INTERMEDIATE FINANCIAL ACCOUNTING 1

ACC311

Course Guide

Course Developer/Writer: ICAN STUDY PACK

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Course Aim

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Study Units

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Final Examination and Grading

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INTRODUCTION

You are holding in your hand the course guide for ACC311 (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 a B.Sc. 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. Specifically, the published financial statements, cash flow statement and interpretation of financial statements, accounting for insurance claims and foreign branches, accounting for contract, investment, lease and hire purchase were the main focus of this course material.

COURSE AIM

The aim of the course is to bring to your cognizance the practical treatment and presentation of financial transactions as regards issues in financial accounting appropriate at this level.

COURSE OBJECTIVES

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

1. Explain the conceptual framework of the International Accounting Standard Board;
2. Explain Financial Statement and the underlying assumptions, concepts, principles and standards;
3. Explain the concept of capital maintenance.
4. Familiarize yourself with the disclosure requirements for banks and non-bank financial institutions.
5. Make analysis based on the use of ratio analysis.
6. Calculate the hire purchase interest attributable to each year.
7. Show relevant ledger entries in the books of the seller and buyer.
8. Prepare balance sheet extract reflecting the balances as at the end of the period.

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: PUBLISHED FINANCIAL STATEMENTS

Unit 1: Accounting and Reporting Concepts
Unit 2: Company Accounts and Report
Unit 3: Preparation of Published Financial Statements of Limited Liability Companies
Unit 4: Preparation of Published Financial Statements for Bank and Non-Bank Financial Institutions
Unit 5: Preparation of Published Financial Statements of Insurance Companies

MODULE 2: CASH FLOW STATEMENT AND INTERPRETATION OF FINANCIAL STATEMENTS

Unit 1: Basic Principles Governing the Preparation of Cash Flow Statements and the Approved Formats
Unit 2: Format of Cash Flow Statement for Banks and Insurance Companies
Unit 3: Analysis and Interpretation of Financial Statements
Unit 4: Accounting Ratio Interpretation, Value Added Statement and Report Writing

MODULE 3: ACCOUNTING FOR INSURANCE CLAIMS AND FOREIGN BRANCHES

Unit 1: Accounting for Insurance Claims 1
Unit 2: Accounting for Insurance Claims 2
Unit 3: Accounting for Independent and Foreign Branches

MODULE 4: ACCOUNTING FOR CONTRACT, INVESTMENT, LEASE AND HIRE PURCHASE

Unit 1: Contract Accounts
Unit 2: Accounting Procedures for Long-Term Projects
Unit 3: Sinking Fund and Annuity
Unit 4: Underwriter and Stock Brokerage Account
Unit 5: Accounting for Lease
Unit 6: Accounting for Hire Purchase

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 to 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 BSc. 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. Good luck.
INTERMEDIATE FINANCIAL ACCOUNTING 1

ACC311

Main Content

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Unit 4: Underwriter and Stock Brokerage Account

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UNIT 1: ACCOUNTING AND REPORTING CONCEPTS

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1.0 INTRODUCTION
In this unit, you will learn that financial statements possess certain qualitative characteristics that enhance the usefulness of the information they convey to a wide range of users. In this unit, we shall look at the elements and desirable qualities of financial statements. We shall also look at the concepts of capital and capital maintenance, from the point of view of accountants. A number of these issues are covered in the framework for the preparation and presentation of statements issued by the International Accounting Standards Board (IASB).

2.0 OBJECTIVES
After studying this unit, you should be able to:
1. Define a conceptual framework.
2. State the purpose, status and scope of the IASB framework.
3. State the objectives of financial statements.
4. State the underlying assumptions in respect of accrual basis and going concern basis.
5. Define and describe four qualitative characteristics.
6. State and describe the elements of financial statements.
7. Explain the concept of capital maintenance.
3.0 MAIN CONTENT
3.1 THE IASB FRAMEWORK
In July 1989, the International Accounting Standards Committee (IASC), now replaced by the International Accounting Standards Board (IASB), produced a document titled, (or simply the “Framework”). This document sets out the concepts that determine how financial statements are prepared and the information they contain. This is why the IASB is also called the “conceptual framework”.

A conceptual framework is a clearly defined set of objectives and principles that can lead to the production of consistent accounting standards. The framework is therefore the “conceptual framework”. The frame of reference from which the accounting standards are issued by the IASB is constructed.

