2

Calculate the non-controlling interest (NCI).

Non-controlling interest in the equity of the acquire is calculated as follows:

	N'000
Ordinary shares	15,000
Retained earnings	4,000
Total equity	19,000

NCI = N19M x 20% = N3.8m

Step 4

Calculate the goodwill in accordance with SAS 26

	N'000
Consideration transferred	30,000
Non-controlling interest	3,800
	33,800
Net assets acquired	19,000
Goodwill	14,800

Contingent Considerations

Some changes in the fair value of contingent consideration that the acquirer recognises after the acquisition date may be the result of additional information that the acquirer obtained after that date about facts and circumstances that existed at the acquisition date.

Such changes are measurement period adjustments in accordance with paragraphs 45 – 49 of SAS 26. However, changes resulting from events after the acquisition date, such as meeting an earnings target, reaching a specified share price or reaching a milestone on a research and development project, are not measurement period adjustments.

SELF ASSESSMENT EXERCISE

Explain what you understand by a de-commissioning cost and an interconnection cost.

4.0 CONCLUSION

A business segment is a distinguishable component of an enterprise that is engaged in providing an individual product or service or a group of related products or services and that is subject to risks and returns that are different from those of other business segments.

The dominant source and nature of risks and returns of an enterprise should govern whether its primary segment reporting format will be business segments or geographical segments. If the risks and returns of an enterprise are affected predominantly by differences in the products and services it produces, its primary format for reporting segment information should be business segments, with secondary information reported geographically. Similarly, if the risks and returns of the enterprise are by the fact that it operates in different countries or other geographical areas, its primary format for reporting segment information should be geographical segments, with secondary information reported for groups of related products and services.

5.0 SUMMARY

In this unit, we discussed Statement of accounting Standard 24: Segment Reporting and Statement of Accounting Standard 25: Telecommunication Activities.

In determining business segments, a reporting entity would need to consider factors which include: Existing profit centres; the nature of the product or service; the nature of the production process; Markets and marketing methods; and the nature of the regulatory environment, for example, bank, insurance, oil and gas, public utilities, etc.

The present value of management's best estimate (based on annual probability analysis) of the cost of de-commissioning and dismantling a site at the time of installation, shall be included in the cost of an item of property, plant and equipment. Any subsequent change to this estimate shall be added to, or deducted from, the item's cost. The carrying amount shall be added to, or deducted from, the item's cost. The carrying amount shall then be subsequently depreciated over its remaining useful life.

6.0 TUTOR MARKED ASSIGNMENT

1. Where it is necessary to apply the recognition criteria to the separately identifiable components of a single transaction in order to reflect the substance of the transition, what shall be properly itemised and revenue recognition criteria shall apply to them separately?
2. A business or geographical segment shall be identified as a reportable segment if a majority of its revenue is earned from what?

7.0 REFERENCES/FURTHER READING

Institute of Chartered Accountant of Nigeria, Financial Accounting, Study Pack Lagos.

International Accounting Standard Board, International Accounting Standard.

Nigerian Accounting Standard Board, Statement of Accounting Standard

MODULE 4: FINANCIAL REPORTING 2

UNIT 1: BUSINESS COMBINATIONS, INTERIM FINANCIAL REPORTING, PRESENTATION OF FINANCIAL STATEMENTS, EVENTS AFTER THE REPORTING PERIOD AND REVENUE

CONTENT

1.0 INTRODUCTION

In this unit we shall be discussing a couple of issues as contained in the various financial accounting standards. Specifically, we shall be discussing Statement of Accounting Standard 26: Business Combinations, Statement of Accounting Standard 30: Interim Financial Reporting, International Accounting Standard 1: Presentation of Financial Statements, International Accounting Standard 10: Events after the Reporting Period, and International Accounting Standard 18: Revenue.

A business combination is the bringing together of separate entities or businesses into one reporting entity. The result of nearly all business combinations is that one entity, the acquirer, obtains control of one or more other businesses, the acquirees.

Events after the reporting period is a favourable or unfavourable event that occurs between the end of the reporting period and the date that the financial statements are authorized for issue.

IAS 18 prescribes the accounting treatment for revenue arising from sale of goods and other operating activities of the enterprise. Generally, revenue is recognised when it is probable that future economic benefits will flow to an enterprise, and the amount of revenue can be measured with reliability.

2.0 OBJECTIVES

After studying this unit, you should be able to:

1. State some of the provisions concerning business combinations according to SAS 26.
2. State some of the provisions concerning interim financial reporting according to SAS 30.
3. State some of the provisions concerning presentation of financial statements.
4. Identify the formats of financial presentation.
5. State some of the provisions concerning events after the reporting period.
6. State some of the provision s concerning revenue

3.0 MAIN CONTENT

3.1 SOME PROVISIONS OF THE STATEMENT OF ACCOUNTING STANDARD 26: BUSINESS COMBINATIONS

Method of Accounting

All business combinations shall be accounted for by applying the acquisition method.

Identifying the acquirer

An acquirer shall be identified for all business combinations. The acquirer is the combining entity that obtains control of the combining entities or businesses.

Adjustment to the cost of a Business Combination contingent on Future Events

When a business combination agreement provides for an adjustment to the cost of the combination contingent on future events, the acquirer shall include the amount of that adjustment in the cost of the combination at the acquisition date if the adjustment is probable and can be measured reliably.

Goodwill

The acquirer shall, at the acquisition date:

(a) Recognise goodwill acquired in a business combination as an asset; and

(b) The acquirer shall recognise goodwill as of the acquisition date measured as the excess of (i) over (ii) below:

(i) The aggregate of:

- The consideration transferred, measured in accordance with this standard, which generally requires acquisition date fair value;
- The amount of any non-controlling interest in the acquire, measured in accordance with this Standard; and
- In a business combination achieved in stages, the acquisition-date fair value of the acquirer's previously held equity interest in the acquire.

(ii) the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed measured, in accordance with this standard.

Measurement Period Adjustments

The acquirer shall account for changes in the fair value of contingent considerations that are not measurement period adjustment as follows:

(a) Contingent consideration classified as equity shall not be re-measured and its subsequent settlement shall be accounted for within equity.
(b) Contingent consideration classified as an asset or a liability is treated, thus:
(i) as a financial instrument, it is measured at fair value, with any resulting gain or loss recognised either in profit or loss or in other comprehensive income; or
(ii) accounted for in accordance with SAS 23 – Provisions, Contingent Liabilities and Contingent Assets or other SASs as appropriate.

Disclosure requirements
An acquirer shall disclose information that enables users of its financial statements to evaluate the nature and financial effect of business combinations that were effected during the period.

An acquirer shall disclose information that enables users of its financial statements to evaluate the nature and financial effect of business combinations that were effected after the balance sheet date but before the financial statements are authorized for issue.

To give effect to the principle in paragraph 85, the acquirer shall disclose the following information for each business combination that was effected during the period:

(a) The names and descriptions of the combining entities or business;
(b) The acquisition date;
(c) The percentage of voting equity instruments acquired;
(d) The cost of the combination and a description of the components of that cost; and
(e) Acquisition related costs.

SELF ASSESSMENT EXERCISE
What information is expected to be disclosed by the acquirer for each business combination?

3.2 STATEMENT OF ACCOUNTING STANDARD 30: INTERIM FINANCIAL REPORTING
Interim financial reports should be prepared to provide current updates on the financial position, results of operations and changes in cash flows of the financial year, from the beginning of the accounting year to date.

An interim financial report should include, at a minimum, the following components:
(a) Condensed statement of accounting policies;
(b) Condensed balance sheet;
(c) Condensed profit and loss account;
(d) Condensed statement of cash flows; and
(e) Selected notes to the accounts.

The interim financial report should carry a statement indicating whether or not the interim financial statements are audited. Where they are audited, the auditors' report shall be included.

The set of condensed financial statements which an entity publishes in its interim financial report shall include, at a minimum, each of the headings and sub-totals that were included in its most recent annual financial statements and the selected explanatory notes as required by this Standard. Additional line items or notes shall be included if their omission would make the condensed interim financial statements misleading.

An entity shall apply the same accounting policies and principles in its interim financial statements as are applied in its annual financial statements, except for accounting policy changes made after the date of the most recent annual financial statements and are to be reflected in the next annual financial statements. However, the frequency of an entity's reporting (annual, half-yearly or quarterly) shall not affect the measurement of its annual results. To achieve that objective, measurements for interim reporting purposes, shall be made on a year-to-date basis.

Exceptional and extraordinary items shall be recognised and disclosed in the profit and loss account of the interim period in which they occur in accordance with SAS 6- Extraordinary items and prior year adjustments.

Significant movements in key indicators of the entity's financial position shall be explained by way of notes.

A reconciliation of net income to net cash provided by operating activities shall be given in sufficient detail for users to appreciate its main components.

Interim financial reports shall include interim financial statements (condensed or complete) for periods as follows:

(a) Balance sheet as of the end of the current interim period and a comparative balance sheet as of the end of the immediately preceding financial year;
(b) Profit and loss account for the current interim period and cumulatively for the current financial year to date, with comparative profit and loss account for the immediately preceding financial year; and
(c) Cash flow statement cumulatively for the current financial year to date, with a comparative statement for the comparable year-to-date period of the immediately preceding financial year.

Disclosure requirements
Subject to the few exceptions noted in this statement, disclosures required by Statements of Accounting Standards are not generally required in the presentation of interim financial reports.

However, other disclosure specific to interim financial reports that are helpful to users in assessing the relevance and reliability with which the reports might be used, and which shall be disclosed are:
(a) The period covered by the report;
(b) The date on which it is approved by the Board of Directors;
(c) The extent to which the information it contains has been audited or reviewed; and
(d) The frequency with which the organization presents interim reports.
(e) Interim financial reports should be prepared to provide current updates on the financial position, results of operations and changes in cash flows of the financial year, from the beginning of the accounting year to date.

If an estimate of an amount reported in an interim period is changed significantly during the final interim period of the financial year but a separate financial report is not published for that final interim period, the nature and amount of that change in estimate shall be disclosed in a note to the annual financial statements for the financial year.

SELF ASSESSMENT EXERCISE
What are the components of interim financial reporting?

3.3 INTERNATIONAL ACCOUNTING STATEMENT 1: PRESENTATION OF FINANCIAL STATEMENTS

A revised IAS 1 was issued in September 2007 by the IASB. Since this Standard deals with the form and contents of financial statements, aspects of the basic requirements are already addressed by SAS 1, Disclosure of Accounting Policies and SAS 2, Information to be disclosed in the Financial Statements. However, there are some financial statements introduced by this standard that professional accounting students should be familiar with. These financial statements are:

(a) Statement of financial position, and
(b) Statement of comprehensive income

The formats of the two statements are presented below:

FORMAT OF STATEMENT OF FINANCIAL POSITION
XYZ GROUP STATEMENT OF FINANCIAL POSITION AT 31 DECEMBER

		2008	2007
ASSETS		N'000	N'000
Non-current assets			
Property, plant and equipment		350,700	360,020
Goodwill		80,800	91,200
Other intangible assets		227,470	227,470
Investments in associates		100,150	110,770
Available –for – sale financial assets		142,500	156,000
		901,620	945,460
Current assets			
Inventories		135,130	132,500
Trade receivables		91,600	110,800
Other current assets		25,650	12,540
Cash and cash equivalents		312,400	322,900
		564,780	578,740
Total assets	(a + b)	1,466,400	1,524,200
		N'000	N'000
Equity and liabilities			
Equity attributable to owners of the parent			
Share capital		650,000	600,000
Retained earnings		243,500	161,700
Other components of equity		10,200	21,200
		903,700	782,900
Non-controlling interest		70,050	48,600
Total Equity	(a)	973,750	831,500
Non-current liabilities			
Long-term borrowings		120,000	160,000
Deferred tax		28,800	26,040
Long-term provisions		28,850	52,240
Total non-current liabilities	(b)	177,650	238,280
Current liabilities			
Trade and other payables		115,000	187,620
Short-term borrowings		150,000	200,000
Current portion of lang-term borrowings		10,000	20,000
Current tax payable		35,000	42,000

Short-term provisions		5,000	4,800
Total current liabilities	(c)	315,000	454,420
Total liabilities	(d)	492,650	692,700
Total equity and liabilities	(a + d)	1,466,400	1,524,200

FORMAT OF STATEMENT OF COMPREHENSIVE INCOME
XYZ GROUP- STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER

	2008	2007
	N'000	N'000
Revenue	390,000	355,000
Cost of Sales	(245,000)	(230,000)
Gross profit	145,000	125,000
Other income	20,667	11,300
Distribution costs	(9,000)	(8,700)
Administration expenses	(20,000)	(21,000)
Other expenses	(2,100)	(1,200)
Finance costs	(8,100)	(7,500)
Share of profit of associates	35,200	30,100
Profit before tax	161,667	128,000
Income tax expenses	(40,417)	(32,000)
Profit for the year from continuing operations	121,250	96,000
Loss for the year from discontinued operations	-	30,500
Profit for the year	121,250	65,500
	N'000	N'000
Other comprehensive income:		
Exchange differences on translating foreign operations	5,334	10,667
Available –for –sale financial assets	(24,000)	26,667
Cash flow hedges	(667)	(4,000)
Gains on property revaluation	993	3,367
Actuarial gains (losses) on defined benefit pension plans	(727)	1,333
Share of other comprehensive income of associates	400	(700)
Income tax relating to components of other comprehensive income	4,667	(9,334)
Other comprehensive income for the year, net of tax	(14,000)	28,000
Total comprehensive income for the year	107,250	93,500
Profit attributable to:		
Owners of the parent	97,000	52,400
Non-controlling interest	24,250	13,100
	121,250	65,500
Total comprehensive income attributable to:		
Owners of the parent	85,800	74,800
Non- controlling interest	21,450	18,700
	107,250	93,500
Earnings per share (in currency units)	0.46	0.30

As can be readily seen from the formats, a statement of financial position is the equivalent of balance sheet. The format of this statement is, however, slightly different from the two balance formats in the second schedule of the Companies and Allied Matters Act, CAP C20, LFN 2004. The statement of financial position observes the current assets in the asset side of the balance sheet, and non-current liabilities is similarly presented before current liabilities in the other side of the balance sheet.

The statement of comprehensive income is the equivalent of profit and loss account or income statement as it is sometimes called. IAS 1 allows a reporting entity to present the income statement either in a single statement of comprehensive income as shown above, or in two separate statements: one statement displaying components of profit or loss and the other statement beginning with profit or loss and displaying components of other comprehensive income.

SELF ASSESSMENT EXERCISE
What are the two financial statements introduced by IAS 1 that professional accounting students should be familiar with?

3.4 INTERNATIONAL ACCOUNTING STANDARD 10: EVENTS AFTER THE REPORTING PERIOD
Categorization of events: events after the balance sheet date are broadly categorized into two: adjusting events and non-adjusting events.

Adjusting event is an event after the reporting period that provides further evidence of conditions that existed at the end of the reporting period, including an event that indicates that the going concern assumption in relation to the whole or part of the enterprise is no longer appropriate. Example of adjusting event is the bankruptcy of a customer a few weeks after the balance sheet date.

Non-adjusting event is an event after the reporting period that is indicative of a condition that arose after the end of the reporting period. Suppose the factory of a manufacturing company was destroyed by fire on 13th February 20X7. If the reporting date of the company is 31st December, and the financial statements were authorized for issue on 10th April 20X8, the destruction of the factory on 13th February 20X7, is a non-adjusting event.

Accounting treatment of adjusting events

The financial statements of a reporting entity should be adjusted when an adjusting event occurs. If a debtor who owed N15m was declared bankrupt, adequate provisions should be made for bad debts by reducing the trade debtors as well as the retained profit figure.

Accounting treatment of non-adjusting events

The financial statements of the reporting entity should not be adjusted for non-adjusted for non-adjusting events.

Treatment of proposed dividends

Under IAS 10, if a dividend is declared after the reporting period, it should not be recognised as a liability at the end of the reporting period. It is an adjusting event.

Disclosure

Non-adjusting events should be disclosed if they are material. The disclosure should include the nature of the event and an estimate of its financial effect. If a reasonable estimate cannot be obtained, that fact must be stated. Examples of a material non-adjusting event are: (a) a major business combination after the reporting date (b) abnormal fluctuation in exchange rates, and (c) issue of shares or debentures after the reporting date.

SELF ASSESSMENT EXERCISE
What is adjusting invent and non-adjusting invent?

3.5 INTERNATIONAL ACCOUNTING STANDARD 18: REVENUE
Definition of revenue
Revenue is the gross inflows of economic benefits during the period, arising in the course of the ordinary activities of an enterprise when those inflows result in increases in equity and not contribution from equity participants.

Measurement of revenue
Revenue should be measured at the fair value of the consideration receivable. When goods or services are exchanged for other goods or services of a similar nature and value, the transaction is not recognised as revenue under IAS. But when dissimilar items are exchanged, the transaction is regarded as generating revenue.

Recognition of revenue from sale of goods
Revenue from sale of goods should be recognised only when all the following conditions are met:

(a) The seller has transferred to the buyer the significant risk and reward of ownership;
(b) The seller retains no continuing managerial involvement to the degree usually associated with ownership, nor effective control over the goods sold;
(c) The amount of revenue can be measured reliably;
(d) It is probable that economic benefits associated with the transaction will flow to the seller; and
(e) The cost incurred in respecting the transaction can be measured reliably.