3.11 PURPOSE OF THE IASB FRAMEWORK
The framework is expected to serve the following purposes:
(a) Assist the IASB in the development of future accounting standards and in the review of existing standards.
(b) Assist the IASB in promoting harmonisation of regulations, accounting standards and procedures, relating to the presentation of financial statements by providing a basis for reducing the number of alternative accounting treatments permitted by international accounting standards.
(c) Assist national standard-setting bodies in developing national standards.
(d) Assist preparers of financial statements in applying international accounting standards and in dealing with issues not yet covered by an International Accounting Standards (IASC).
(e) Assist auditors in forming an opinion as to whether financial statements conform to IASs.
(f) Assist users of financial statements in interpreting the information contained in financial statements that comply with IASs; and
(g) Provide those who are interested in the work of the IASB with information on its approach to the formulation of accounting standards.

SELF ASSESSMENT EXERCISE
Outline the purposes of International Accounting Standards Board

3.12 STATUS AND SCOPE OF THE IASB FRAMEWORK
As stated above, the framework describes the basic concepts that guide the preparation of financial statements for presentation to a wide range of users. The framework is not an accounting standard; neither does it override the requirements of any specific Standard. Thus, in the event of a conflict between the Framework and an International Financial Reporting Standard (IFRS), the latter will prevail. Such conflicts will gradually cease to exist as future accounting standards will be produced in accordance with the guidelines set by the framework.

The framework deals with the following:
(a) The objectives of financial statements.
(b) Underlying assumptions.

(c) Qualitative characteristics of financial statements.

(d) Definition, recognition and measurement of the elements of financial statements; and

(e) Concepts of capital and capital maintenance.

3.2 THE OBJECTIVES OF FINANCIAL STATEMENTS

The objectives of financial statements are to provide information about the financial position, performance and changes in financial position that will assist wide spectrum of users in making useful economic decisions. It identifies the following users of financial information: investors, employees, lenders, suppliers, customers, government and the public.

Information relating to financial position is normally found in the balance sheet of an entity, and is affected by the following:

(a) Economic resources controlled by the entity. This information will enable users to predict the ability of the entity to generate cash.

(b) Financial structure of the entity. Users can predict borrowing needs, distribution of future profits and the ability of the entity to raise new finance.

(c) Liquidity and solvency of the entity. Users need this information to predict the ability of the entity to meet its financial commitments as they fall due.

Information on the financial of an entity is basically provided by the income statement. Such information is useful in evaluating the returns obtained by an entity from the resources available to it.

Information about changes in financial position is contained in the cash and how the cash generated is utilized.

SELF ASSESSMENT EXERCISE

What could affect the information relating to financial position in the balance sheet?

3.3 UNDERLYING ASSUMPTIONS

The Framework specifies and explains the two main assumptions that underlie the preparation of financial statements. These assumptions are the accrual basis of accounting and the going concern principle.

Accrual Basis: When financial statements are prepared under the accrual basis of accounting, the effects of transactions and other events are recognized when they occur and not as cash or its equivalent are received or paid. They are recorded in the accounting records and reported in the financial statements, of the periods to which they relate.

Going Concern Basis: Under the going concern basis, the enterprise is regarded as a going concern, that is, as continuing in operation for the foreseeable future. It is assumed that the enterprise has neither the intention nor the necessity to liquidate or reduce materially the scale of its operations.

ILLUSTRATION 1
Exotic Furniture Nig. Ltd recorded the following transactions in the first week of January 2009:

(a) Rented an office space in Port Harcourt for ₦1 million per annum and paid ₦5 million, being rent for five years demanded by the landlord.
(b) Bought office equipment for ₦240,000 on credit from Modern Business machines Ltd. The expected useful life of the equipment is four years.
(c) Received cheque of ₦1.3 million from Rivers State Polytechnic, Bori, being final payment for sales made to the Institution in 2007.
(d) Sold furniture items on credit to a local government in Rivers State for ₦4 million. The local government did not pay until the following year.

You are required to prepare extracts of the income statement and balance sheet of the company for the year ended 31 December, 2009, on the assumption that financial statements are prepared under (a) the accrual basis and (b) the cash basis accounting.

**SUGGESTED SOLUTION 1**

Exotic Furniture Nigeria Ltd
Income Statement for the year ended 31 December 2009 (extract)

<table>
<thead>
<tr>
<th></th>
<th>Accrual Basis</th>
<th>Cash Basis</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>4,000</td>
<td>1,300</td>
</tr>
<tr>
<td>Rent</td>
<td>1,000</td>
<td>5,000</td>
</tr>
<tr>
<td>Depreciation (₦240,000 x ¼)</td>
<td>60</td>
<td>-</td>
</tr>
</tbody>
</table>

Exotic Furniture Nigeria Ltd
Balance Sheet as at 31 December, 2009 (Extract)

<table>
<thead>
<tr>
<th></th>
<th>Accrual Basis</th>
<th>Cash Basis</th>
</tr>
</thead>
<tbody>
<tr>
<td>Property, plant and equipment</td>
<td>180</td>
<td>Nil</td>
</tr>
</tbody>
</table>

Under the cash basis of accounting, as can be readily seen from the suggested solution to illustration 1, the effects of transactions and other events are recognized when cash or its equivalent is received or paid (and not when they occur), and they are recorded in the accounting records and reported in financial statements of the periods in which cash or its equivalent is received or paid. This is why the sales of ₦1.3 million made in 2007 was not recorded in that year but was recorded in 2009, when the cash was received.