Recognition of revenue from rendering services
Revenue from rendering of services should be recognised when all of the following conditions are met:
(a) The amount of revenue can be measured reliably;
(b) It is probable that the economic benefits associated with the transaction will flow to the seller;
(c) The stage of completion at the balance sheet date can be measured reliably; and
(d) The costs incurred, and cost to complete the transaction can be measured reliably.

Recognition of revenue from interest, royalties and dividends
Revenue from interest, royalties and dividends should be recognised when it is probable that the economic benefits will flow to the enterprise and the amount of revenue can be measured reliably. The following additional conditions apply:

(a) Interest is recognised on a time proportion basis that takes into account the effective yield on the asset.
(b) Royalties are recognized on an accrual basis in accordance with the substance of the relevant agreement.
(c) Dividends are recognised when the shareholder's right to receive payment is established.

Disclosure
The following items should be recognised:

(a) Accounting policies adopted for the recognition of revenue and the methods adopted to determine the stage of completion of transactions involving the rendering services;
(b) The amount of each significant category of revenue recognised during the period, including revenue arising from;
(i) the sale of goods;
(ii) the rendering of services;
(iii) interests on loans;
(iv) royalties; and
(v) dividends

(c) The amount of revenue arising from exchanges of goods or services included in each significant category of revenue.

SELF ASSESSMENT EXERCISE
What are the conditions to be met before the recognition of revenue from sale of goods?

4.0 CONCLUSION
In conclusion, it should be noted that a business combination is the bringing together of separate entities or businesses into one reporting entity. The result of nearly all business combinations is that one entity, the acquirer, obtains control of one or more other businesses, the acquiree. If an entity obtains control of one or more other entities that are not businesses, the bringing together of those entities is not a business combination.

Statement issued for an accounting period of less than one year, such as quarterly or monthly. Interim financial statements should be based on the accounting principles employed in the previous year's annual report unless a change has been adopted in the current year. Interim financial statements are typically unaudited. Footnote disclosure is given of seasonality effects. If a fourth quarter is not presented, any significant adjustments to it must be commented upon in the annual report.

The objective of the financial statement presentation project is to establish a global standard that will guide the organisation and presentation of information in the financial statements. The boards' goal is to improve the usefulness of the financial information provided in an entity's financial statements to assist management to better communicate its financial information to the users of its financial statements, and to help users in their decision-making.

The Standard also requires that an entity should not prepare its financial statements on a going concern basis if events after the reporting period indicate that the going concern assumption is not appropriate.

5.0 SUMMARY

In this unit, we discussed business combination, presentation of financial statements, interim financial reporting, events after the reporting period and revenue, according to the provisions of the various Standards.

6.0 TUTOR MARKED ASSIGNMENT

1. An acquirer shall disclose information that enables users of its financial statements to evaluate the nature and financial effect of business combinations that were effected after the balance sheet date but before the financial statements are_________ for issue.
2. _________ should carry a statement indicating whether or not the interim financial statements are audited.
3. __________ should be prepared to provide current updates on the financial position, results of operations and changes in cash flows of the financial year, from the beginning of the accounting year to date.
4. ____________ should be prepared to provide current updates on the financial position, results of operations and changes in cash flows of the financial year, from the beginning of the accounting year to date.
5. Categorization of events: events after the balance sheet date are broadly categorized into _____________
6. ___________ is an event after the reporting period that provides further evidence of conditions that existed at the end of the reporting period.
7. ___________ is an event after the reporting period that is indicative of a condition that arose after the end of the reporting period.
8. Non-adjusting events should be disclosed if they are __________
9. Revenue should be measured at the ___________ of the consideration receivable.

7.0 REFERENCES/FURTHER READING

Institute of Chartered Accountant of Nigeria, Financial Accounting, Study Pack Lagos.

International Accounting Standard Board, International Accounting Standard.

Jennings, A. R., (2001), Financial Accounting, London, Letts Educational

Jennings, A. R., (2001), Financial Accounting, Solution Manual, London, Letts Educational

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MODULE 4: FINANCIAL REPORTING 2

UNIT 2: ACCOUNTING FOR GOVERNMENT GRANTS AND DISCLOSURE OF GOVERNEMENT ASSISTANCE, BORROWING COSTS, RELATED PARTY DISCLOSURES AND FINANCIAL REPORTING IN HYPER INFLATIONARY ECONOMY

CONTENT

1.0 INTRODUCTION

Government grants refer to assistance by government in the form of transfers of resources to an entity in return for past or future compliance with certain conditions, relating to the operating activities of the entity.

Government assistance refers to action by government designed to provide an economic benefit specific to an entity or range of entities, qualifying under certain criteria.

Grant related to assets refers to a government grant whose primarily condition is that an entity qualifying for it, should purchase, construct or otherwise acquire long-term assets.

Grant related to income refers to government grant other than those related to assets.

Borrowing costs are interest and other costs incurred by an enterprise in connection with the borrowing of funds.

The objective of IAS 24, is to ensure that an entity's financial statements contain the disclosure necessary to draw attention to the possibility that its financial position and profit or loss may have been affected by the existence of related parties and by transactions and outstanding balances with such parties.

The objective of IAS 29 is to establish a standard to be applied in the financial reporting of any entity whose functional currency is the currency of a hyperinflationary economy.

2.0 OBJECTIVES

After studying this unit, you should be able to:

1. State accounting treatment of government grants.

2. Show how grant is recognized and presented in the financial statement.
3. State accounting treatment of borrowed costs.
4. State some of the provision of International Accounting Standard 24: Related Party Disclosures.
5. State some of the provisions of International Accounting Standard 29: Financial Reporting in Hyper Inflationary economy.
6. Redraft the financial statement, using the current purchasing power basis.

3.0 MAIN CONTENT

3.1 STATEMENT OF ACCOUNTING STANDARD 20: ACCOUNTING FOR GOVERNMENT GRANTS AND DISCLOSURE OF GOVERNMENT ASSISTANCE

IAS 20, prescribes the accounting treatment of government grants and other forms of government assistance.

Accounting treatment

(a) A government grant should be recognised only when there is reasonable assurance that:
(i) the enterprise will comply with the conditions attached to the grant; and
(ii) the grant will be received.
(b) A grant in the form of non-monetary assets, such as, motor vehicle or other assets, may be valued at fair value or nominal value.
(c) Government grant should not be credited directly to equity: rather, it should be recognised as income, on a systematic basis, over the period necessary to match it with the related cost, that is, the cost it is intended to compensate.
(d) Grants relating to income may be presented in the income statement either separately as "other income" or deducted from the related expense.
(e) Grants relating to assets may be presented in the balance sheet either as deferred income or deducted in arriving at the carrying amount of the asset.

Disclosures

(i) Accounting policy adopted for government grants.

(ii) Nature and extent of grants recognised in the financial statements.

(iii) Unfulfilled conditions attached to recognised government grants.

ILLUSTRATION 19

Antsa Farms Ltd, received a grant of N300,000, from Benue State government on 1st January 20X6, to assist the company procure an agricultural equipment which cost N400,000. The useful life of the equipment is estimated at three years after which it will be sold as scrap for N25,600.

(a) Show the amount of grant to be recognised in the income statement if Antsa depreciates equipment using the straight line method and the reduction balance method.
(b) Show how the grant will be presented in the financial statements if the company adopts the straight line method of depreciation and
(i) deducts the grant from the cost of the asset, or
(ii) treats the grant as deferred income. Assume that the company's profit before depreciation of the equipment is N800,000, per annum.

SUGGESTED SOLUTION 19

(a) The depreciable amount of the equipment is N(400,000 – 25,600) N374,400.

(i) Straight Line Method

Amount of grant to be recognised if depreciation is calculated using the straight line method.

Year	Depreciation	Grant Income
	N	N
20X6	124,800	100,000
20X7	124,800	100,000
20X8	124,800	100,000

The annual depreciation is calculated as follows: N374,400/3. Similarly, the grant will be recognised in the same manner depreciation is calculated. Therefore, annual amount to be recognised would be: N300,000/3years.

(ii) Reducing Balance Method

As in the straight line method, the amount of grant to be recognised will be calculated in the same proportion as the depreciable.

Year	Depreciation	Grant Income
	N	N
20X6	240,000	180,000
20X7	96,000	72,000
20X8	38,400	48,000

Tutorial

Recall the formula for calculating depreciation rate under reducing balance method. You will be able to determine that the appropriate rate of depreciation is 60%. In the third year, the grant income that will be recognised is the balance of the grant amount in the year.

(b) (i) Reducing the grant from the cost of the asset

Profit and Loss Account (extract)

	2006	2007	2008
	N	N	N
Profit before depreciation	800,000	800,000	800,000
Depreciation (see w. 1)	(24,800)	(24,800)	(24,800)
Profit before taxation	775,200	775,200	775,200

Balance sheet (extract)

	2006	2007	2008
	N	N	N
Government grant	100,000	100,000	100,000
Depreciation	24,800	49,600	74,400
Net book value	75,200	50,400	25,600

(ii) Grant is treated as deferred income

Profit and Loss Account (extract)

	2006	2007	2008
	N	N	N
Profit before depreciation & grant	800,000	800,000	800,000

Depreciation	(124,800)	(124,800)	(124,800)
Grant income	100,000	100,000	100,000
Profit before tax	775,200	775,200	775,200

(iii) Balance sheet (extract)

	2006	2007	2008
	N	N	N
Equipment at cost	400,000	400,000	400,000
Depreciation	124,800	(249,600)	374,400
Net book value	275,200	150,400	25,600
Equity and Liabilities			
Deferred income			
Government grant (w.2)	200,000	100,000	______

Workings

(i) Depreciation charge when grant is reduced from the cost of the asset carrying value, when cost is deducted.

N400,000 – N300,000 = N100,000

Depreciable amount N(100,000 – 25,600) = N74,400

(ii) Balance on government grant account

	N
Amount granted in 2006	300,000
Amount recognised in income in 2006	(100,000)
Balance at the end of 2006	200,000
Amount recognised in 2007	(100,000)
Balance at the end of 2007	100,000
Amount recognised in 2008	(100,000)
Balance at end of 2008	Nil

SELF ASSESSMENT EXERCISE

Solve the question in the illustration without looking at the solution and compare your result with the solution in the illustration.

3.2 INTERNATIONAL ACCOUNTING STANDARD 23: BORROWING COSTS

Definitions

Qualifying asset is an asset that necessarily takes substantial period of time to get it ready for its intended use. Examples are property, plant, equipment and investing property.

Accounting treatment

(a) Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset must be capitalized as part of the cost of the asset. Other borrowing costs should be expensed.

(b) Where funds are borrowed for specific qualifying assets, the amount of borrowing costs eligible for capitalization, are the actual costs incurred less any income earned on the temporary investment of such borrowings.
(c) Where funds are borrowed generally, but are applied in part of obtaining a qualifying asset, the eligible amount for capitalization is determined by applying a "capitalization rate" to the expenditure on the asset. The capitalization rate is the weighted average of the borrowing costs applicable to the borrowings of the entity that are outstanding during the period, other than borrowings made for specific asset. The amount of the borrowing costs that an entity capitalizes during the period shall not exceed the amount of borrowing cost it incurred during that period (IAS 23.14).
(d) An entity should commence capitalization when expenditure for the asset is being incurred, borrowing costs are being incurred and activities necessary to prepare the asset for its intended use are being undertaken.
(e) An entity should suspend capitalization during the periods in which it suspends active development of a qualifying asset.
(f) Capitalization of borrowing cost should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.
(g) When the construction of a qualifying asset is completed in parts and each part can be used while construction continues on other parts, capitalization should cease when the entity completes substantially all the activities necessary to prepare that part for its intended use or sale.

Disclosure
An entity should disclose the amount of borrowing cost capitalized during the period and the capitalization rate used.

SELF ASSESSMENT EXERCISE
What is a borrowing cost?

3.3 INTERNATIONAL ACCOUNTING STANDARD 24: RELATED PARTY DISCLOSURES
Definition of related party (IAS 24.9). A party is related to an entity if:

(a) Directly, or indirectly, though one or more intermediaries, the party;
    (i) controls, is controlled by, or is under common control with, the entity (this includes parents, subsidiaries and fellow subsidiaries);
    (ii) has an interest in the entity that gives it significant influence over the entity; or
    (iii) has point control over the entity;
(b) The party is an associate (as defined by IAS 28 Investment in Associates) of the entity;
(c) The party is a joint venture in which the entity is a venture (see IAS 31 Interest in Joint Ventures);
(d) The party is a member of the key management personnel of the entity or its parent;
(e) The party is a close member of the family of any individual referred to in (a) or (b);
(f) The party is an entity that is controlled, partly controlled or significantly influenced by, or for which significant voting power in such entity resides with, directly or indirectly, any individual referred to in (d) or (e); or
(g) The party is a post-employment benefit plan for the benefit of the employees of the entity, or of any entity that is a related party of the entity

Related party transaction (IAS 24.9)

A related party transaction is a transfer of resources, services or obligations between related parties, regardless of whether a price is charged.

Close members of the family of an individual are those who may be expected to influence or be influenced by that individual in their dealings with the entity. They may include the individuals' children, domestic partner and dependants.

Disclosure of relationship between parents and subsidiaries

An entity must disclose the name of its parent and, if different, the ultimate controlling party, irrespective of whether there has been transactions between a parent and a subsidiary.

Disclosure of management compensation

IAS 24 requires an entity to disclose key management personnel compensation in total and for each of the following categories:

(a) Short-term employee benefits;
(b) Post-employment benefits;
(c) Other long-term benefits;
(d) Termination benefits; and
(e) Share-based payment

Disclosure of related party transactions

If there have been transactions between related parties, an entity is required by IAS 24, to disclose the nature of the related party relationship as well as information about the transactions and outstanding balances necessary for an understanding of the potential effect of the relationship on the financial statements. At a minimum, the entity should disclose:

(a) The amount of the transactions;
(b) The amount of outstanding balances and their terms and conditions as well as details of any guarantees given or received;
(c) Provisions for doubtful debts related to the amount outstanding; and
(d) The expense recognised during the period in respect of bad or doubtful debts due from related parties.

The disclosures shall be made separately for parents, subsidiaries, associates, joint ventures, key management personnel and other related parties.

Examples of the transactions to be disclosed

The following are examples of transactions that should be disclosed if they are with a related party;

(a) Purchases or sales of goods;
(b) Purchases or sales of property and other assets
(c) Rendering or receiving of services;
(d) Leases;
(e) Transfers or research and development;

(f) Transfers under finance arrangements;
(g) Provision of guarantees or collateral; and
(h) Settlement of liabilities on behalf of the entity or by the entity on behalf of another party.

SELF ASSESSMENT EXERCISE
How do you determine if a party is related to an entity?

3.4 INTERNATIONAL ACCOUNTING STANDARD 29: FINANCIAL REPORTING IN HYPER INFLATIONARY ECONOMIES

Hyperinflation
IAS 29 does not establish an absolute rate at which hyperinflation is deemed to arise but it identifies the following characteristics of such an economy.

(a) The general population prefers to keep its wealth in non-monetary assets or in relatively stable foreign currency. Amount of local currency held are immediately re-invested to maintain purchasing power.
(b) The general 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 and purchases on credit take place at loss of purchasing power during the credit period, even if the period is short.
(d) Interest rates, wages and prices are linked to a price index.
(e) The cumulative inflation rate over three years is approaching, or exceeds, 100%.

Further explanation of the 100% cumulative inflation rate

Under IAS 29, one of the characteristic of a hyperinflationary economy, is that the rate of inflation over three years is approaching, or exceeds 100%. With compounding, this rates translates to an average of 26.7% for three consecutive years. This example illustrates how to determine when to classify an economy as hyperinflationary, based on the 100% three-year inflation rate.

ILLUSTRATION 20
The inflation rate in country X, as indicated by the general price index, has moved as follows over the past ten years:

Year	General price index
1	1,200
2	1,800
3	2,160
4	2,400
5	3,780
6	4,000
7	4,480
8	5,560
9	8,000
10	9,960

You are required to indicate the years in which a country should apply inflation accounting, based on the requirements of IAS 29.

SUGGESTED SOLUTION 20

Year 4 (2,400 – 1,200)/1,200 x 100 = 100%

Year 5 (3,780 – 1,800)/1,800 x 100 =110%

Year 6 (4,000 – 2,160)/2,160 x 100 = 85%

Year 7 (4,480 – 2,400)/2,400 x 100 = 87%

Year 8 (5,560 – 3,780)/3,780 x 100 = 47%

Year 9 (8,000 – 4,000)/4,000 x 100 = 100%

Year 10 (9,960 – 4,480)/4,480 x 100 = 122%

Based on IAS 29, inflation adjustments should be made in years 4, 5, 9 and 10 because, in those years, the increase in inflation for three years in a row was 100% or above.

The same conclusion is reached if calculation is done on the annual rate of change and selection of the years when the average rate for three years is greater or approximately equal to 26.7%.

Year	Rate of change	Average for three years in a row
1	-	-
2	50%	-
3	20%	-
4	10%	26.7%
5	57.6%	29.2%
6	6%	24.5%
7	12%	25.2%
8	24%	14%
9	44%	26.7%
10	24.5%	30.8%

*Rate of change for year 2 is calculated as follows (1,800 1,200)/1,200 = 50%

**Average change for three years in year 4 is calculated as follows; (50 + 20 + 10)/3 = 26.7%

Restatement of financial statements

The financial statements of an entity whose functional currency is the currency of a hyperinflationary economy, should be stated in terms of the measuring unit current at the balance sheet date, irrespective of whether those statements are based on historical cost approach or current cost approach. Comparative figures for the previous period should also be restated in terms of the measuring unit current at the balance sheet date.

Gain or loss on net monetary position

The gain or loss on net monetary position should be included in profit or loss and separately disclosed.

Restatement of items in the statement of financial position

IAS 29, provides detailed procedures that should guide the restatement of items in the statement of financial position. The procedures are summarized below:

(a) Restatements are made by applying a general price index
(b) Monetary items are not restated because they are already expressed in terms of the monetary unit current at the end of the reporting period.
(c) Assets and liabilities linked to agreement on changes in prizes, such as index linked loans, are adjusted accordingly.
(d) Non-monetary items carried at amounts current, net realizable value and fair value, are not restated. All other non-monetary assets and liabilities are restated.
(e) A non-monetary asset carried at cost less depreciation is restated by applying the change in general price index from the date of its acquisition to the balance sheet date.
(f) A non-monetary asset carried at amount current at dates other than that of its acquisition, for example, property, plant and equipment that has been revalued at some earlier date, is restated from the date of its revaluation.
(g) The restated amount of non-monetary item is reduced, in accordance with appropriate IFRSs, when it exceeds its recoverable amount.
(h) At the beginning of the first period of application of IAS 29, the components of owners' equity, except retained earnings and any revaluation surplus, are restated by applying a general price index from the dates that the components were contributed or otherwise arose. Any revaluation surplus that arose in previous periods is eliminated.

Historical statement of comprehensive income

IAS 29, requires items of income and expenses to be restated by applying the change in the general price index from the dates when they were initially recorded in the financial statements.

Current cost statement of comprehensive income

All income and expenses should be restated into the measuring unit at the end of the reporting period by applying a general price index.

Disclosures
The following disclosures should be made:

(a) The fact that the financial statements and the corresponding figure for the previous periods have been restated for the changes in the general purchasing power of the functional currency.
(b) Whether the financial statements are based on a historical cost approach or a current cost approach.
(c) The identity and level of the price index at the end of the reporting period and the movement in the index during the current and the previous period.

ILLUSTRATION 21

Mr. Giwa Jikolo furnished his company's latest financial statements prepared under the historical cost basis, to Mr. Field Grass, a friend residing in the United States of America to seek financial assistance from him. The assistance is to purchase machines and equipment to replace the old ones, at present in use. Mr. Grass faxed back the accounts requesting that they should be more realistic by showing the present values adapted to price index, current purchasing power or current cost; noting that the value of money is not constant especially in Nigeria where the Naira fluctuates widely against major foreign currencies. He insists that his bank requires the information to grant the loan which he has applied for on behalf of Jikolo and Son Ltd. Jikolo's financial statements are:

JIKOLO AND SONS LIMITED
PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 31ST DEC., 2008

	N'000	N'000
Sales		15,000
Less: cost of sales:		
Opening stock	2,650	
Purchases	10,490	
	13,140	
Closing stock	2,960	10,180
Gross profit		4,820
Less: depreciation:		
Buildings	220	
Plant and equipment	956	
Other expenses	2,614	3,790
Net profit		1,030

JIKOLO AND SONS LIMITED
BALANCE SHEET AS AT 31ST DECEMBER, 2008

	N		N
Equity Funds:		Fixed Assets	

Ordinary capital	70,000	Land & building	44,600
Profit and loss account	22,000	Plant & equipment	77,400
	92,000		122,000
Mortgage loan	50,000		
	142,000		
Current liabilities:		Current assets:	
Creditors	13,000	stock	29,700
Taxation	8,500	debtors	15,300
Dividend	5,500	Cash	2,000
	169,000		169,000

Required:

(a) Redraft the financial statements, using the current purchasing power basis. The price index at the beginning of the year was 100 while the index at the yearend was 120. All revenue transactions during the year are stated at average index of 110.

(b) Against historical cost measurement, advise on the use of:
(i) price index
(ii) current purchasing power
(iii) monetary unit

(c) Outline the major requirements, Jikolo and Sons Ltd, might provide to meet the conditions for obtaining the foreign loan.

SUGGESTED SOLUTION 21

(a)

JIKOLO AND SONS LIMITED
INCOME STATEMENT FOR THE YEAR
ENDED 31ST DECEMBER, 2008

	HISTORICAL COST BASIS		CONVERSION RATE	CURRENT PURCHASING POWER BASIS
	N'000	N'000		N'000
Sales		15,000	$\frac{120}{110}$	16,364
Cost of sales:				
			120	

Opening stock	2,650		100	3,180
Purchases	10,490		120	11,444
	13,140		110	14,624
Closing stock	(2,960)	(10,180)	120	3,229
Gross profit		4,820	110	4,969
Expenses:				
Depreciation:			120	
Buildings	220		100	264
			120	
Plant & equipment	956		100	1,147
			120	
Other expenses	2,614	(3,790)	110	2,852
Net profit		1,030		706

JIKOLO AND SONS LIMITED
BALANCE SHEET AS AT 31st DECEMBER, 2008

	HISTORICAL COST BASIS	CONVERSION FACTOR	CURRENT PURCHASING POWER BASIS
	N		N
FIXED ASSETS:		120	
Land & Building	44,600	100	53,520
		120	
Plant & Equipment	77,400	100	92,880
	122,000		146,400
Current Assets:			
		120	
Stocks	29,700	110	32,400
Debtors	15,300		15,300

Cash	2,000		2,000
	47,000		49,700

	HISTORICAL COST BASIS	CONVERSION FACTOR	CURRENT PURCHASING POWER BASIS
	N	N	N
Less:			
Current liabilities:			
Creditors	13,000	13,000	
Taxation	8,500	8,500	
Dividend	5,500	5,500	
	27,000	27,000	
Net current assets	20,000	22,700	
Net assets	142,000	169,100	
Financed by:			
Ordinary share capital	70,000	70,000	
Retained profit	22,000	22,000	
Capital maint. Reserve	-	27,100	
	92,000	119,100	
Mortgage loan	50,000	50,000	
	142,000	169,100	

Workings:	Historical cost	Current Purchasing Basis	Difference Power
	N	N	N
Land and equipment	44,600	53,520	8,920
Plant and equipment	77,400	92,880	15,480
Stock	29,700	32,400	2,700
			27,100

(b) Advice

(i) Price Index

This is the expression of the prices of a group of commodities or general price levels of goods and services at a point in time to their prices at a chosen base period. The use of price index to restate historical cost accounting items ensures that assets are not understated and profits are not overstated which is usually the case with historical cost accounting in periods of rising prices.

(ii) Current Purchasing Power

This involves accounting for the effect of general price changes. The owners of the business are shareholders who suffer from general inflation as the purchasing power of their investment in the business declines. Changes in general prices are thus used to record the effect by adjusting all figures shown in terms of money with the same purchasing power. The re-statement is done using a general price index which tends to overcome the problem associated with historical cost accounting in periods of inflation.

(iii) Monetary Unit

This is the fixed nominal amount of money attributable to an item in the financial statements without considering the effect of inflation. Monetary unit is not an alternative basis for restating items in the historical accounts to reflect the effect of inflation.

SELF ASSESSMENT EXERCISE

What are the characteristics of a hyperinflation economy?

4.0 CONCLUSION

Government grants are assistance by government in the form of transfers of resources to an entity in return for past or future compliance with certain conditions relating to the operating activities of the entity. They exclude those forms of government assistance which cannot reasonably have a value placed upon them and transactions with government which cannot be distinguished from the normal trading transactions of the entity.

Exchange differences arising from foreign currency borrowings and considered as borrowing costs are those exchange differences which arise on the amount of principal of the foreign currency borrowings to the extent of the difference between interest on local currency borrowings and interest on foreign currency borrowings.

Related party - parties are considered to be related if at any time during the reporting period one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions. Related party transaction - a transfer of resources or obligations between related parties, regardless of whether or not a price is charged.

In a hyperinflationary economy, reporting of operating results and financial position in the local currency without restatement is not useful. Money loses purchasing power at such a rate that comparison of amounts from transactions and other events that have occurred at different times, even within the same accounting period, is misleading.

5.0 SUMMARY

In this unit, you would recall that we discussed International Accounting Standard 20: Accounting for Government Grants and Disclosure of Government Assistance, International Accounting Standard 23: Borrowing Costs, International Accounting Standard 24: Related Party Disclosures, and International Accounting Standard 29:Financial Reporting in Hyper Inflationary Economy.

You will recall that we discussed the theoretical content of the various standards and made some computations according to the provisions of the International Accounting Standard.

6.0 TUTOR MARKED ASSIGNMENT

1. A grant in the form of non-monetary assets, such as, motor vehicle or other assets, may be valued at fair value or _______ value.
2. Restatements are made by applying a________
3. Monetary items are not restated because they are already expressed in terms of the ________ at the end of the reporting period.
4. A non-monetary asset carried at cost less depreciation is restated by applying the change in _________ from the date of its acquisition to the balance sheet date.
5. The use of price index to restate _________ ensures that assets are not understated and profits are not overstated.

7.0 REFERENCES/FURTHER READING

Institute of Chartered Accountant of Nigeria, Financial Accounting, Study Pack Lagos.

International Accounting Standard Board, International Accounting Standard.

Jennings, A. R., (2001), Financial Accounting, London, Letts Educational

Jennings, A. R., (2001), Financial Accounting, Solution Manual, London, Letts Educational

Nigerian Accounting Standard Board, Statement of Accounting Standard

MODULE 4: FINANCIAL REPORTING 2

UNIT 3: IMPAIRMENT OF ASSETS

CONTENT

1.0 INTRODUCTION

If the sum of all estimated future cash flows is less than the carrying value of the asset, then the asset would be considered impaired and would have to be written down to its fair value. Once an asset is written, it may only be written back up under very few circumstances.

Firm's carrying goodwill on their books are required to make tests of impairment annually. Any impairment found will then be expensed on the company's income statement.

The objective of IAS 36 is to prescribe the procedure that an entity should apply to ensure that its assets are carried at no more than their recoverable amounts.

2.0 OBJECTIVES

After studying this unit, you should be able to:

1. Defines some key terms used in International Accounting Standard 36.
2. State the indicators for determining asset impairment.
3. State the factors in measuring recoverable amount.
4. State the provision for the reversal of an impairment loss.
5. Show how impairment loss are allocated to reduce carrying amount of assets
6. Prepare a revised note to fixed assets.

3.0 MAIN CONTENT

3.1 DEFINITION OF KEY TERMS

Active market: This is a market in which all the following conditions exist:

(a) The items traded within the market are homogenous;
(b) Willing buyers and sellers can normally be found at any time; and
(c) Prices are available to the public.

Carrying amount: This is the amount at which the asset is recognised after deducting any accumulated depreciated (amortization) and accumulated impairment losses thereon.

Cash generating unit: This is the smallest identifiable group of assets that generate cash inflows that are largely independent of the cash inflows from other assets or group of assets.

Corporate assets: These are assets other than goodwill that contribute to the future cash flows of both the cash-generating unit under review and other cash-generating units.

Fair value less cost to sell: This is the amount obtainable from the sale of an asset or cash-generating unit in an arm's length transaction between knowledgeable, willing parties, less the cost of disposal.

Impairment loss: This is the amount by which the carrying amount of an asset or cash-generating unit exceeds its recoverable amount.

Recoverable amount: of an asset or cash-generating unit is the higher of its fair value less costs to sell and its value in use.

Value in use is the present value of the future cash flows expected to be derived from an asset or cash-generating unit.

Assessing and testing assets for impairment

At the end of each reporting period, an entity should assess its assets to determine whether there is any indication that an asset may be impaired. If such indication exists, the entity should estimate the recoverable amount of the asset.

An entity should test an intangible asset with an indefinite useful life or an intangible asset not yet available for use for impairment annually, by comparing its carrying value with its recoverable amount.

Goodwill acquired in a business combination should also be tested for impairment annually.

SELF ASSESSMENT EXERCISE

What is an impairment loss?

3.2 INDICATIONS OF IMPAIRMENT

In assessing whether there is any indication that an asset may be impaired, an entity shall consider the following indications:

External source of information

(a) Market value declines significantly during the period;
(b) Significant changes with adverse effect on the entity in technological, market, economic and legal environment;
(c) Increases in market interest rates that are likely to affect the discount rate used in calculating an asset's value in use; and
(d) The carrying amount of the net assets of an entity is more than its market capitalization.

Internal sources of information

(a) Obsolescence or physical damage of an asset;
(b) Assets likely to become idle or being earmarked for disposal; and
(c) Evidence is available that the economic performance of an asset is, or will be, worse than expected.

SELF ASSESSMENT EXERCISE
What are the internal and external source indications of impairment?

3.3 MEASURING RECOVERABLE AMOUNT

IAS 36, defines recoverable amount (RA) as the higher of an asset's or cash-generating unit' fair value less costs to sell (FV) and its value in use (VIU).

(a) It is necessary to calculate both FV and VIU. If FV is greater than the carrying amount of the asset, then the asset is not impaired and it is not necessary to calculate the VIU. Similarly, if VIU is greater than the asset's carrying amount, the asset is not impaired and it is not necessary to calculate the FV.
(b) If FV cannot be estimated, then the RA is equal to VIU.
(c) For an asset held for disposal, RA is equal to FV.

Determining fair value less cost to sell
(a) If there is a binding sale agreement, then the price in that agreement attributable to the disposal of the asset is fair value less cost to sell.
(b) If there is no binding agreement but an asset is traded in active market, use the asset's market price less cost to disposal.
(c) If there is no binding sale agreement or active market for an asset, use the amount that could be obtained from the disposal of the asset less costs of disposal.

Determining value in use
The following elements should be reflected in the calculation of an asset's value in use:
(a) An estimate of future cash flows which the entity expects to derive from the asset;
(b) Expectations about possible variations in the amount or timing of those future cash flows;
(c) The time value of money, represented by the current market risk-free rate of interest;
(d) The price for bearing the uncertainty which is in the asset; and
(e) Other factors, such as illiquidity, that market participants would reflect in pricing the future cash flows which the entity expects to derive from the asset.

Recognizing and measuring an impairment loss
(a) If the recoverable amount of an asset is less than its carrying amount, the carrying amount should be reduced to its recoverable amount. That reduction is an impairment loss.
(b) An impairment loss is recognized immediately in profit or loss unless it relates to a re-valued asset where the increase in value was recognized in equity. The impairment loss of such an asset should be treated as a revaluation decrease.
(c) After the recognition of an impairment loss, the depreciation charges of the asset should be adjusted in future periods.

Cash generating units
If there is any indication that an asset may be impaired, recoverable amount shall be estimated for the individual asset. If it is not possible to estimate the recoverable amount of the individual asset, an entity should determine the cash-generating unit to which the asset belongs.

Goodwill
(a) Goodwill should be tested annually for impairment.

(b) To test for impairment, goodwill acquired in a business combination should be allocated to each of the acquirer's cash-generating units, that is expected to benefit from the synergies of the combination.
(c) If goodwill has been allocated to a cash-generating unit, and the entity disposes of an operation within the unit, the goodwill associated with the operation disposed of shall be included in the carrying amount of the operation and measured on the basis of the relative values of the operations disposed of and the portion of the cash-generating unit retained.
(d) In testing a cash-generating unit for impairment, an entity is required to identify all the corporate assets of the cash-generating unit under review.

Impairment loss for a cash-generating unit
If the recoverable amount of a cash-generating unit is less than the carrying amount of the unit, an entity should recognize an impaired loss. The impairment loss is allocated to reduce the carrying amount of the assets of the unit in the following order:

(a) First, to reduce the carrying amount of any goodwill allocated to the cash-generating unit (group units); and
(b) Second, to the other assets of the unit (group of units) pro rata on the basis of the carrying amount of each asset of the unit (group of units).

These reductions in amounts are treated as impairment losses on the individual assets and recognized immediately in the profit or loss, or equity, if the asset is carried at a re-valued amount.

ILLUSTRATION 22
After an impairment test on 31 December 20X8, Ogene Hostels ltd, concluded that one of its cash-generating unit's net assets at the date of impairment test was N800m.

Assets and liabilities of the cash-generating unit on 31 December 20X8 comprised:

	N m
Goodwill	50
Property	480
Plant and equipment	80
Motor vehicles	40
Net monetary assets	150

Show how the impairment loss would be allocated to reduce the carrying amount of the assets.

SUGGESTED SOLUTION 22

	Nm
Carrying amount of the unit's identifiable assets	
N(50 + 360 +120 + 40 +284 – 54)	800

Recoverable amount	(600)
Impairment loss	200

Allocation of impairment loss

Assets	carrying values (Nm)	Impairment loss (Nm)	Impaired values (Nm)
Goodwill	50	50	Nil
Property (w.1)	480	120	360
Plant (w.1)	80	20	60
Motor vehicles	40	10	30
Net monetary asset	150	-	150
	800	200	600

Workings- allocation of impairment loss

Property	480/600 x 150 = 120
Plant	80/600 x 150 = 20
Motor vehicles	40/600 x 150 = 10

Tutorials

First, the carrying amount of goodwill is reduced, and the remaining amount of impairment loss 150m (200m less 50m that is, total impairment loss less the carrying amount of goodwill) is allocated to property, plant and motor vehicles on a pro rata basis as required by IAS 36.104.