**ILLUSTRATION 2**

The values of the following noncurrent assets have been presented by the accountant of Antsa farms Ltd. The figures are in respect of the year ended 31 December 2008.

<table>
<thead>
<tr>
<th></th>
<th>Net book value</th>
<th>Market value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Land</td>
<td>24</td>
<td>42</td>
</tr>
<tr>
<td>Plant and machinery</td>
<td>8</td>
<td>5</td>
</tr>
<tr>
<td>Equipment</td>
<td>4</td>
<td>2</td>
</tr>
<tr>
<td>Motor vehicles</td>
<td>6</td>
<td>7</td>
</tr>
</tbody>
</table>

What would be the carrying values of the assets in the balance sheet of Antsa Farms Ltd, as at 31 December 2008, if:
(a) Antsa farms Ltd is expected to continue its operation in the foreseeable future?
(b) Antsa farms ltd will be liquidated on 31 July 2009. Assume that the liquidating values of the company’s assets are equal to the market values given above.

SUGGESTED SOLUTION 2

Antsa Farms Ltd

Carrying value of assets as at 31 December, 2008

<table>
<thead>
<tr>
<th>Where going concern principle is applicable</th>
<th>Where going concern principle is not applicable</th>
</tr>
</thead>
<tbody>
<tr>
<td>₦m</td>
<td>₦m</td>
</tr>
<tr>
<td>Land</td>
<td>Land</td>
</tr>
<tr>
<td>24</td>
<td>42</td>
</tr>
<tr>
<td>Plant and machinery</td>
<td>Plant and machinery</td>
</tr>
<tr>
<td>8</td>
<td>5</td>
</tr>
<tr>
<td>Equipment</td>
<td>Equipment</td>
</tr>
<tr>
<td>4</td>
<td>2</td>
</tr>
<tr>
<td>Motor vehicles</td>
<td>Motor vehicles</td>
</tr>
<tr>
<td>6</td>
<td>7</td>
</tr>
</tbody>
</table>

Note that if the “going concern” assumption is no longer applicable, the assets of an enterprise will be carried at their liquidating values.

SELF ASSESSMENT EXERCISE

What do you understand by the following terms ‘accrual concept’ and ‘going concern concept’?

3.4 QUALITATIVE CHARACTERISTICS OF FINANCIAL STATEMENTS

Meaning of Qualitative Characteristics

According to the Framework, qualitative characteristics are the attributes that make the information provided in financial statements useful to users. The Framework identifies four principal qualitative characteristics, namely: understandability, relevance, reliability and comparability.

Understandability

Information in financial statements should be readily understandable by users who have business, economics and accounting knowledge and willingness to study the information carefully. Although financial reports should be understandable, complex matters that are relevant to economic decision-making should not be excluded merely because they are too difficult for users to understand.

Relevance

To be useful, financial information should be relevant to the decision-making needs of users. According to the Framework, information has the quality of relevance when it influences the economic decision of users by helping them evaluate past, present or future events or confirming, or correcting, their past evaluations. Information may be considered relevant either because of its nature (e.g. employee benefit expense) or because it is material. Financial information is material if its omission or misstatement could affect the economic decisions of users. Although materiality is not classified as a threshold or cut-off point any information that fails the test of materiality need not be disclosed separately in the financial statements.

Reliability

According to the framework, information is said to be “reliable” when it is free from material bias and can be depended upon by users to represent faithfully that which it either purports to represent
or could reasonably be accepted to represent. In view of the inherent difficulties in identifying certain transactions or in finding appropriate methods of measurement or presentation, financial statements cannot be perfectly “accurate”, hence faithful representation might be regarded as describing the closest that accountants can come towards the absolute of total accuracy (Lewis and Pendrill, 1996).

Reliability is enhanced when the following principles are observed in the presentation of financial statements:

(a) Substance over form. Transactions should be accounted for according to their substance and economic reality even if their legal form is different.
(b) Neutrality. Information should be objective and free from bias.
(c) Prudence. Reasonable effort should be made to ensure that the position, or degree of success of an entity is not overstated (Alexander and Britton, 1996); and
(d) Completeness. Financial information must be complete, if the information is to be reliable.