No impairment loss is attributable to the net monetary assets as they will be realized in full. Monetary items are money held and other items to be received or paid in money.

SELF ASSESSMENT EXERCISE

How do you recognize and measure impairment loss?

3.4 REVERSAL OF AN IMPAIRMENT LOSS

(a) An entity is required by IAS 36, to assess at each balance sheet date, whether there is any indication that an impairment loss recognized in prior periods for an asset may no longer exist or may have decreased. If such indication exists, the entity is required to calculate the recoverable amount of the asset. If the recoverable amount is greater than the impaired value, the impairment loss should be reversed and the reversal should be recognised immediately in the income statement.

(b) An increased carrying amount due to reversal of an impairment loss, should not exceed what the value would have been if the impairment had not been recognized for the asset in prior years.

(c) Depreciation charge for the asset should be adjusted in future periods to allocate the asset's carrying amount less its residual value (if any), on a systematic basis over its remaining useful life.
(d) Reversal of an impairment loss recognized for goodwill is debarred.
(e) Reversal of unwinding of discount is also prohibited. (IAS 36.116)

SELF ASSESSMENT EXERCISE
Outline the provision for the reversal of impairment loss.

3.5 DISCLOSURE
Disclosure by class of assets and reportable segments

An entity should disclose the following for each class of assets:

(a) Impairment losses recognized in profit or loss; and
(b) Reversal of impairment losses recognized in profit or loss.

Similar disclosures should be made for each reportable segment. (IAS 36.129)

Other disclosures

For each material impairment loss, an entity is required to disclose:

(a) The events and circumstances that led to the impairment loss or reversal of the loss;
(b) The amount of the impairment loss;
(c) In the case of individual assets, the nature of loss and the reportable segment involved;
(d) For a cash-generating unit, a description of the unit and the amount of impairment loss recognized or reversed; and
(e) Whether the recoverable amount of the asset is its fair value less costs to sell or its value in use.

ILLUSTRATION 23
Obun Ltd is into Car Hire services. The notes relating to the fixed assets figure in the financial statements for the year ended 31 December 20X6, showed the following:

	N'000	N'000
Cost of acquisition		12,000
Accumulated depreciation:		
At 1 January 20X6	4,800	
Charge for the year	2,400	(7,200)
Net Book Value as at 31 December, 20X6		4,800

The cars on hire are being written off at the rate of 20% per annum. However, the car hire market has slumped, and as a result, it will only be able to generate N2.5 million income per annum for the year 20X7 and 20X8 only. Alternatively, the car could be sold immediately (31 December 20X6) for its fair value of N2.8 million, but a selling cost of N180,000, will be incurred. The cost of capital is 15%.

Required:
(i) calculate the impairment as at 31 December 20X6.

(ii) prepare a revised note to the fixed assets.

(iii) show the note to the fixed asset for the year ended 31 December 20X7

(iv) assuming the market for car hire services picked up, and the cars now have a recoverable amount of N3.9 million, you are required to draft the note to the accounts for the year ended 31 December 20X7.

(ICAN NOV 2006)

SUGGESTED SOLUTION 23

(i) Calculation of impairment loss as at 31 December 20X6

			N'000	N'000
Net book value				4,800
Recoverable amount				
The higher of:				
Fair value less costs to sell N(2.8m – 0.18)			2,620	
And value in use (N2.5m x 0.86)	2,150			
(N2.5m x 0.74)	1,850	4,000		4,000
Impairment loss				800
Carrying amount				4,000

(ii) Revised notes to the fixed assets amount as at 31 December 20X6

	N'000	N'000
Cost		12,000
Depreciation		
1/1/20X3	4,800	
Charge for the year	2,400	(7,200)
Net book value		4,800
Impairment loss		(800)
Carrying amount		4,000

(iii) Note to fixed assets account as at 31 December 20X7

N'000

Carrying value of assets at 1/1/20X7	4,000
Depreciation charge for the year (4000/2)	2,000
Carrying value at 31/12/20X7	2,000

(iv) Revised note to fixed assets account as at 31 December 20X4

	N'000	N'000
Cost		12,000
Depreciation 1/1/20X4	7,200	
Charge for the year N4m/2	2,000	
Reversal of impairment loss	400	
Accumulated depreciation if no impairment loss		
Had been recognized (12m x 20% x 4 years)		(9,600)
Carrying value		2,400

Tutorial
IAS 36 requires that in the event of a reversal of an impairment loss, the increased carrying amount of the asset should not exceed the carrying amount that would have been determined (net of depreciation), had no impairment loss been recognized for the asset in prior years. Thus, the reversal has been restricted to such amount that will ensure that the carrying amount of the asset does not exceed the ceiling set by IAS 36.117.

SELF ASSESSMENT EXERCISE
What is an entity expected to disclose for material impairment loss?

4.0 CONCLUSION
Under U.S. GAAP impaired assets must be recognized once there is evidence of a lack of recoverability of the net carrying amount. Once impairment has been recognized it cannot be restored. Analysts must know that some foreign countries and the IASB allow companies to recognize increases in previously impaired assets.

Asset impairment occurs when there are:

- Changes in regulation and business climate
- Declines in usage rate
- Technology changes
- Forecasts of a significant decline in the long-term profitability of the asset

Once a company has determined that an asset is impaired, it can write down the asset or classify it as an asset for sale. Assets will be written down if the company keeps on using this asset. Write-downs are sometimes included as part of a restructuring cost. It is important to be able to distinguish asset write-downs, which are non-cash expenses, from cash expenses like severance packages.

5.0 SUMMARY

In this unit we discussed impairment of asset according to the provision of International Accounting Standard 36. You would recall that assets are said to be impaired when their net carrying value, (acquisition cost - accumulated depreciation), is greater than the future undiscounted cash flow that these assets can provide and be disposed for.

The provision was discussed under the following sub units such as definition of key terms, indications of impairment, measuring recoverable amount, reversal of an impairment Loss and disclosure.

6.0 TUTOR MARKED ASSIGNMENT

1. __________ is the smallest identifiable group of assets that generate cash

   inflows that are largely independent of the cash inflows from other assets or group of assets.

2. __________ are assets other than goodwill that contribute to the future cash flows of both the cash-generating unit under review and other cash-generating units.
3. __________ is the amount obtainable from the sale of an asset or cash-generating unit in an arm's length transaction between knowledgeable, willing parties, less the cost of disposal.
4. __________ is the present value of the future cash flows expected to be derived from an asset or cash-generating unit.
5. If the recoverable amount of an asset is less than its carrying amount, the carrying amount should be reduced to its ___________
6. An impairment loss is recognized immediately in _________ unless it relates to a re-valued asset where the increase in value was recognized in equity.
7. After the recognition of an impairment loss, the _________ charges of the asset should be adjusted in future periods.

7.0 REFERENCES/FURTHER READING

Institute of Chartered Accountant of Nigeria, Financial Accounting, Study Pack Lagos.

International Accounting Standard Board, International Accounting Standard.

Nigerian Accounting Standard Board, Statement of Accounting Standard

MODULE 4: FINANCIAL REPORTING 2

UNIT 4: FIRST-TIME ADOPTION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS, SHARE-BASED PAYMENT, NON-CURRENT ASSETS HELD FOR SALE AND DISCONTINUED OPERATIONS

CONTENT

1.0 INTRODUCTION

IFRS 1 First-time Adoption of International Financial Reporting Standards sets out the procedures that an entity must follow when it adopts IFRSs for the first time as the basis for preparing its general purpose financial statements.

Entities often grant shares or share options to employees or other parties, share plans and share option plans are common features of employee remuneration for directors, senior executives and many other employees. Some entities issue shares or share options to pay suppliers, such as suppliers of professional services; the objective of IFRS 2 is to specify the financial reporting by an entity when it undertakes a share-based payment transaction.

IFRS 5 specifies the accounting treatment of assets held for sales, and the presentation and disclosure of discontinued operations. In particular, the standard requires;

(a) Assets that meet the criteria to be classified as, held for sale to be measured at the lower of carrying amount and fair value less costs to sell, and depreciation on such assets to cease; and
(b) Assets that meet the criteria to be presented separately in the statement of financial position and the results of discontinued operations to be presented separately in the statement of comprehensive income.

2.0 OBJECTIVES

After studying this unit, you should be able to:

1. Calculate the amount to be recognized as expense.
2. Show how impairment loss will be allocated to non-current assets.
3. Show how transactions would be accounted for in accordance with IFRS 2.
4. Prepare a statement comprehensive income for the year according to IFRS 5.
5. State definitions of terms, provisions as contained in IFRS 1, 2, and 5.

3.0 MAIN CONTENT

3.1 IFRS: 1 FIRST-TIME ADOPTION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS

Key terms

Date of Transition to IFRS is the beginning of the earliest period for which an entity presets full comparative information under IFRSs in its first IFRS financial statements.

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

First IFRS financial statements- The first financial statements in which an entity adopt international financial reporting standards (IFRSs), by an explicit and unreserved statement of compliance with IFRSs.

First IFRS reporting period is the latest reporting period covered by an entity's first IFRS financial statement.

International Financial Reporting Standards (IFRSs). Standards and interpretations adopted by the International Accounting Standards Board (IASB). They comprise:

(a) International Financial Reporting Standards;
(b) International Accounting Standards; and
(c) Interpretations developed by the Interactional Financial Reporting Interpretations Committee (IFRIC) or the former Standing Interpretations Committee (SIC).

Opening IFRS Statement of Financial Position

An entity's statement of financial position at the date of transition to IFRSs.

Previous GAAP- the bans of accounting that a first-time adopter used immediately before adopting IFRSs.

Objective of IFRS 1

The objective of IFRS is to ensure that an entity's first IFRS financial statements, and its interim financial reports for part of the period covered by those financial statements, contain high quality information that:

(a) Is transparent for users and comparable over all periods presented;
(b) Provides a suitable starting point for accounting in accordance with IFRSs and
(c) Can be generated at a cost that does not exceed the benefits.

An entity is, therefore, required to apply IFRS 1, in its first IFRS financial statements and each interim financial report for the part of the period covered by its first IFRS financial statements.

Definition of first-time adoption

Financial statements prepaid by an entity in accordance with IFRSs are the entity's first IFRS financial statements. If the entity:

(a) Presented its most recent previous financial statements in accordance with national requirements that are partially consistent or totally inconsistent with IFRSs;
(b) Prepared financial statements in accordance with IFRSs for internal use only;

(c) Prepared a reporting package for consideration purposes only or;
(d) Did not present financial statements for previous periods.

First IFRS Reporting Period
An entity is required to use those accounting policies that comply with IFRSs, effective at the end of its first IFRS reporting period. If First and last bank decides to prepare its financial statements using IFRSs, with effect from the reporting period ending on 31 December, 20X9, in:

(a) Preparing and presenting its opening IFRS statement of financial position at 1 January 20X8; and
(b) Preparing and presenting its statement of financial position for 31 December 20X9 (including comparative amounts for 20X8), statement of comprehensive income, statement of changes in equity and statement of cash flows for the year to 31 December 20X9 (including comparative amounts for 20X8) and disclosures (including comparative information for 20X8).

The bank's date of transition to IFRSs is 1 January 20X8.

Content of opening IFRS statement of financial position

In its opening IFRS statement of financial and entity should:

(a) Recognize all assets and liabilities whose recognition is required by IFRSs;
(b) Not recognize items as assets or liabilities if IFRSs do not permit such recognition;
(c) Reclassify items it recognized in accordance with previous GAAP where appropriate; and
(d) Apply IFRSs in measuring all recognized assets and liabilities.

IFRS 1 allows a first-time adopter some exemptions in accounting for certain transactions, such as, share-based payment transaction, insurance contracts, leases, compound financial instruments and borrowing cost (see appendix D of IFRS 1 for details.

Explanation of Transition to IFRSs
An entity is required to explain how the transition from previous GAAP to IFRSs affected its reported financial position, financial performance and cash flows. To comply with this; a first-time adopter is required to include the following in its first IFRS financial statements.

(a) Reconciliations of its equity reported in accordance with previous GAAP, to its equity in accordance with IFRSs, for both the date of transition and of the latest period, presented in the entity's most recent financial statements in accordance with previous GAAP.
(b) A reconciliation to its total comprehensive income, in accordance with IFRSs for the latest period, in the entity's most recent annual financial statements.
(c) If the entity recognized or reverse any impairment losses for the first time in preparing its opening IFRS statement of financial position, the disclosures that IAS 36 Impairment of Assets would have required if the entity had recognized those impairment losses or reversals in the period beginning with the date of transition to IFRSs.

SELF ASSESSMENT EXERCISE
What is a deemed cost?

3.2: IFRS 2: SHARE-BASED PAYMENT

KEY TERMS

Entity instrument: A contract that evidences a residual interest on the assets of an entity after deducting all its liabilities.

Share-based payment transaction: A transaction in which the entity receives goods or services as consideration for equity instruments of the entity (including shares or share options), or acquires goods or services by incurring liabilities to the supplier of those goods or services for amount that are based on the price of the entity's share or other equity instruments of the entity.

Grand date: This is the date at which the entity and another party (including an employee) agree to a share-based payment arrangement.

Intrinsic value: The difference between the fair value of the shares to which the counterparty has the right to subscribe or receive and the price the counterparty is required to pay for those shares.

Measurement date: The date at which the fair value of the equity instruments granted is measured for the purposes of IFRS 2.

Reload feature: A feature that provides for an automatic grant of additional share options whenever the option holder exercises previously granted options using the entity's shares, rather than cash, to satisfy the exercise price.

Reload option: A new share option granted when a share is used to satisfy the exercise price of a previous share option.

Share option: A contract that gives the holder the right but not the obligation, to subscribe to the entity's shares at a fixed or determinable price for a specified period of time.

Vest: To become an entitlement, under a share-based payment arrangement, a counterparty's right to receive cash, other assets or equity instruments of the entity vests when the counterparty's entitlement is no longer conditional on the satisfaction of any vesting condition.

Vesting conditions: The conditions that determine whether the entity receives the services that entitle the counterparty to receive cash, other assets or equity instruments of the entity, under a share-based payment arrangement.

Vesting period: The period during which all the specified vesting conditions of a share-based payment arrangement are to be satisfied.

Equity-settled share based payment transaction: A share based payment transaction in which the entity receives goods or services as consideration for equity instrument of the entity (including shares or share options).

Cash-settled share-based payment transaction: A share-based payment transaction in which the entity acquires goods or services by other assets to the supplier of those goods or services for amounts that are based on the price (or value) of the entity's share or other equity instruments of the entity.

Overviews

Typically, shares, share options or other equity instruments are granted to employees as part of their remuneration package, in addition to a cash salary and other employment benefits. Usually, it is not possible to measure directly the services received for particular component of the employee benefit. By granting shares and share options, in addition to other remuneration, the entity is paying additional benefits is likely to be difficult. In view of the difficulty of measuring directly the fair value of the services received, the entity measures the fair value by reference to the fair value of the equity instrument granted. (IFRS 2.15).

Recognition

(a) An entity should recognize the goods or services received or acquired in a share-based payment transaction as assets if they qualify for recognition as such, otherwise, they should be recognized as expenses.

(b) An entity should recognize the goods and services received or acquired in a share-based payment transaction when it obtains the goods or as the services are received. The entity shall recognize a corresponding increase in equity if the goods or services were received in an equity-settled share-based payment transaction, or a liability if the goods or services were acquired in a cash-settled share-based payment transaction.

ILLUSTRATION 24

On 1 January 20X6, Mozunim Plc, granted 1000 share options to each of its 20 executives on the management team. Each grant is conditional upon each executive being on the management team till 31 December 20X8. In other words, the options vest at the end of a three year period. The fair value of each share option is N50 and the company expects that all the share options will be vest required:

(a) Calculate the amount to be recognized as expense for each of the three years and show the double entry at the end of the first year.

(b) Suppose the company estimated that 20% actually left at the end of the third year, calculate the amount to be recognized as expense for each of the three years.

SUGGESTED SOLUTION 24

(a) If all the options vest, the annual expense is calculated as follows: 1000 options x N50 x 1/3 = N333,333.

The double entries at the end of 20X6, would be as follows:

Dr profit or loss – N333,333

Cr Equity - N333,333

(b) If 20% is estimated to leave but 25% actually left in the third year, the annual expense would be calculated as follows:

		Cumulative Expenses	Expenses for the year
Year		N	N
20X6	1000 x 20 x 50 x 80% x 1/3	266,667	266,667
20X7	1000 x 20 x 50 x 80% x 2/3	533,333	266,666
20X8	1000 x 15 x 50	750,000	216,667

Measurement of equity settled transactions

(a) For equity-settled share-based transactions, the entity shall measure the goods and services received, and the corresponding increase in equity, directly, at the fair value of the goods and services received.
(b) If the entity cannot estimate reliably the fair value of the goods and services received, the entity shall measure their value, and the corresponding increase in equity, indirectly, by reference to the fair value of the equity instruments granted.

Simply put, the fair value of equity-settled transactions is determined in two ways: (1) directly, at the fair value of the goods or services received; and (2) indirectly, by reference to the value to shares issued.