Comparability
(a) Users should be able to compare the financial statements of an entity through time (that is, over a period of time), to identify trends in its financial position and performance.
(b) Users should also be able to compare the financial statements of different entities to determine their relative financial positions, performance and changes in financial positions.

To effectively compare an entity’s financial information over time, accounting transactions should be consistently treated and correspondingly, information of preceding periods should be disclosed. Similarly, to compare financial information across entities, the financial statements of the different entities should comply with the requirements of a set of accounting standards and their separate accounting policies should be disclosed.

‘Trade-Offs’ between Qualitative Characteristics of Financial Statements

There is usually a ‘trade-off’ between the different qualitative characteristics discussed above. Emphasis on one of the attributes may lead to a reduction in the application of another desirable quality. Under such circumstances, it is necessary to strive to achieve an appropriate balance among the characteristics in order to meet the objectives of financial statements.

Examples of these ‘trade-offs’ are as follows:

(a) Timeliness. In some cases it may take some time for every detail of a transaction to be determined. In such cases, financial information cannot be presented on a timely basis if financial statements are to be reliable. On the other hand, delay in presenting financial statements may affect the relevance of the information. A balance has to be struck between the benefits of reliability and relevance. The overriding consideration should be how best the information satisfies decision-making needs.
(b) ‘Trade-off’ between cost and Benefit
There is also ‘trade-off’ between cost and benefit of preparing and presenting financial information. In principle, the benefit derived by users should exceed the cost of providing and presenting the information.
(c) ‘Trade-off’ between Qualitative Characteristics
‘Trade-offs’ may also arise between the qualitative characteristics in other circumstances. For instance, market values are more relevant but less reliable than historical costs. On the other hand, historical costs are usually not relevant for decision-making purposes.

True and fair View/fair Presentation

Financial statements are usually required to give a true and fair view, or present fairly the financial position and performance of an entity. The framework does not define these concepts but it states that the application of qualitative characteristics of financial information and compliance with appropriate accounting standards will lead to financial statements that give a true and fair view.

SELF ASSESSMENT EXERCISE

Explain the term ‘Reliability’

3.5 ELEMENTS OF FINANCIAL STATEMENTS

The financial effects of transactions and events are grouped into broad classes in the Framework. These classes comprise the elements of financial statements, namely: assets, liabilities, equity, income and expenses. The first three elements are shown in the balance sheet and are used in measuring the financial position of an entity, while the last two elements (income and expenses) are used to measure the performance of an entity and are shown in the statement, otherwise known as the profit and loss account or income and expenditure account. The Framework defines the elements as follows.

(a) Assets

An asset is a resource controlled by an entity as a result of past events and from future economic benefits is expected to flow to the entity.

Note the following key terms/phrases used in the above definition:

(i) Resource Controlled by an Entity
    An entity has control over a resource if it can direct the use of the resources for its benefit.

(ii) Past Events
    The events should have occurred before the ownership of the asset.

(iii) Future Economic Benefits
    The resource controlled by the entity should have the potential to contribute directly or indirectly to the receipt of cash and cash equivalents by the entity.

(b) Liability

A liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity, of resources embodying economic benefits. Based on this definition, a liability is not merely an obligation; it is a present obligation. A present obligation is different from a future commitment. Other key terms include past events and outflow of an economic benefit, for example, transfer of cash or other assets by the enterprise.

(c) Equity

Equity is the residential interest in the assets of the entity after deducting all its liabilities.

(d) Income items

These have been defined by the Framework as increases in economic benefits during the accounting period, in the form of inflows or enhancements of assets or decrease of liabilities.
that result in increases in equity, other than those relating to contributions from equity participants.

(e) Expenses
These are decreases in economic benefits during an accounting period in the form of outflows or depletions of assets or incurring of liabilities that result in decreases in equity, other than those relating to distributions to equity participants.

Recognition of the Elements of Financial Statements

Recognition Criteria
According to the Framework, recognition is the process of incorporating in the balance sheet or income statement an item that meets the definition of an element and satisfies the following criteria for recognition:

(a) It is probable that any future economic benefit associated with the item will flow to or from the entity; and
(b) The item has a cost or value that can be measured reliably.

It is necessary to note that the first recognition criterion is that the items should meet the definition of an element of financial statements.

Recognition Stages
Under the framework, the recognition of assets and liabilities fall under three stages. These are:

(a) Initial recognition
This occurs when an item first meets the definition of an asset or a liability (for instance, the acquisition of a building).