ILLUSTRATION 25
The management of Agudama Fishes Plc encountered some problems with its fish lake in Bayelsa State. To solve the problem, the company sought for and obtained the specialist advice of Professor T. Popoola, an environmental biologist, in one of the nation's premier universities. To pay for his services, the company gave him 20,000 of its 50k shares with market value of N2.80 each.

You are required to show how this transaction would be accounted for in accordance with IFRS 2.

SUGGESTED SOLUTION 25
Under IFRS 2, an equity-settled transaction that cannot be measured directly at the fair value of the services received should be measured indirectly by reference to the fair value of the equity instruments granted.

The formal entries would be as follows:

Dr share capital	N10,000
Cr share premium	N46,000

Cash-settled share-based transactions

For cash-settled share-based payment transactions, the entity should measure the goods or services acquired and liability incurred at the fair value of the liability. Until the liability is settled, the entity should re-measure the fair value of the liability at the end of each reporting period and at the date of settlement, with any charges in fair value recognized in profit or loss.

Disclosures
An entity should disclose information that will enable users to understand:

(a) The effect of share-based payment transactions on the entity's profit or loss for the period and on its financial position;
(b) How the fair value of the goods or services received, or the fair value of the equity instruments granted, during the period was determined; and
(c) The nature and extent of share-based payment arrangements that existed during the period.

SELF ASSESSMENT EXERCISE
What is a share-based payment transaction?

3.3: IFRS 5: NON-CURRENT ASSETS HELD FOR SALE AND DISCONTINUED OPERATIONS

Classification as held for sale

A non-current asset or disposal group should be classified as, held for sale if its carrying amount will be recovered principally through a sale of transaction rather than through continuing use.

The standard requires the following conditions to be met for such a classification to take place:

(a) The asset must be available for immediate sale in its present condition;
(b) Management must be committed to a plan to sell the asset or disposal group;
(c) An active programme to locate a buyer and complete it at a reasonable price must have been initiated;
(d) Sale is expected to be completed within one year; and
(e) It is unlikely that significant change to the plan will be made or that the plan will be withdrawn.

When a non-current asset or disposal group is acquired exclusively with a view to its subsequent disposal within one year, it should be classified as held for sale. (IFRS 5.11).

Measurement of a non-current asset

(a) A non-current asset or disposal group held for sale should be measured at the lower of its carrying amount and fair values less cost to sell.
(b) A non-current asset or disposal group classified as held for distribution to owners should be measured at carrying amount and fair value less costs to distribute.
(c) The entity should recognize an impairment loss for any initial or subsequent write-down of the asset (or disposal group), to fair value less costs to sell. Any subsequent increase in fair value less cost to sell should be recognized as a gain.
(d) The impairment loss (or any subsequent gain) recognized for a disposal group, should be allocated to the carrying amount of the assets in accordance with IAS 36.

ILLUSTRATION 26

Weris Hotels Plc plans to dispose of a group of its assets in Kaduna, as an asset sale. The assets constitute a disposal group and had the following values:

	Carrying amount at the end Of the reporting period before Classification as held for sale	carrying amount as re-measured immediately before classification as held for sale
	N’000	N’000
Goodwill	5,600	5,600
Property, plant & equipment carried		
At re-valued amount	10,700	9,000
Property, plant & equipment	10,000	8,000
Building construction in progress	8,600	8,000

Stock	4,100	3,800
Total	39,000	34,400

The company estimates that fair value less cost to sell of the disposal group amounts to N30.4million.

You are required to show how the impairment loss will be allocated to non-current assets. (Adopted from IFRS 5 implementation guide).

SUGGESTED SOLUTION 26

The impairment loss is the difference between the carrying amount N39million and fair value less cost to sell, N30.4million.

According to IAS 36, the impairment loss will first reduce the goodwill. The residual loss will be allocated to the other non-current assets prorate, based on their carrying amounts.

Allocation schedule

	Carrying amount	Impairment loss	Impairment values
	N'000	N'000	N'000
Goodwill	5,600	5,600	0
PPE (at re-valued amount)	9,000	1,080	9
PPE (at cost)	8,000	960	0
Construction work in progress	8,000	960	0
Stock	3,800	0	3,800
	34,400	8,600	

Discontinued operations

A discontinued operation is a component of an entity that either has been disposed of or is classified as held for sale and;

(a) Represents a separate major line of business or geographical area of operations;
(b) Is part of a single coordinated plan to dispose of a separate major line of business or geographical area of operation; or
(c) Is a subsidiary acquired exclusively with a view to reselling.

Presentation and disclosure

IFRS 5 requires the following disclosures concerning discontinued operations:

(a) An entity shall disclose a single amount in the statement of comprehensive income 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.

(b) An analysis of the single amount in (a) into:
   (i) the revenue, expenses and pre-tax profit or loss of discontinued operations;
   (ii) the related tax;
   (iii) the gain or loss recognized on the measurement to fair value less costs to sell or on the disposal of the discontinue operation; and
   (iv) the related income tax expense.

The following presentation and disclosures are required in respect of assets classified as held for sale:

(a) An entity should present a non-current asset classified as held for sale and the assets of a disposal group classified as held for sale separately from other assets in the statement of financial position.
(b) The entity should disclose the following information in the notes to the financial statements of the period:
   (i) a description of the non-current assets;
   (ii) a description of the facts and circumstances of the sale; and
   (iii) if applicable, the reportable segment in which the non-current asset is presented.

ILLUSTRATION 27
As a result of frequent disruption of its operations in Zaramafa, Opuene Oil Services Ltd decided to sell off its business in that geographical area. The net assets of the company's businesses in Zaramafa at 31 December 20X8 amounted to N208million, but its fair value less cost to sell has been estimated at N198million. The company is confident that it could affect the disposal within one year as willing buyers have started indicating interest.

During the year ended 31 December, 20X8 the businesses in Zaramafa reported the following. Revenue operating expenses N126million and estimated income tax, N15million.

The rest of the other businesses of Opuene Oil Services ltd had the following incomes and expenses.

	N'm
Revenue	2,980
Cost of sales	(1,020)
Gross profit	1,960
Other income	420
Distribution costs	(580)
Administrative expenses	(800)
Other expenses	(390)
Finance costs	(20)
Profit before tax	590

Income tax expense	(112)
Profit for the period	478

You are required to prepare a statement of comprehensive income for the year ended 31 December 20X8 in accordance with IFRS 5. Ignore comparative figures.

SUGGESTED SOLUTION 27

OPUENE OILD SERVICES LTD

Statement of Comprehensive Income for the year ended 31 December, 20X8

Continuing operations

	N'm
Revenue	2,980
Cost of sales	(1,020)
Gross profit	1,960
Other income	420
Distribution costs	(580)
Administrative expenses	(800)
Other expenses	(390)
Finance costs	(20)
Profit before tax	590
Income tax expense	112
	478

Note to the income statement

Discontinued operations

	N'm
Revenue	140
Operating expenses	(126)
Impairment loss (208 -198)	(10)
Operating profit	4

Income tax expense	(15)
Loss for the year	11

SELF ASSESSMENT EXERCISE
Solve the questions in the illustrations without looking at the solution and later compare your result to the solutions in the illustrations.

4.0 CONCLUSION
International Financial Reporting Standards (IFRS) are principles-based standards, interpretations and the framework (1989) adopted by the International Accounting Standards Board (IASB).

Many of the standards forming part of IFRS are known by the older name of International Accounting Standards (IAS). IASs were issued between 1973 and 2001 by the Board of the International Accounting Standards Committee (IASC). On April 1, 2001, the new IASB took over from the IASC the responsibility for setting International Accounting Standards. During its first meeting the new Board adopted existing IAS and Standing Interpretations Committee standards (SICs). The IASB has continued to develop standards calling the new standards IFRS.

5.0 SUMMARY
In this unit, you would recall that we discussed International Financial Reporting Standard 1, 2 and 5: First-Time Adoption of International Financial Reporting Standards, Share-Based Payment and Non-Current Assets Held for Sale and Discontinued Operations respectively.

6.0 TUTOR MARKED ASSIGNMENT
1. _________ is a contract that evidences a residual interest on the assets of an entity after deducting all its liabilities.
2. _________ is a transaction in which the entity receives goods or services as consideration for equity instruments of the entity (including shares or share options), or acquires goods or services by incurring liabilities to the supplier of those goods or services for amount that are based on the price of the entity's share or other equity instruments of the entity.
3. The difference between the fair value of the shares to which the counterparty has the right to subscribe or receive and the price the counterparty is required to pay for those shares, can be referred to as?
4. The conditions that determine whether the entity receives the services that entitle the counterparty to receive cash, other assets or equity instruments of the entity, under a share-based payment arrangement can be referred to as?
5. A share based payment transaction in which the entity receives goods or services as consideration for equity instrument of the entity, can be referred to as?
6. A share-based payment transaction in which the entity acquires goods or services by other assets to the supplier of those goods or services for amounts that are based on the price (or value) of the entity's share or other equity instruments of the entity can be referred to as?

7.0 REFERENCES/FURTHER READING
Institute of Chartered Accountant of Nigeria, Financial Accounting, Study Pack Lagos.

International Accounting Standard Board, International Accounting Standard.

International Accounting Standard Board, International Financial Reporting Standard

Nigerian Accounting Standard Board, Statement of Accounting Standard

MODULE 5: REGULATORY FRAMEWORK

Unit 1: Regulatory Framework of Financial Accounting 1

Unit 2: Regulatory Framework of Financial accounting 2

Unit 3: Legal and Regulatory framework of Group Accounts

UNIT 1: REGULATORY FRAMEWORK OF FINANCIAL ACCOUNTING 1

CONTENT

1.0 Introduction

2.0 Objectives

3.0 Main Content

- 3.1 Classification of Companies
- 3.2 Capital Structure
- 3.3 Presentation of Financial Statements

4.0 Conclusion

5.0 Summary

6.0 Tutor Marked Assignment

7.0 References/Further Reading

1.0 INTRODUCTION

In this unit and subsequent unit we shall discuss regulatory framework of financial accounting. Accounting standard applies to all financial statements whose purpose is to give a "true and fair view". Consequently, they apply to every Nigerian company's financial statements.

Therefore, regulatory framework of financial accounting are based on company laws, accounting standards, international accounting standards, and other national standard setting bodies influence.

Accounting standards are rules or set of rules prescribing the method(s) by which accounts (financial statements) are prepared and presented. These are 'working regulations' and are issued by national or international bodies of the accountancy profession.

2.0 OBJECTIVES

After studying this unit, you should be able to:

1. State the classification of companies according to Companies and Allied Matters Act 2004.
2. State and explain the various types of shares.
3. State the provision concerning acquisition of own shares.
4. Identify and explain the make-up of the capital structure.
5. Familiarize yourself with the content and presentation of financial statements.

3.0 MAIN CONTENT

3.1 CLASSIFICATION OF COMPANIES

Under section 21 of CAMA 2004, an incorporated company may be any of the following:

(a) Company limited by shares. This is a company where the liability of each member to contribute to the assets of the company in the event of winding-up or liquidation is limited by the Memorandum and Articles of Association to the amount, if any, unpaid on the shares held by him.
(b) Company limited by guarantee. In this type of registered company, the liability of each member to contribute to assets of the company in the event of winding up, is limited by the Memorandum and Articles of Association to the amount which the member undertakes to pay. Unlike companies limited by shares, a company limited by guarantee, shall not be registered with a share capital (see section 26 of the CAMA 2004). Such companies are usually formed to promote commerce, art, science, education, research and similar objects. The name of the company shall end with the word limited by guarantee or Ltd/Gte.
(c) Unlimited Company. In an unlimited company, there is no limit on the liability of its members. The name of the company shall end with unlimited or Ultd. (see Section 29 of CAMA 2004).

Any of the foregoing types of company may be a:
(a) Private limited liability company, or
(b) Public limited liability company

A private limited liability company: Section 22 of CAMA defines a private company as one which is stated in its Memorandum and Articles of Association to be a private company and which its articles of Association:

(a) Restricts the right to transfer its shares;
(b) Limits the number of its members to fifty;
(c) Prohibits any invitation to the public to subscribe for any shares or debentures of the company;
(d) Requires that appointment of directors may be done by an ordinary resolution; and
(e) Requires that the name of the company shall end with the word Limited or Ltd (see Section 29).

A public limited liability company: A public company is any other than a private limited liability company. It, however, has the following characteristics:

(a) The word “public” is stated in its Memorandum of Association;
(b) Does not restrict the right to transfer its shares;
(c) Does not limit the number of its members;
(d) Makes its accounts public for all to see;
(e) Places invitation to the public to subscribe for any shares or debentures of the company;
(f) Appointment of directors may be done individually on separate resolutions. Note, however, that one of its members may move that all directors be appointed by one resolution and where this is not opposed, then the public company’s directors may be appointed by a single resolution;
(g) Any public company can issue its shares and debentures by way of prospectus or statement in lieu of prospectus in appropriate circumstances after presentation to the Securities and Exchange Commission; and
(h) The name of the company shall end with word Public Limited Company or Plc.

SELF ASSESSMENT EXERCISE
What is the difference between company limited by shares and company limited by guarantee?

3.2 CAPITAL STRUCTURE

The capital structure of a company consists of ordinary shares, preference shares and debentures. Under these structures, there are different types:

Types of capital

Nominal or Authorized: This is the initial capital with which the company is registered. It does not change within a short time except where the capital is increased. It is therefore, the maximum capital at any given time. There are specified minimum capitals as stipulated by law. The authorized minimum share capital of a private company is N10,000,00 and N500,000.00 for a public company. The subscribers of the Memorandum must together take shares of a value not less than 25% of the authorized capital.

Issued Capital: The portion of the nominal capital or authorized capital issued or made available to shareholders. It must not at any time be less than 25% of the authorized capital.

Paid-up capital: This is that part of the share capital which has been issued to and paid for by the shareholders.

Reserve capital: It is that portion of uncalled capital which a company limited by shares has, by special resolution, determining that it will not be capable of being called up except for the purpose of winding up the company.

Note that an unlimited company, which resolves to be registered as a limited company, may provide for reserve share capital on re-registration.

Equity Share capital: This means a share other than a preference share, which does not carry fixed return on investment: for example, ordinary shares.

CLASSES OF SHARE

Any company, authorized by its articles, the Act or any other law, may issue different classes of shares. Such a share must not have more than one vote or no vote at all. A company may, however, subject to the above principle, issue shares having preferred, deferred or other special rights or restrictions, such as, regards dividends or return of capital. The usual classes of shares are:

Ordinary shares: They have no special rights and carry no fixed rate of return on the capital. They bear the major financial risk of the company and are therefore often called the equity shares of the company. They cost much less than the ordinary shares and preference shares. In voting matters, deferred shareholders are more at an advantage compared with preference shareholders who are regarded as investors.

Payment for share

This may be in cash or if authorized by the articles, by property or services and, if payment is not in cash, the consideration must be valued by an expert. See section 135-137 of CAMA (2004). It should be noted that at formation of a company, there is actual payment for the shares.

Membership of the company:
Membership of the company is made up of:

(a) Subscribers who are deemed to have agreed to become members and whose names must be entered in the register of members.
(b) Every other person who agrees in writing to become member a member by payment and allotment of shares and such person's name is entered in the register of members.

Public Issue of shares
Only public companies can issue their shares or debentures to the public, usually by way of a prospectus but where no prospectus is issued, a statement in lieu of prospectus is filed. Filing the prospectus is no longer a prerequisite for the formation of a public company. The company may now be formed while work on the prospectus is carried on, pursuant to issuance of shares.

Issue of Shares at Premium
Share are said to be issued at a premium where the price at which they are issued is higher than the par (nominal) value of the share. Thus, the shares of a company with nominal or par value of N1.00 per share may be issued at N1.20. When a company issue shares at a premium, the sum equal to the aggregate amount or value of the premium on those shares must be transferred to an account called "share premium account". This account cannot be used to pay dividend but can be used for the following:

(a) Paying up unissued shares of the company to be issued to members as fully paid bonus shares;
(b) Writing off the preliminary expenses of the company or the expenses of or commission paid or discount allowed on any issue of shares of the company; and
(c) Providing for the premium payable on redemption of redeemable preference shares of the company.

Issue of Shares at a Discount
Shares may be issued at a discount which means that the amount paid by the applicants/subscribers is less than the par(nominal) value of the share. This could be possible only where a resolution:

(a) Authorizes the issue of shares at a discount; or
(b) Specifies the maximum rate of discount at which the shares are to be issued; and
(c) Stipulates the time frame of the issue which must be within the month after the date on which must be within the month after the date on which the issue is sanctioned by the court or within such extended time as the court may allow.

Allotment of Shares
Subject to the provisions of the Investment and Securities Act, the power to allot shares is vested in the company which it may delegate to the director, subject to the conditions or directions that may be imposed by Articles or from time by the company in General Meetings.

The method of application for allotment is dependent on the type of company. In the case of a private company or a public company, where the company issues shares and a member indicates the number of shares which he wishes to purchase. In the case of a public company, where the issue of shares is public, subject to any condition that may be imposed by the Securities and Exchange

Commission, the application for allotment is made by completing and returning to the company the form of application as prescribed by the Articles.

Upon the receipt of an application, a company shall, where it wholly or partially accepts the application, make an allotment to the applicant and within 42 days after the allotment, notify the applicant of the fact of the allotment and number of shares allotted to him. The application is an offer to take shares and allotment amounts to an acceptance. An applicant shall have the right at any time before allotment, to withdraw the application by written notice to the company.