(b) Subsequent re-measurement
This involves changing the value at which an asset or a liability was initially recognized (that is, if a building is partly destroyed or when assets are re-valued by professional revaluers, the carrying values will be restated).

(c) De-recognition
This occurs when an item no longer meets the definition of an asset or liability (for instance, if the building is sold or completely destroyed).

Measurement of the Elements of Financial Statements
The Framework defines “measurement” as the process of determining the monetary amount at which the elements of financial statements are to be recognized and carried in the balance sheet and income statement. It identifies four bases of measurement, namely: historical cost, current cost, realisable (settlement) value and present value.

(a) Historical cost
Assets are recorded at the amounts of cash and cash equivalents paid or the fair value of the consideration given in exchange for them at the time of acquisition. Liabilities are recorded at the amounts of proceeds received in exchange for the obligations.

(b) Current cost
Assets are carried at the amount of cash or cash equivalent required to acquire the same or identical assets currently. Liabilities, on the other hand, are carried at the undiscounted amount currently required to settle the obligation.

(c) Realisable (settlement) value
According to the Framework, a realisable value is the amount of cash or cash equivalents that will currently be obtained by selling an asset in an orderly disposal, while “settlement value” refers to the undiscounted amount of cash and cash equivalents expected to be paid to satisfy the liabilities in the normal course of business.

(d) Present value
This refers to a current estimate of the present discounted value of the future net cash flow in the normal course of business.

The Framework does not require the application of any particular basis. In practice, historical cost is the most common basis; the other bases are applied as appropriate. For instance, stock is valued at the lower of cost and net realisable value, in accordance with the prudence concept of “not counting chickens before they are hatched”.

SELF ASSESSMENT EXERCISE
State and explain the bases of measurement

3.6 CONCEPTS OF CAPITAL AND CAPITAL MAINTENANCE
Concepts of Capital: The Framework identifies two concepts of capital: Financial concept of capital and physical concept of capital. Under the financial concept, capital is the net asset or equity of the enterprise; but under the physical concept, capital is the productive capacity of the enterprise.

Concepts of capital Maintenance: As with the concepts of capital, the framework identifies two types of capital maintenance concepts: financial capital maintenance and physical capital maintenance. Generally, capital is maintained when an enterprise has as much capital at the end of the year as it had at the beginning. Thus, financial capital is maintained when the nominal money capital at the end of the year to the figure at the beginning. Similarly, physical capital is maintained when the physical productive capacity at the year end is equal to the productive capacity at the beginning. Financial capital maintenance is sometimes classified into money financial capital maintenance (already explained above) and real financial capital maintenance which is achieved when the purchasing power of an entity’s shareholders' fund is as much at the end of the year as at the beginning.

SELF ASSESSMENT EXERCISE
What do you understand by the concepts of capital maintenance?

4.0 CONCLUSION
In this unit, it is concluded that an enterprise records a profit when its capital at the end of the year exceeds its capital at the beginning of the same year. The Framework defines “profit” as the residual amount that remains after expenses (including capital maintenance adjustments, where applicable) have been deducted from income. Any amount over and above that required to maintain the capital at the beginning of the period is “profit”.

5.0 SUMMARY
This unit examined the basic concepts that guide the production and presentation of financial statements. These concepts include the objectives, elements, and attributes of financial statements, the concept of capital and capital maintenance and the IASB conceptual framework. Financial reports that do not apply the principal qualitative characteristics of financial statements will not show a true and fair view of the financial position and performance of the reporting entity.
6.0 TUTOR MARKED ASSIGNMENT
1. What do you understand by the term “conceptual framework”?
2. Sea-Glass Ltd paid N3 million for three years rent for an office apartment at Awka on 2 January 2006. During the year to 31 December 2006, the company sold goods valued at N25 million, to pay the balance on 30 January, 2007. You are required to show how these transactions would appear in the income statement of the company for the year ended 31 December, 2006, using the accrual basis of accounting.
3. Mary Jude Hospitals Ltd has been experiencing low patronage due to increasing private medical practice. The Directors of the centre, Dr (Mrs) Mary Adesina and Dr Jude Adesina, are wondering whether the business should be closed permanently. The accountant of the enterprise has provided the following asset values relating to the year ended 31 December 2007.