ACQUISITION OF OWN SHARES

Section 160(2) of CAMA states the reasons why a company may wish to purchase or own its shares. They include:

(a) Settling or compromising a debt or claim asserted by or against the company;
(b) Eliminating fractional shares;
(c) Fulfilling the terms of a non-assignable agreement under which the company is obliged to acquire from an officer or employee of the company;
(d) Satisfying the claim of a dissenting shareholder; and
(e) Complying with a court order.

Conditions for purchase of own shares

(a) The shares of a company shall be purchase only out of the company's profits which would otherwise be available for dividend or the proceeds of a fresh issue of shares, made for the purpose of the purchase.
(b) Redeemable shares shall not be purchased at a price greater than the lowest price at which they are redeemable or shall be redeemable at the next date thereafter at which they are due or liable to be redeemed

Reciprocal Acquisition of a Holding Company's Shares by its Subsidiary

Section 165 of CAMA, allows a subsidiary to acquire or retain the shares of its holding company, under the following conditions:

(a) The subsidiary company may acquire the shares of its holding company as a personal representative or trustee of its holding company; and
(b) A subsidiary company which had acquired the shares of its holding company before 1990, shall continue to retain such shares but shall not be entitled to vote at the meetings of its holding company, and shall not acquire further shares in the holding company, particularly where their security may be in danger.

DEBENTURES

This is an acknowledgement of indebtedness issued by a company to a lender and it is normally by way of a deed.

Securities and Charges

This is a collateral given by a debtor to secure a loan and it is meant for protection and assurance that the loan will be paid when due.

Types of debentures

(a) **Perpetual debenture**: This is a debenture that is made irredeemable or redeemable at a very long period of time.
(b) **Convertible debenture**: This is a type that may be converted to the shares of the company which issued it. See S.172 of CAMA 2004.
(c) **Secured and naked debenture**: Security here may either be fixed or floating. See s.173 of CAMA 2004.
(d) **Redeemable debenture**: This may be redeemed at any time. See S.174 of CAMA 2004.

For detailed provisions of the CAMA on the creation of debentures and debenture stock, please refer to section 166 to 210 of the Act.

SHAREHOLDERS' FUND
Shareholders' fund is made up of ordinary share capital, preference share capital and reserves.

Ordinary share capital/preference share capital
As earlier discussed above, they are part of the share capital of the company, with different rights to dividend and capital repayment in accordance with the Articles of Association of the company.

Reserves: It is an appropriation of the company's profit during a financial year.

CLASSES OF RESERVES

Revenue reserves
A revenue reserve is where an amount has been voluntarily transferred from the profit and loss appropriation account by debiting it, thus reducing the amount of profits left available for cash dividend purposes. It might be for some particular purpose, or the amount could be called up in future to help swell the profit shown in the profit and loss appropriation account, as being available for dividend purposes.

General reserves
A company might create a general reserve account to take care of unforeseen circumstances, instead of paying out the entire amount in form of dividend.

Capital reserves
This is a reserve that is not readily available for transfer to the profit and loss appropriation account, to swell the profit shown as available for cash dividend purpose.

The following types of capital reserves are created in accordance with the Act:
(a) Capital redemption reserve fund is created by law to meet the following:
(i) paying up unissued shares of the company as fully paid bonus issues; and
(ii) applied in redeeming preference shares or debentures.
(b) **Share premium account**: This is an account created from issuing shares at an amount higher than the nominal value. The account is used to meet the following:
(i) writing off preliminary expenses;
(ii) writing off expenses and commission paid on the issue of shares and debentures;
(iii) writing off discount on shares or debentures issued; and
(iv) providing for any premium payable on redemption.
(c) **Revaluation account**: A revaluation account is usually created when the value of existing assets are either increased or decreased in line with the dictates of the market.

SELF ASSESSMENT EXERCISE
What do you understand by shares issued at premium and shares issued at discount?

3.3 PRESENTATION OF FINANCIAL STATEMENTS
Duty to keep Accounting Records: Every company must keep accounting records that will be sufficient to show and explain the transactions of the company so as to:

(a) Disclose with reasonable accuracy, at any point in time, the financial position of the company; and
(b) Enable the directors to ensure that the financial statements comply with the requirements of section 331 of CAMA 2004 as to form and contents of the company's financial statements.

Contents of accounting records
(a) Entries from day to day of all sums of money received and expended by the company and the matters in respect of which they take place;
(b) A record of the assets and liabilities of the company.

The accounting records of a company dealing in goods shall contain: amongst other things:
(a) Statements of stock held at the end of the financial year;
(b) Statements of stock takings from which the annual statements of stocks in (a) above are prepared; and
(c) Statements of all goods sold and purchased other than by retail trade.

Location and Presentation of accounting Records: the accounting records shall be kept at the company's registered office or such other place in Nigeria as the directors think fir and will at times be open to inspection by officers of the company. A company is required to keep the accounting records for a period of six(6) years from the date on which they were made.

Directors' Duty to prepare Annual Accounts: The directors must prepare financial statements for the relevant accounting period. At the first meeting of the Board after incorporation, the directors must determine to what date each year, the financial statements shall be made up and notify the Commission within 14 days of the determination.

Contents of Financial Statements (Section 334): The financial statement of a company should include:

(a) Statement of the accounting policies;
(b) The balance sheet as at the last day of the company's accounting year;
(c) A profit and loss account or in the case of a company not trading for profit, and income and expenditure account for the year;
(d) Notes on the accounts;
(e) The auditors' report;
(f) The directors' report;
(g) A cash flow statement;
(h) A value-added statement for the year;
(i) A five-year financial summary; and
(j) In the case of a holding company, the group financial statements.

However, the financial statements of a private company need not include matters stated in paragraph (a), (g), (h), and (i) above.

Directors' report: The Directors of a company shall in respect of each year, prepare report:

(a) Containing a fair view of the development of the company and its subsidiaries during the financial year; and
(b) Stating the amount, if any, which they recommend should be paid as dividend and the amount they propose to carry to reserve.

MODIFIED FINANCIAL STATEMENTS OF SMALL COMPANIES

Under Section 351 of CAMA 2004, a company qualifies as a small company in a year, if in that year, the following conditions are satisfied:

(a) The company is a private company having share capital.
(b) Its turnover for that year is not more than N2 million or such amount as may be fixed by the Corporate affairs Commission.
(c) The company's net assets value is not more than N1 million or such amount as may be fixed by the commission.
(d) None of its members is an alien.
(e) None of its members is a Government or Government corporation or agency or its nominee.
(f) The directors hold not less than 51 percent of the company's equity share capital.

The Act allows a small company to deliver a modified balance sheet which is an abbreviated version of the full balance sheet. A small company is not required to deliver its profit and loss account to the Corporate Affairs Commission.

ANNUAL RETURNS (SECTIONS 370 – 378)

Every company shall, at least, once in every year, make and deliver to the Commission, an annual return but the company need not make a return in the year of its incorporation. The annual return of a company having shares other than a small company shall contain, among other things, a register of members and debenture holders, indebtedness of the company, past and present members and directors.

FORMATS OF FINANCIAL STATEMENTS

Section C of the Second Schedule of the Act, provides two balance sheet formats and four income statement formats. A reporting entity is required to choose any of the formats in presenting its balance sheet and profit and loss accounts. In this unit, we present only the format relating to group companies.

PROFIT & LOSS ACCOUNT FORMAT

S/No	Descriptions	Amount
1.	Turnover	x
2.	Cost of sales	(x)
3.	Distribution expenses	(x)
4.	Administrative expenses	(x)
5.	Operating income	x

6. Other operating income x
7. Income from shares in group companies x
8. Income from shares in related companies x
9. Income from other fixed asset investment x
10. Other interest receivables and similar income x
11. Amounts written off investments (x)
12. Accrued interest expenses and similar charges (x)
13. Tax on profit & loss on ordinary activities (x)
14. Profit & loss on ordinary activities after taxation x
15. Extra-ordinary income x
16. Extra-ordinary charges (x)
17. Extra-ordinary profit or loss x
18. Tax on extra-ordinary profit & loss (x)
19. Other taxes under the above items (x)
20. Profit or loss for the financial year x
21. Earnings per share x
22. Dividend per share x

BALANCE SHEET FORMAT

1. Called up share capital not paid x
2. Fixed assets:
    a. Land & building x
    b. Plant & machinery x
    c. Fixtures, fittings, tools & equipment x
    d. Construction in progress x
    e. Pre-payment for stocks in transit x

    Xx
3. Long-term investments:
    a. Shares in group companies x
    b. Loan to group companies x
    c. Shares in related companies x
    d. Loan to related companies x
    e. Other investments other than loan x
    f. Other loans x
    g. Own shares x
    h. Bonds, debentures and Federal Government development Stocks x

    Xx
4. Deferred changes:
    a. Development cost x
    b. Concessions, patients, licences, franchise, trademarks and similar right x
    c. Goodwill x
    d. Pre-payment for services to be received x

    Xx
5. Current assets:
    a. Stocks x

	b.	Raw materials and consumables	x
	c.	Work in progress	x
	d.	Finished goods and goods awaiting sales	x
	e.	Pre-payment for stocks in transit	x
			X
6.	Debtors:		
	a.	Trade debtors	x
	b.	Amount owed by group companies	x
	c.	Amount owed by related companies	x
	d.	Other debtors	x
	e.	Called-up share capital not paid	x
	f.	Pre-payment and accrued income	x
			X
7.	Short-term Investments:		
	a.	Shares in group companies	x
	b.	Own shares	x
	c.	Other investment	x
			X
8.	Cash at bank and in hand		x
			X
9.	Pre-payments and accrued income		x
			X
10.	Creditors, amount falling due within one year:		
	a.	Debenture loans	x
	b.	Bank loans/overdrafts	x
	c.	Payments received on account	x
	d.	Trade creditors	x
	e.	Bills of exchange payable	x
	f.	Amounts owed to group companies	x
	g.	Amounts owed to related companies	x
	h.	Other creditors including taxation and PAYE	x
	i.	Accruals and deferred income	x
			Xx
11.	Net current assets/(liabilities)		x
12.	Total assets less current liabilities		XX
13.	Creditors: amount falling due after more than one year:		
	a.	Debenture loans	x
	b.	Bank loans and overdrafts	x
	c.	Payment received on account	x
	d.	Trade creditors	x
	e.	Bills of exchange payable	x
	f.	Amount owed to group companies	x
	g.	Amount owed to related companies	x

h. Other creditors including taxation x
i. Accruals and deferred income x
X

14. Provisions for liabilities and charges:
    a. Pensions and similar obligations x
    b. Taxation, including deferred taxation x
    c. Other provisions x
    X

15. Accruals and deferred income x
    Xx

16. Capital and reserves:
    a. Called-up share capital x
    b. Share premium account x
    c. Revaluation reserves x
    d. Other reserves:
       (i) capital redemption reserves x
       (ii) reserves for own shares x
       (iii) reserves provided for by the articles of association x
       (iv) other reserves x
    e. Profit & loss account x
    Xx

Self assessment exercise
Outline according Section 334 of CAMA what the financial statement should include.

4.0 CONCLUSION
In conclusion, you have learnt that Financial Accounting Standard Board (USA) has defined conceptual framework as a constitution, a coherent system of interrelated objectives and fundamentals that can lead to consistent (accounting) standards and that prescribes the nature, function and limits of financial accounting and financial statements.

Some arguments hold that some standards concentrated on income statement and others concentrated on balance sheet. An unambiguous definition of income and value would ensure that all financial statements have equal usefulness to different users groups. Counter argument might be that financial statements intended for variety of users and may not be possible to devise single conceptual framework suiting all users. May need variety of accounting standards, each produced for different purpose (and with different concepts as basis).

5.0 SUMMARY
In this unit, you would recall that we discussed regulatory framework of financial accounting 1. This was discussed using the sub units; classification of companies; capital structure; and presentation of financial statements.

You would recall that companies are classified as company limited by shares, company limited by guarantee and unlimited company. You would also recall that the capital structure of a company consists of ordinary shares, preference shares and debentures. Under these structures, there are different types.

Finally you should also recall that every company must keep accounting records that will be sufficient to show and explain the transactions of the company so as to:

(a) Disclose with reasonable accuracy, at any point in time, the financial position of the company; and
(b) Enable the directors to ensure that the financial statements comply with the requirements of section 331 of CAMA 2004 as to form and contents of the company's financial statements.

6.0 TUTOR MARKED ASSIGNMENT

1. State one of the requirements for the registration of a limited liability company under the Companies and Allied Matters Act, CAP C20 LFN 2004.
2. State the first item in the format of the profit and loss account of a limited liability company.

3. ________ is a debenture that is made irredeemable or redeemable at a very long period of time.
4. ________ is a type of debenture that may be converted to the shares of the company which issued it.
5. The Act allows a small company to deliver a modified balance sheet which is _________ of the full balance sheet.
6. _________ is not required to deliver its profit and loss account to the Corporate Affairs Commission.

7.0 REFERENCES/FURTHER READING

Institute of Chartered Accountant of Nigeria, Financial Accounting, Study Pack Lagos.

International Accounting Standard Board, International Accounting Standard.

International Accounting Standard Board, International Financial Reporting Standard

Nigerian Accounting Standard Board, Statement of Accounting Standard

MODULE 5: REGULATORY FRAMEWORK

UNIT 2: REGULATORY FRAMEWORK OF FINANCIAL ACCOUNTING 2

CONTENT

1.0 INTRODUCTION

In this unit, you will learn that the statutory backing for the establishment and regulation of banks and other non-banks financial institutions (discount houses, finance houses, etc., except Insurance Companies) in Nigeria is the Banks and Other Financial Institutions Act, 1991 (as amended).

The regulatory body for the insurance industry is the National Insurance Commission (NAICOM), while the regulatory statute is the Insurance Act, 2003 (as amended).

The information disclosed through the registration of securities enables investors to make informed judgments about whether to purchase a company's securities. While the Securities and Exchange Commission requires that the information provided be accurate, it does not guarantee it. Investors who purchase securities and suffer losses have important recovery rights if they can prove that there was incomplete or inaccurate disclosure of the important information.

2.0 OBJECTIVES

After studying this unit, you should be able to:

1. State some of the accounting requirements of BOFIA.
2. Familiarize yourself with and state some of the provisions contained in Insurance Act 2003.
3. Familiarize yourself with the history and functions of the Securities and Exchange Commission.
4. State the provisions contained in Investment and Securities Act 1999.
5. State the objective of Pension Reform Act 2004.

3.0 MAIN CONTENT

3.1 BANK AND OTHER FINANCIAL INSTITUTIONS ACT, 1991 (BOFIA)

Some of the accounting requirements of the Act are stated below.

Minimum Capital

The President shall on the advice of the Central bank of Nigeria (CBN) determine, from time to time, the appropriate minimum paid up share capital of each category of banks subject to subsection (1) of this section. The minimum shareholders' fund of banking institutions shall in respect of:

(a) Universal banks be at N25 billion
(b) Bureau de change be at N500 million
(c) Micro finance banks be at N20 million
(d) Mortgage institutions be at N2 billion

Cash Reserves, Special Deposits and specified Liquid Assets
The BOFIA requires every bank to maintain with the CBN, cash reserves and special deposit and hold specified liquid assets or stabilization securities, as the case may be, as prescribed by the Central Bank by virtue of section 39 of central bank of Nigeria Act, 1991 (as amended) where both assets and liabilities are due.

For the purpose of this section, specified liquid assets are:
(a) Currency notes and coin which are legal tender in Nigeria;
(b) Balances at the bank;
(c) Net balances at any licensed bank and money at call in Nigeria;
(d) Treasury bills and treasury certificates issued by the Federal Government;
(e) Inland bills of exchange and promissory notes re-discountable at the Central Bank; and
(f) Negotiable Certificate of deposit approved by the Central Bank.
(g) Such other negotiable instruments as may from time to time be approved by the Central Bank.

Statutory Reserve Fund
The Act also requires every bank to maintain a reserve fund. Each year, a bank must transfer an amount to the reserve fund, equal to and not less than 30% of the profit after tax, if the amount in the reserve fund is equal or greater than the paid-up share capital.

Conditions for payment of dividends
No bank shall pay dividend until:
(a) All its preliminary expenses, organizational expenses, share selling expenses, brokerage, losses incurred and other capitalized expenses not represented by tangible assets have been written-off;
(b) Adequate provision has been made for contingent losses on risk assets, liabilities, off balance sheet commitment; and
(c) It has complied with capital ratio requirement specified by section 13(1) of the Act.

Reserve for Small Scale Industries
CBN monetary and credit policies require each bank to set aside 10 percent of its profits for the financing and promotion of small scale industries in Nigeria.