<table>
<thead>
<tr>
<th></th>
<th>Net book value</th>
<th>Fair value</th>
<th>Market value</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>₦000</td>
<td>₦000</td>
<td>₦000</td>
</tr>
<tr>
<td>Plant and equipment</td>
<td>10,000</td>
<td>14,000</td>
<td>15,000</td>
</tr>
<tr>
<td>Furniture and fittings</td>
<td>2,000</td>
<td>1,800</td>
<td>2,200</td>
</tr>
<tr>
<td>Motor vehicles</td>
<td>4,000</td>
<td>3,000</td>
<td>5,000</td>
</tr>
</tbody>
</table>

You are required to state the carrying values of these assets in the balance sheet of the hospital at 31 December, 2007, if the going concern assumption cannot be applied to the company.
4. State one scope of IASB Framework
5. Briefly explain the trade-off between two qualitative characteristics of financial statements. How can a balance be achieved?

7.0 REFERENCES/FURTHER READING

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


Nigerian Accounting Standard Board, Statement of Accounting Standard
MODULE 1: PUBLISHED FINANCIAL STATEMENTS

UNIT 2: COMPANY ACCOUNTS AND REPORT

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2.0 Objectives
3.0 Main Content
   3.1 The Provision of Companies and Allied Matters Act (CAMA)
   3.2 Users of Accounting Information
   3.3 Contents of Financial Statements
   3.4 Notes to the Accounts
   3.5 Report
   3.6 Cash Flow Statement
   3.7 Value Added Statement
   3.8 Five-year Financial Summary
4.0 Conclusion
5.0 Summary
6.0 Tutor Marked Assignment
7.0 Reference/Further Reading

1.0 INTRODUCTION
In this unit we shall be discussing company’s account and report. Financial accounting is a specialized branch of accounting that keeps track of a company's financial transactions. Using standardized guidelines, the transactions are recorded, summarized, and presented in a financial report or financial statement such as an income statement or a balance sheet. Financial reporting is a broader concept than financial statements. In addition to the financial statements, financial reporting includes the company's annual report to shareholders, its annual report to the Securities and Exchange Commission, its proxy statement, and other financial information reported by the company. It's important to point out that the purpose of financial accounting is not to report the value of a company. Rather, its purpose is to provide enough information for others to assess the value of a company for themselves.

2.0 OBJECTIVES
After studying this unit, you should be able to:
   1. State the provision of CAMA relating to company financial reporting.
   2. State the users of financial statements.
   3. Note the content of financial statements
   4. State issues that requires notes to the accounts.
   5. Outline the steps in cash flow statements.

3.0 MAIN CONTENT
3.1 THE PROVISION OF COMPANIES AND ALLIED MATTERS ACT
Section 331 of companies and allied matters Act (CAMA), Cap C20 LFN 2004, states that:

   (a) Every company shall cause accounting records to be kept.
(b) The accounting records shall be sufficient to show and explain the transactions of the company and shall be such as to:

(i) Disclose with reasonable accuracy, at anytime, the financial position of the company; and

(ii) Enable the Directors to ensure that financial statements prepared comply with the requirements of the Act with regard to form and content.

(c) The accounting records shall, in particular, contain:

(i) Entries from day-to-day of all sums of money received and expended by the company, and the matters in respect of which the receipts and expenditure take place, and

(ii) A record of assets and liabilities of the company.

(d) If the business of the company involves dealing in goods, the accounting records shall contain:

(i) Statements of stock held by the company at the end of each accounting year of the company;

(ii) All statements of stock takings from which any such statement of stock has been or is to be prepared; and

(iii) Except in the case of goods sold by way of ordinary retail trade, statement of all goods sold and purchased, showing the goods and the buyers and sellers in sufficient detail to enable all these to be identified.

Section 334 of CAMA further states that:

(a) In the case of every company, the directors shall in respect of each year of the company, prepare financial statements for the year.

(b) The financial statements required shall include:

(i) Statement of accounting policies;

(ii) The balance sheet as at the last day of the company’s financial year;

(iii) A profit and loss account or, in the case of a company not trading for profit, an income and expenditure account for the year;

(iv) Notes to the accounts;

(v) The auditors’ report;

(vi) The directors’ report;

(vii) The Audit Committee’ report;

(viii) Cash flow statement;

(ix) A value-added statement for the year;

(x) A five-year financial summary; and

(xi) In the case of a holding company, the group financial statements.

(c) The financial statements of a private company need not include the matters stated in paragraphs (i), (vii), (viii), and (ix) in sub-section (b) above.

3.2 USERS OF ACCOUNTING INFORMATION

Accounting information is required by a wide range of users for various reasons. These users and their information needs include:
(a) Individuals, financial institutions or group of investors who need accounting information to determine the liquidity, profitability and viability of the enterprise.
(b) Mangers in an enterprise require accounting information to measure performance, plan and control operations.
(c) Customers and employees of an enterprise need accounting information in order to assess the ability of the enterprise to produce goods or render services on a continuous basis.
(d) Governments and regulatory bodies, such as the Central Bank of Nigeria (CBN), Securities and Exchange Commission (SEC), Nigeria Stock Exchange (NSE), Federal Inland Revenue Services (FIRS) and State Internal Revenue Service (SIRS) need accounting information to regulate certain business and plan, execute and evaluate government projects. The Federal Inland Revenue Service (FIRS) and State internal Revenue Service (SIRS) need accounting information so as to impose and collect taxes.
(e) Quasi-government established need accounting information in order to meet their statutory obligations.
(f) Competitors need accounting information to assist in formulating policies to counter competition.
(g) Creditors need accounting information to assess companies’ liquidity and ability to meet their obligations to creditors as and when due.
(h) Financial analysts need accounting information in order to facilitate comparison of a company’ financial statements from year to year, evaluation of results of companies within the same industry and between one industry and the other, as well as determining the industry average.

The information expected to be provided in financial statements are those that are quantitative and qualitative in nature, to aid their users in making informed economic decisions. To meet the objectives of its divers users, some of whom may not have accounting knowledge or background, financial statements are expected to be simple, clear and easy to understand.

**SELF ASSESSMENT EXERCISE**
State the users of financial statements.

**3.3 CONTENTS OF FINANCIAL STATEMENTS**
Financial statements are expected to be drawn up:
(a) In conformity with Generally Accepted Principles (GAAP);
(b) In accordance with the Statement of Accounting Standards (SAS) issued up-to-date by the Nigerian Accounting Standards Board (NASB);
(c) In agreement with the books of accounts of the entity; and
(d) In accordance with the Companies and Allied Matters Act, Cap C20 LFN 2004. Treatment of accounting matters that are not at present covered by the Nigerian Accounting Standards are expected to conform with the provisions of the International Accounting Standards (IAS). This is so because the Institute of Chartered Accountants of Nigeria (ICAN) is a member of International Federation of Accountants (IFAC). Consequently, ICAN members are obliged to comply with the pronouncements of IFAC. Besides, financial statements prepared in Nigeria are expected to be used globally without any problem in interpreting their contents.
All financial statements must as a matter of statutory requirement, contain the comparative figures for the preceding year (or period), to facilitate comparison of performance of the enterprise.

SELF ASSESSMENT EXERCISE
State three sources financial statements are expected to conform to.

Statement of Accounting Policies
Accounting policies are those bases, rules, principles, conventions and procedures adopted in preparing and presenting financial statements. Judgment is required in the choice of the accounting policies which are appropriate to the circumstances of an enterprise and will be best suited to present the “true and fair” view of its results and financial position. This had been dealt with in your earlier accounting courses. Therefore as a form of revision, the highlight of significant accounting policies that have to be stated in the financial statements is as follows:

(a) Accounting Convention
   There should be information as to the fact that the financial statements are prepared on the historical cost basis; that is, no adjustment for specific or general price level changes such as inflation. Where there has been revaluation of some or all the assets, it should be so stated that the historical cost concept is modified to include the revaluations.

(b) Fixed Assets
   Directors may decide the minimum expenditure to be recognised as capital item. It should also be stated that fixed assets are stated at cost or valuation, less accumulated depreciation.

(c) Depreciation of Fixed Assets:
   1. The basis of depreciation of each class of fixed assets has to be stated. The methods which can be used included: straight-line, reducing balance, amortisation over lives of the assets, sum-of-the years digit.
   2. The rate of depreciation for each class of fixed assets should be stated.

(d) Debtors
   Debtors are stated after the deduction of specific or general provision for any debts considered doubtful of recovery.

(e) Stocks
   Stocks are stated at the lower of cost and net realisable value, after making provision for obsolete and damaged items. For manufactured goods, ‘cost’ may include a proportion of factory overhead.

(f) Investments
   Investments are stated at cost. Diminution in values is not taken into account unless it is considered to be permanent.

(g) Turnover: Turnover represents the net invoiced value of sales to external customers.

(h) Deferred Taxation: Deferred taxation is provided for by the liability method which represents taxation at the current rate of company income tax, and the difference between the net book value of the assets qualifying for capital allowances and their corresponding tax written down values.
(i) Foreign Currencies: transactions in foreign currencies are translated to naira at the rates of exchange ruling on the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are translated at the official rates ruling at the balance sheet date. Exchange gains and losses are included in the profit and loss account of the period in which they arise.

(j) Employee’s Retirement benefit Schemes: The company makes annual provision for retirement benefits under its unfunded pension plan, using the aggregate method based upon actual valuation. Under this method, costs related to the plan are charged over the average service lives of active employees.