Analysis of Nonperforming Loans and Advances
Prudential guidelines issued by the CBN required banks to classify non-performing loans and advances, and to provide for loan impairment as follows:

Interest and principal outstanding for over	Classification	Provision
90 days but less than 180 days	Substandard	10%
180 days but less than 360 days	Doubtful	50%

360 days and over	lost	100%

SELF ASSESSMENT EXERCISE
Outline the minimum shareholders' fund for banking institutions

3.2 INSURANCE ACT, 2003
Relevant sections of the statute are summarized below:

Minimum paid up capital (section 9(1))

The Act mandates every insurance business in Nigeria to maintain specified minimum paid up capital which has been reviewed by NAICOM as follows:

(a) Life insurance not less than N2 billion;
(b) General insurance not less than N3 billion;
(c) Composite insurance business not less than N5 billion;
(d) Reinsurance business not less than N10 billion

Statutory deposit (Section 10)

This Section requires that:
(a) An insurer intending to commence insurance business in Nigeria, after the commencement of the Act, shall deposit the equivalent of 50 percent of the paid-up share capital, referred to above, with the Central Bank of Nigeria. This deposit is called statutory deposit.
(b) Upon registration as an insurer, 80 percent of the statutory deposit shall be returned with interest not later than 60 days after registration.
(c) In the case of existing companies, an equivalent of 10 percent of the minimum paid-up share capital stipulated in Section 9, shall be deposited with the CBN.
(d) Statutory deposit shall attract interest at the minimum lending rate by the CBN on every 1 January of each year.
(e) Any short fall in the statutory deposit must be replenished within 30 days.

Statutory books and record (Section 17 and 18)
Section 17(1), requires an insurer to keep and maintain at its principal office, the following records:

(a) The Memorandum and Articles of Association or other evidence of the Constitution of the insurer;
(b) A record containing the names and addresses of the owners of the insurance business, whether known as, or called shareholders or otherwise.
(c) The minutes of any meeting of the owners and of the policy making executives (whether known as or called the Board of directors);
(d) A register of all policies, in which shall be entered, in respect of every policy issued, the names and addresses of the policy-holders, the date when policy was effected and a record on any transfer, assignment or any transfer, assignment or nomination of which the insurer has notice.
(e) A registrar of claims, in which shall be entered, every claim made together with the date of claim, the names and addresses of the claimant and the date on which the claim was settled,

or in the case of claim which is repudiated, the grounds for the rejection or in the case of litigation, the particulars of the litigants and the court in this matter.

(f) A register of investments, showing those which are attributable to the insurance funds and those which are not, and also any alteration in their values, from time to time.
(g) A register of its assets.
(h) A register of re-insurance ceded, showing separately those ceded in Nigeria and those ceded outside Nigeria.
(i) A cash book.
(j) A current account book.
(k) A register of open policies, in respect of marine insurance transactions, and management report by external auditors.

Section 17(2), requires a life insurance business, to maintain and keep the following additional records:

(a) A register of assured, under group policies;
(b) A register of loans on policies;
(c) A register of cash surrendered values; and
(d) A registrar of lapsed and expired policies.

Section 18(1), mandates a re-insurance business, to keep and maintain at its principal office, the following records:

(a) The Memorandum and Articles of Association or other evidence of the Constitution of the reinsurer;
(b) Records containing the names and addresses of the owners of the reinsurer (whether known as or called shareholders or otherwise);
(c) Minutes of any meeting of the owners and of the policy making executives (whether known as the board of directors or otherwise);
(d) A register of all treaties, in which shall be entered, in respect of every treaty issued, the name of the cedant, and the date when the date when the treaty was effected;
(e) A register of all claims, in which shall be entered, every claim made together with the date the claim is settled;
(f) A register of events, showing those which are attributable to the insurance funds and those which are not and also any alteration in value from time to time;
(g) A register of assets;
(h) A register of business or retrocession, showing separately those ceded within ant outside Nigeria;
(i) A register of new and existing clients;
(j) A cash book; and
(k) Domestic or management report prepared by the external auditors.

A life reinsurance business, shall keep the following additional records:

(a) A register of assured, under group policies;
(b) A register of cancelled, leased and expired policies, and
(c) A register of claims, showing the names of the cedant and when the claim is settled.

Separation of Accounts and Insurance Funds (Section 19)

Section 19(1), requires every insurer, who carries on the two classes of insurance business, to enter all receipts of each of those classes of insurance business, in a separate and discount account. Separate insurance funds are also required for each class of insurance business and, in the case of life insurance business, there should be:

(a) The individual life insurance business fund;
(b) The group life insurance business and pension fund; and
(c) Health insurance business.

Section 19(2), contains the following additional requirements:

(a) In the case of life insurance business, the life business funds, shall be a sum not less than the mathematical reserve; and
(b) In the case of general insurance business, the insurer is required to maintain provisions for unexpired risk and provisions for outstanding claims, including in the case of the latter, provisions estimated to provide for the expenses of adjustment or settlement of suck claims.

The insurance fund of each particular class, shall:

(a) Be absolutely the security of the policy holders of that class, as though it belongs to an insurer carrying on other business than insurance business of that class;
(b) Not be liable for any contract of the insurer for which it would not have been liable, had the business of the insurer been only that of particular insurance class; and
(c) Not be applied directly or indirectly, for a purpose other than those of the class of business, to which the fund is applicable.

Technical reserves (Sections 20 – 23)

Section 20(1), requires an insurer, in respect of its general business, to establish and maintain the following provisions applicable in respect of each class of insurance business:

(a) Provisions for unexpired risks which shall be calculated on a time appointment basis of the risks accepted in the year.
(b) Provisions for outstanding claims which shall be credited with an amount equal to the total estimated amount of all outstanding claims with a further amount representing 10 percent of the estimated figure for outstanding claims in respect of claims incurred but not reported at the end of the year under review and

Under section 21

(a) An insurer shall establish and maintain contingency reserves to cover fluctuations in securities and variations in statistical estimates.
(b) The contingency reserves shall be credited with an amount not less than 3 percent of the total premium or 20 percent of the net profit (whichever is greater) and the amount shall accumulate until it reaches the amount of the minimum paid up capital or 50 percent of the net premium (whichever is greater).

Section 22(1), requires an insurer maintain the following reserves in respect of its life insurance business.

(a) A general reserve fund which shall be credited with an amount equal to the net liabilities on policies in force at the time of the actuarial valuation and an additional 25 percent of net premium for every year between valuation date; and
(b) A contingency reserve fund which shall be credited with an amount equal to 1 percent of the gross premium or 10 percent of the profits (whichever is greater) and accumulated until it reaches the amount of the minimum paid up capital.

A reinsurer shall establish a general reserve fund which shall be credited with an amount:
(a) Not less than 50 percent of the reinsurer's gross profit for the year, where the fund is less than the authorized capital of the insurer; and
(b) Not less 25 percent of the reinsurer's gross profit for the year, where the fund is equal to or exceeds the authorized capital of the reinsurer.

Margin of safety (Section 24(1))
The Act further requires an insurer to maintain at all times, in respect of its general business, a margin of solvency, being the excess of the value of its admissible assets in Nigeria over its liabilities in Nigeria, consisting of:

(a) Provision for unexpired risks;
(b) Provisions for outstanding claims;
(c) Provision for claims incurred but not yet reported; and
(d) Funds to meet other liabilities.

The margin of solvency shall not be less than 15 percent of the gross premium income less reinsurance premium paid up capital, whichever is greater.

The Act defines "admissible assets" as those designated as admissible assets, consisting of the following:
(a) Cash and bank balances;
(b) Quoted investment at market value;
(c) Unquoted stock at cost;
(d) Land and buildings;
(e) Furniture and fittings;
(f) Office equipment;
(g) Motor vehicles;
(h) Prepared expenses made to members of staff;
(i) Amount due from retrocession;
(j) Staff loans and advances; and
(k) Claims receivable.

Assets and investments (Section 25)

An insurer, shall at all times, in respect of the insurance transacted by it in Nigeria, invest and hold in Nigeria assets equivalent to not less than the amount of policy holder's funds in such insurance business, as shown in the balance sheet and the revenue account of the insurer.

Subject to the provisions of this Section, the policy holders' funds shall not be invested in property and securities except;

(a) Shares of limited liability companies;
(b) Shares in other securities of a cooperative society registered under a law of relating to cooperative societies;
(c) Loans to building societies approved by the Commission;
(d) Loans on real property, machinery and plant in Nigeria;
(e) Loans on life policies within their surrender values;
(f) Cash deposit in bills of exchange accepted by license bank; and
(g) Such investments as may be prescribed by the Commission.

No insurer, shall:

(a) In respect of its general insurance business, invest more than 25 percent of its assets in real property; or
(b) In respect of its life insurance business, invest more than 35 percent of its assets as defined in subjection (1), in real property.

ILLUSTRATION 28

(A) SECTIONS 20, 21, and 22 of Insurance Act, 2003, require an insurer to keep certain technical reserves. List and discuss:
(i) the reserves with respect to general insurance business; and
(ii) the reserves with respect to life insurance business.

SUGGESTED SOLUTION 28

(A) Section 20(1) an insurer shall, in respect of its general business, establish and maintain the following provisions applicable in respect of each class of insurance business:
(i) provisions for unexpired risks, which shall be calculated on a time appointment basis of the risks accepted in the year;
(ii) provisions for outstanding claims, which shall be credited with an amount equal to the total estimated amount of all outstanding claims, with a further amount representing 10 percent of the estimated figure for outstanding claims in respect of claims incurred but not reported at the end of the year under review; and
(iii) provision for outstanding claims.

Section 21(1) an insurer, shall establish and maintain contingent reserves to cover fluctuations in securities and variations in statistical estimates.

Section 21(2) the contingency reserves shall be credited with an amount not less than 3 percent of the total premium or 20 percent of the net profit (whichever is greater) and the amount shall accumulate until it reaches the amount of the minimum paid up capital or 50 percent of the net premium (whichever is greater).

Section 22(1) an insurer, shall in respect of its life insurance business, maintain the following reserves:

(a) A general reserve fund, which shall be credited with an amount equal to the net liabilities on policies in force at the time of the actuarial valuation and an additional 25 percent of net premium for every year between valuation date; and
(b) A contingency reserves fund, which shall be credited with an amount equal to 1 percent of the gross premium or 10 percent of the profits (whichever is greater) and accumulated until it is equal to the minimum paid up capital.

SELF ASSESSMENT EXERCISE
Outline the admissible assets according to the Insurance Act.

3.3 SECURITY AND EXCHANGE COMMISSION AND NIGERIAN STOCK EXCHANGE REGULATION REGULATIONS

Historical background
In most jurisdictions, the Securities and Exchange Commission (SEC) exists as the apex capital market institution, providing the right regulatory framework for orderly development of the market, ensuring the integrity of securities business and protection of all participants, particularly the investors. The extent of powers and scope of regulatory responsibilities conferred on the Commission depends on enabling laws. In Nigeria, the Commission came into full existence following the enactment of Securities and Exchange Commission Act 1979, re-enacted as Act 29 of 1988. Historically, it grew out of the capital issues Committee, housed under the Central Bank of Nigeria in the sixties.

This Committee led to the establishment of Capital Issues Commission and subsequently Nigerian Securities exchange Commission (NSEC), which played key role in the indigenization era of 1973-1977 period. Roles assigned to the Commission can be broadly classified into developmental and surveillance roles.

Development roles
These relate to efforts aimed at increasing the depth and breadth of securities business and include facilitating the establishment of important capital market institutions such as Stock and Commodity Exchange, Capital Trade Points, Rating Agencies. These roles which are largely by SEC in developing markets also include development of innovative instruments such as derivatives and facilitating knowledge and awareness of securities.

The traditional role of surveillance includes oversight responsibilities in ensuring that existing institutions and participants confirm to rules and regulations. Originally, the following specific functions were taken up by the Commission.

(a) Pricing of new issues- following deregulations of the market, this function has been transferred to the issuing house.
(b) Timing of issues- this is to ensure that the market is not glutted with shares at any point in time.
(c) Registering and licensing- of market operators including the stock exchanges.
(d) Approval of allotment of shares to members of the public.
(e) Registering of instruments issued with the possibility of transfer to persons other than those initially offered.

(f) The companies and Allied Matters Act, Cap. C20 LFN 2004, also empowers the Commission to regulate mergers and acquisitions, including unit trust and similar schemes.

The enabling Act for the activities of the Securities and Exchange Commission is the Investment and Securities Act, 1999.

SELF ASSESSMENT EXERCISE
What are the functions of the Security and Exchange Commission?

3.4 INVESTMENTS AND SECURITIES ACT, 1999
The Securities and Exchange Commission is empowered by the Investment and Securities Act (ISA) 1999, to administer securities laws and regulate investment and securities in Nigeria. The Act requires comprehensive set of accounting records and accounting reports in a number of circumstances, including business combinations, content of prospectus, and records of security dealers. A few of these requirements are stated below.

Books of Accounts of Security Dealers (S37)
Section 37(1) requires a security dealer to keep or cause to be kept such accounting and other records:

(a) As shall sufficiently explain the transactions and financial position of its business accounts and balance sheets to be prepared, from time to time; and
(b) In such a manner as to enable them to be conveniently and properly audited.

A security dealer shall be deemed not to have complied with subsection (1) of this section in relation to records unless the accounting and other records:

(a) Are kept in sufficient details to show particulars of:
(i) all money received or paid by the security dealer including money paid to or deducted from a trust amount;
(ii) all purchases and sales of securities made by the security dealer, the charges and credits arising from them, and the names of each of these securities;
(iii) all income received from commissions, interest and other sources and all expenses, commissions and interest paid for by the security dealer;
(iv) all the assets and liabilities (including contingent liabilities) of the security dealer;
(v) all securities which are the priority of the security dealer, showing by whom the securities or documents of the title to the security are held and, where they are held by another person, whether or not they are held as security against loans or advances;
(vi) all securities that are not the property of the security dealer and for which the dealer or any nominee controlled by the security dealer is accountable, showing by whom, and for whom, the securities are held and the extent to which they are either held for safe custody or deposited with a third party as security for loans or advances made to the security dealer;
(vii) all purchases and sales of options made by the security dealer and all fees (being options money) arising from them; and
(viii) all underwriting transactions entered into by the security dealer.
(b) Are kept in sufficient details to show separately particulars of all transactions by the security dealer.

(c) Specify the day on which or the period during which each transaction by the security dealer took place; and
(d) Contain copies of acknowledgements of the receipt of securities or of documents of title to securities received by the security dealer from clients for sale or safe custody, clearly showing the name or names in which the particular securities are registered.

Accounts for Investor Protection Fund

Section 152 of ISA 1999, requires a security exchange or capital trade point to establish and keep proper books of accounts in relation to its investors protection fund and prepare income and expenditure account and balance sheet not later than 30th April following each 31st December.

Accountant's Report to be set out in a Prospectus

Section 17 of the 3rd schedule, requires the report of accountants to be contained in the prospectus of a company wishing to issue shares or debentures. The report should cover (a) the profits and losses of the business for the five years preceding the issue of the prospectus and (b) the assets and liabilities of the business at the last date to which the accounts of the business were made.

Part 2 of schedule 4, also requires accountants' report where there is a proposal to acquire a business or a subsidiary.

3.5 PENSION REFORM ACT OF 2004

Section 1 of the Pension Reform Act 2004, mandates the establishment of a contributory pension scheme for the payment of retirement benefits of workers in Nigeria. Section 2 of the Act insists that the requirement is applicable to employees in both private and public sectors, thereby setting aside the use of defined benefit plan permitted by SAS 8, Accounting for Employee Retirement Benefits.

4.0 CONCLUSION

In conclusion, it was established that the regulatory authorities providing the regulations discussed in this unit has an enabling law that guides the activities of the various institutions operating in the sector. The Central Bank of Nigeria has the Banks and Other Financial Institutions Act (BOFIA) 1991, the Nigerian Insurance Commission (NAICOM) has the Nigerian Insurance Act 2003, while the Securities and Exchange Commission (SEC) has the Investment and Securities Act, 1999. These Acts provide some specific requirements relating to the accounts of every corporate entity within its fold.

5.0 SUMMARY

This unit highlights the relevant provisions of:

1. BOFIA 1991 and Investment and Securities Act 1999;
2. Insurance Act 2003;and
3. Pension Reform Act 2004, as they govern financial accounting in Nigeria.

6.0 TUTOR MARKED ASSIGNMENT

1. Mention one of the major roles of Securities and Exchange Commission.
2. Give one example of admissible assets under the Insurance Act, 2003.
3. State the pension scheme required by the Pension Reform Act of 2004.
4. The apex capital market institution is _______

7.0 REFERENCES/FURTHER READING

Institute of Chartered Accountant of Nigeria, Financial Accounting, Study Pack Lagos.

International Accounting Standard Board, International Accounting Standard.

International Accounting Standard Board, International Financial Reporting Standard

Nigerian Accounting Standard Board, Statement of Accounting Standard

MODULE 5: REGULATORY FRAMEWORK

UNIT 3: LEGAL AND REGULATORY FRAMEWORK OF GROUP ACCOUNTS

CONTENT

1.0 INTRODUCTION

In this unit, you will learn of the combinations based on the purchase of controlling shares by one company in another company, directly or indirectly, giving rise to a group of companies within which the company that purchased the controlling shares is called the parent or holding company and the company whose shares are acquired is referred to as the subsidiary company.

Combinations of this nature do not affect the existence of the combined companies, as separate legal entities. However, this transfer of control from one group of owners to another affect the economic substance of members of the group. To this effect, the operations of group companies and the preparation of consolidated financial statements are regulated by an Act and International Accounting Standards.

2.0 OBJECTIVES

After studying this unit, you should be able to:

1. Explain the theoretical background for consolidation of financial statements.
2. State the regulatory documents for the preparation and presentation of consolidated financial statements.
3. Describe the conditions required for an enterprise to be a subsidiary or an associate of a group or a joint entity.
4. Explain the rules for the exclusion of some subsidiaries from consolidation.
5. State the forms of group accounts.
6. Demonstrate the treatment of positive and negative goodwill arising in consolidation accounts.

3.0 MAIN CONTENT

3.1 THE NEED FOR GROUP ACCOUNTS

In Nigeria, the main reporting obligations of directors of parent companies are contained in the Companies and Allied Matters Act 2004. Section 336 of the Act, requires the Directors of a company that has subsidiaries, at the end of the year, to prepare its individual accounts for that year and the group financial statements. These statements report on the state of affairs, the profit and loss of the company and its subsidiaries.

The objective is to provide the shareholders of the parent company with full information concerning the activities of the entire economic unit in which they have invested. This is achieved by combining all the assets and liabilities of the parent company and its subsidiaries into a single balance sheet so as to disclose the overall financial position of the group.

3.2 REGULATORY DOCUMENTS

(a) The Companies and Allied Matters Act Cap. C20, LFN 2004, hereafter called the Act.
(b) Statement of Accounting Standards (SAS) 26- on Business Combinations
(c) Statement of Accounting Standards (SAS) 27- on consolidated and separate financial statements.
(d) Statement of Accounting Standards (SAS) 28- on Investment in Associates.
(e) International Accounting Standard (IAS) 31- on Interests in Joint Ventures.

3.3 GROUP FINANCIAL STATEMENTS

A group is defined as a parent company and its subsidiaries. Group financial statements are the financial statements of the parent company and its subsidiaries combined to form a set of consolidated financial statements. Consolidated financial statements of a group presented as those of a single enterprise.

In accordance with the Act, the group's financial statements shall consist of three statements as follows:

(a) Consolidated balance sheet dealing with the state of affairs of the company and all the subsidiaries of the company;
(b) Consolidated profit and loss account of the company and its subsidiaries; and
(c) Consolidated statement of cash flows of the company and its subsidiaries.

It is not necessary to publish the parent company's profit and loss account, provided the company' consolidated profit and loss accounts contains a note stating how much of the parent company's profit and loss is dealt with in the accounts (CAMA 2004).

SELF ASSESSMENT EXERCISE

According to the Act, what makes up the group's financial statements?

3.4 PARENT/HOLDING COMPANY AND SUBSIDIARIES

A holding company is one that has one or more subsidiaries. A subsidiary is an enterprise that is controlled by another enterprise known as the parent.

Under section 338 of the Act, a company (say company A) shall be deemed to be the subsidiary of another company (say company B) if

(a) The company (company B) is a member of it and controls the composition of its board of directors; or
(b) Holds more than half the nominal value of its equity share capital; or

(c) The first mentioned company (company A) is a subsidiary of any company which is a subsidiary of company B.

For the purpose of the Act, the composition of the board of directors of a company, shall be deemed to be controlled by another company if that other company has the power to remove all or a majority of the directors without the consent or concurrence of another party.

Generally, control is presumed to exist when the parent owns, directly or indirectly, through subsidiaries more than one half of the voting power of an enterprise.

SAS 27, defines control as the power to govern the financial and operating policies of an entity so to obtain benefits from its activities. Under the standard, control is also presumed to exist when the parent has:

1. Power over more than half the voting right by virtue of agreement with other investors.
2. Power to govern the financial and operating policies of the enterprise under a statute or agreement.
3. Power to appoint or remove the majority of the members of the board of directors.
4. Power to cast the majority of votes at a meeting of board of directors or equivalent governing body and control of the entity is by that board or body.

ILLUSTRATION 29
Company X is said to be a subsidiary of company Y, when:

(i) company Y is a member of company X and controls the composition of the Board of Directors (BOD). This means that Company Y has the power to appoint or remove all or the majority of votes at the meeting of BOD.

(ii) company Y owns more than one half of the nominal value of the equity share capital. This is the power to govern the financial and operating policies of the enterprise under a statute or an agreement.

(iii) company X is a subsidiary of another company Z, which is itself a subsidiary of company Y. In this case, company Y would exercise control over Company X indirectly.

UNIFORM ACCOUNTING POLICIES (SAS 27)
As much as possible, Uniform Accounting Policies should be employed by the members of a group when preparing the accounts of their individual companies. SAS 27 specifically requires an entity to use uniform accounting policies for reporting such transactions and other events in similar circumstances. Where a subsidiary has not adopted a uniform policy, appropriate adjustments should be made to its financial statements in preparing the consolidated financial statements.

CO-TERMINUS ACCOUNTING DATES
A subsidiary is required to prepare its own financial statements at or to the same date as the group.

If a subsidiary does not prepare its own financial statements at the same date as that of the group, adjustments should be made for the effects of significant transactions or events that occur between that occur between that date and the date adopted by the parent. The difference between the reporting date of the subsidiary and that of the parent shall not be more than three months.

When it is not possible to obtain such special financial statements, appropriate adjustments should be made to the consolidated financial statements for any abnormal transactions in the intervening period. The consolidated accounts should disclose:

(i) the name of the subsidiary;

(ii) its accounting date; and

(iii) the reason for using different dates.

SELF ASSESSMENT EXERCISE
What would determine that company X has control over company Y?

3.5 METHODS OF PREPARING CONSOLIDATED ACCOUNTS

SAS 27 prescribes that all business combinations shall be accounted for by applying the purchase method. The method has the following features:

(i) assets and liabilities of the subsidiaries are measured at fair market value at the date of acquisition.

(ii) shares purchased and issued in settlement of the purchase are valued by the parent company at fair value.

(iii) the profits of the subsidiary are divided into pre-acquisition and post- acquisition periods. Only the post-acquisition profits are consolidated.

(iv) goodwill arises on consolidation when the fair value of the consideration is different from the fair value of the net asset acquired.

APPLICATION OF PURCHASE METHOD
Application of the purchase method involves the following steps:

(a) Identifying an acquirer. The acquirer is the combining entity that obtains control of the other combining entries.
(b) Measuring the cost of the business combination.
(c) Allocating the cost of the business combination to the assets acquired and liabilities and contingent liabilities assumed at the acquisition date.

FORMS OF GROUP ACCOUNTS
Section 336(5) of the Act states that a parent company should prepare group accounts in the form of a single set of financial statements. It however allows for alternative forms of group accounts where in the opinion of the directors, the other form would present the same or better view of the group's performance and financial position.

Other forms of accounting for group interests available are:

(a) More than one set of consolidated financial statements dealing respectively with the company and one group of subsidiaries; or
(b) Separate financial statements dealing with each of the subsidiaries; or

(c) Statements expanding the information about subsidiaries in individual financial statements of the company or in any other form.

SELF ASSESSMENT EXERCISE
What are the steps involved in the application of the purchase method?

3.6 EXEMPTION OF SUBSIDIARIES FROM CONSOLIDATION
Under the Act:

(a) Under Section 336(2) of the Act, group accounts need not be prepared where the parent company itself is at the end of its financial year a wholly owned subsidiary of another company incorporated in Nigeria. However, where the ultimate parent company is incorporated overseas, the group accounts should be prepared.
(b) Under Section 336(3) of the Act, a subsidiary may be omitted from the group accounts if:
(i) it is impracticable or would be of no real value to members because of the insignificant amount involved;
(ii) it would involve expenses or delay out of proportion to its value to members of the company;
(iii) the result would be misleading or harmful to the business of the company or any of its subsidiaries. For instance, it may be harmful to consolidate the result of a subsidiary with operating losses, poor liquidity position and massive borrowing; or
(iv) the business of the parent company and that of the subsidiary are so different that they cannot reasonably be treated as a single undertaking.

Under SAS 27 of the Act, a parent need not present consolidated financial statements if, and only if, all the following conditions apply:

(a) The parent is itself a wholly-owned subsidiary of another entity and its other owners have been informed about and do not object to the parent not preparing consolidated financial statements.
(b) The parent's debt or equity instruments are not traded in a public market.
(c) The parent did not file nor is in the process of filling its financial statements with the Securities and Exchange Commission or other regulatory organizations for the purpose of issuing any class of instrument in a public market.
(d) The ultimate or any intermediate parent of the parent, produces financial statements when the parents elect or are required by local regulations to present separate financial statements.
(e) The subsidiary is acquired with the intention to dispose of the company within 12 months and management is actively seeking a buyer.
(f) When the parent company loses control. The loss of control can occur with or without a change in absolute or relative ownership levels. For example, where a subsidiary becomes subject to the control of a government, court, administrator or regulator.

A subsidiary is not excluded from consolidation because its activities are dissimilar from those of other entities within the group. Relevant information is provided by consolidating such subsidiaries and disclosing additional information in the consolidated financial statements about the different activities of the subsidiaries.

Similarly, an entity is not permitted to exclude from consolidation a subsidiary it continues to control simply because that entity is operating under severe long term restrictions that significantly impair its ability to transfer funds to the parent. Control must be lost for exclusion to occur (SAS 27 paragraph 21).

TREATMENT OF AN ENTERPRISE THAT CEASES TO BE A SUBSIDIARY

When an enterprise ceases to be a subsidiary, the investment in the enterprise shall be accounted for in accordance with other SASs from the date when control is lost.

DISCLOSURE REQUIREMENTS FOR SUBSIDIARY EXCLUDED FROM CONSOLIDATION

Under the Act

When a company is not a wholly owned subsidiary of another company incorporated in Nigeria, the directors of the company should state the reason for the exclusion of the subsidiary from consolidation. Schedule II paragraph 68 of the Act states that the notes to the accounts should include:

(a) The reasons why the subsidiaries are not dealt with in group accounts;
(b) Any qualifications by the auditors of the subsidiaries' accounts not covered by the company's own accounts;
(c) The aggregate amount of the total investment of the parent company in the shares of the subsidiaries. For:
    (i) the financial year under consideration; and
    (ii) previous year since acquisition.
(d) Such investments should be accounted for using the equity method of valuation.
(e) Where any of the information in (a) to (d) above are not obtainable, statement to that effect shall be given.

Under SAS 27, a parent that is exempted from presenting consolidated financial statements in accordance with the standard shall present separate financial statements as its only statements.

SELF ASSESSMENT EXERCISE

Outline those conditions required to be present for a parent company to be allowed not to present a consolidated financial statements.

3.7 EXPLANATION OF TERMS UNDER GROUP ACCOUNTS

(a) Equity share capital
    This comprises any equity share capital which carries the right to distribution. Therefore, it includes all share capital other than non-participating preference shares.
    In the absence of information to the contrary, ordinary shares are assumed to be equity while preference shares are not.
(b) Equity method of accounting
    This is a method of accounting where the investment in a company is shown in the consolidated balance sheet at:
    (i) the cost of the investment; plus

(ii) the investing company or group's share of the post-acquisition retained profits and reserves of the company; less

(iii) any amount written off in respect of (i) and (ii) above. The investing company should account separately in the profit and loss account for its share of the profit before tax, taxation and extraordinary items of the acquired company.

This method is usually applied to associated companies under the provisions of SAS 28.

(c) Related company

The Act defines a Related Company as any body corporate (other than that which is a group company in relation to that company) in which that company holds on a long-term basis, a qualifying capital. Interest for the purpose of securing a contribution to that company's own activities by exercising control or influence arising from that interest. Related companies are described by SAS 28 as associated companies.

(d) Associated companies

This is an enterprise in which the investor has significant influence and which is neither a subsidiary nor a joint venture of the investor.

Significant influence is the power to participate in the financial and operating policy decisions of the investee but does not have control over those policies. A holding of 20% but less than 50% of the equity voting rights is regarded as the ability to exercise significant influence (though not in all circumstances).

(e) Fellow subsidiaries

A body corporate is treated as a fellow subsidiary of another body corporate, if both are subsidiaries of the same company, but neither is the other's subsidiary.

(f) Cost of control account

It is described as an account opened to record the purchase of a business so as to determine whether the business is being purchased at a profit or at a loss. In other words, it is a goodwill account. A debit balance on the Cost of Control Account is regarded as a loss on purchase because the cost of shares acquired is greater than the net assets acquired while a credit balance on the cost of control account is regarded as a gain (i.e. negative goodwill). In the cost of control account, the cost of investment is cancelled against the net assets acquired to determine goodwill.

(g) Goodwill on consolidation

Goodwill is the difference between the price paid by the parent company and the fair value of the subsidiary's net assets at the date of acquisition. Included in the definition of net assets are identifiable assets, liabilities and contingent liabilities of the subsidiaries.

(h) Fair value of net assets

In order to calculate a realistic figure for goodwill, it is necessary to determine the fair values of the assets and liabilities of the subsidiary company when preparing consolidated accounts. Fair values need not be accounted for in the books of the subsidiary company and used for the purpose of its legal entity based accounts, but they should be used for consolidation purposes.

The fair value of an asset and a liability is defined as the amount for which an asset could be exchanged or a liability settled between knowledgeable, willing parties in an arm' length (IFRS 3). If additional evidence of the fair values of acquired assets and liabilities becomes available after the acquisition, the consolidated financial statements should be adjusted to reflect this development.

(i) Non-controlling interest (Formerly called Minority Interest)
The 2008 amendments to IAS 27 changed the term minority interest to a new phrase called non-controlling interest. According to the Official Pronouncement of the IASB as issued at 1 January 2009, "the change in terminology reflects the fact that the owner of a minority interest in an entity might control not control the entity". It is the view of the IASB that "non-controlling interest" is a better description than "minority interest" of the interests of those owners who do have a controlling interest in an entity". SAS 27 uses the new phrase non-controlling interest instead of the now outdated minority interest, and defines non-controlling interest as "the equity in a subsidiary not attributable, directly or indirectly, to a parent."
When the parent company owns less than 100% equity shares in the subsidiary, say 70%, the remaining 30% is attributable to the non-controlling interest (NCI). Non-controlling interest shall be presented in the consolidated balance sheet within equity; separately from the parent shareholders' fund. Minority interest in the profit and loss account of the group shall also be separately disclosed below the profit after tax.

(j) Attribution of profit or loss to non-controlling interest
SAS 27 requires an entity to attribute their share of comprehensive income to non-controlling interest (NCI) even if this will result in the NCI having a deficit balance.

(k) Pre-acquisition and post-acquisition profits
The profits of a subsidiary company are distinguished between pre-acquisition and post-acquisition for the purpose of preparing consolidated accounts.
Pre-acquisition reserves are the accumulated reserves earned by the subsidiary prior to its acquisition by the parent company. They are credited to cost of control account as part of the process required to arrive at goodwill arising on consolidation.
Post-acquisition reserves are the accumulated retained profits since the date of acquisition. The proportion of these reserves earned by the parent company is credited to the consolidated accounts. To the extent that post-acquisition profits earned by the subsidiary are transferred to the parent company by way of dividends, the amount to be aggregated when consolidation takes place will be reduced correspondingly.

(l) Other reserves of a subsidiary
Other reserves of a subsidiary may include share premium account, revaluation surplus on fixed assets and other reserves. The principle of dividing them between pre-acquisition and post-acquisition reserves will apply.

CONSOLIDATION PROCEDURES UNDER SAS 27
In its explanatory note, SAS 27 outlines the following consolidation procedures:

(a) Financial statements of the parent and its subsidiaries are combined on a line by line basis by adding together like items of assets, liabilities, equity, income and expenses.
(b) The carrying amount of the parent's investment in each subsidiary and the parent's portion of equity of each subsidiary are eliminated.
(c) Non-controlling interests in the profit or loss of the consolidated subsidiaries for the reporting period are identified.
(d) Non-controlling interests in the assets of consolidated entities are identified and presented in the consolidated balance within equity, separately from the shareholder's fund.

SELF ASSESSMENT EXERCISE
What is a related company?

4.0 CONCLUSION
In conclusion, it would be stated that the disclosure requirements relating to group accounts include the following:

(a) The nature of the relationship between the parent and a subsidiary when the parent does not own directly or indirectly through subsidiaries more than half of the voting power.
(b) The reasons why more than half of the voting power in the investee does not constitute control.
(c) When there is a significant restriction on the ability of the subsidiaries to transfer funds to the parent, the nature and significance of such restrictions must be disclosed.
(d) A list of investments in subsidiaries, jointly controlled entities and associates, including the name and country of incorporation.
(e) Where separate financial statements are prepared by a jointly controlled entity or an investor in an associate, the reason for preparing separate financial statements, the list of significant investment and country of incorporation of the investee must be disclosed.

5.0 SUMMARY
This unit has taken you through the legal and regulatory framework in the presentation of group accounts, with particular reference to the detailed provisions of CAMA 2004 and SAS 27. It has also provided theoretical foundation for consolidation accounting.

6.0 TUTOR MARKED ASSIGNMENT
1. Outline one main problem with group accounting.
2. What is the requirement of SAS 27 on the consolidation or non-consolidation of a subsidiary with activities that are dissimilar to the parent and other subsidiaries?
3. List one of the grounds on which a subsidiary may be exempted from consolidation.
4. Control is presumed to exist when the parent owns, directly or indirectly, through subsidiaries more than _______ of the voting power of an enterprise.
5. According to the year 2008 amendments to IAS, the term 'minority interest' is known as ______

7.0 REFERENCES/FURTHER READING
Institute of Chartered Accountant of Nigeria, Financial Accounting, Study Pack Lagos.

International Accounting Standard Board, International Accounting Standard.

International Accounting Standard Board, International Financial Reporting Standard

Nigerian Accounting Standard Board, Statement of Accounting Standard