(k) Research and Development: Expenditure on research is charged to the profit and loss account in the year it is incurred, while development expenditure can be capitalised if it meets certain criteria set out in IAS 38.

(l) Consolidation: (for group/holding company) the group financial statements comprise the financial statements of the company and its subsidiaries. All inter-company transactions are normally eliminated.

Balance Sheet
The balance sheet and related notes should disclose the following information:

(a) Fixed assets- property, plant and equipment
1. Land-freehold and leasehold.
2. Buildings
3. Plant and equipment
4. Other categories of assets, suitably identified, such as motor vehicles, furniture and fittings.
5. Accumulated depreciation for each class of assets.
   Separate disclosure in a note form should be made of assets on lease and assets acquired on instalment purchase plans; that is, hire purchase. Such a disclosure should include the types of assets involved, their amounts and the periods covered.

(b) Other long-term assets
1. Long-term investments (quoted and unquoted) distinguished between:
   - Investments in subsidiaries
   - Investments in associated companies; and
   - Other investments
2. Long-term debts: All long term debts including their tenure
3. Intangible assets like
   - Goodwill.
   - Patents, trademarks and similar assets.
   - Deferred charges such as: Pre-incorporation and formation expenses; and pre-production expenses and re-organisation expenses.

   Any “write-offs” during the period and the market values of investments should be disclosed.

(c) Current Assets
1. Stocks and work-in-progress.
2. Current portion of long-term debts
3. Trade debts
4. Prepayments and sundry debtors
5. Directors debit balances.
6. Inter-company debit balances of subsidiaries and associated companies.
7. Short-term investments (including treasury bills, certificates of deposits and commercial notes, bills of exchange).
8. Foreign currency deposits for imports.
9. Deposits awaiting remittances to overseas creditors; and
10. Cash and bank balances.

(d) Capital and Reserves
1. The variety of ownership interest such as deferred shares, ordinary shares, preference shares, cumulative, non-cumulative, participating and non-participating preference shares, stating:
   • The number, nominal value and amount of shares authorised and issued.
   • The rights, preferences and restrictions with respect to the distribution of dividends and to the repayment of capital.
   • Cumulative preference dividend in arrears.
   • Shares reserved for future issue under options, sales contracts and options for conversion of loans and debentures into shares, including the terms and amounts; and
   • Movements in the share capital accounts during the period.
2. Other shareholders interests, indicating movements during the period and any restrictions on their capitalisation by way of bonus shares:
   • Capital redemption reserve fund.
   • Share premium or discount
   • Revaluation surplus.
   • Revenue and capital reserves.
   • Retained earnings.

(e) Liabilities
1. Long-term liabilities, distinguishing between:
   • Secured loans
   • Unsecured loans.
   • Loans from holding, subsidiary and associated companies
     Details of the applicable interest rates, repayment terms, covenants, subordinations, etc, should be disclosed.
2. Current liabilities, disclosing separately:
   • Amounts due to holding, subsidiary and associated companies.
   • Trade creditors
   • Other creditors and accrued expenses.
   • Dividends payable
   • Taxation
   • Current portion of long-term liabilities
   • Bank loans and overdrafts.
(f) General information to be disclosed include:
1. Restrictions on the title to assets.
2. Restrictions on the distribution of dividends.
4. The method of providing for pension or retirement scheme together with statement as to whether the scheme is funded or unfunded.
5. Contingent assets and contingent liabilities.
6. Amounts approved or committed for future capital expenditure; and
7. Events that have occurred after the balance sheet date but before the financial statements are approved by the Board.

Profit and Loss Account/Income and Expenditure Account
The profit and loss account with related notes or income and expenditure account (in the case of a company or organization, not trading for profit), should disclose the following information:

(a) Turnover/sales distinguishing between local and export sales.
(b) Other operating revenue- for example rental income or exchange gain.
(c) Other earnings- distinguishing between interest income: income from investments and other sources.
(d) Cost of sales.
(e) Gross profit
(f) Selling and distribution expenses.
(g) Administrative expenses.
(h) Interest charges.
(i) Taxes on income; and
(j) Unusual charges/credits, otherwise known as abnormal or exceptional items.
   These are income items or expenditure, which although unusually large, are within the normal trading activities of the business.
   Examples of exceptional items include:
   1. Abnormal charges for bad debts and “write-offs” of stocks;
   2. Abnormal provision for losses on long-term contracts.
   3. Most adjustments of prior year taxation provisions; and
   4. Shortfalls on actuarial valuation of gratuity scheme liabilities.
(k) Extra-ordinary items- these are items deriving from events or transactions outside the ordinary activities of the business and which are both material and expected not to recur frequently or regularly. Examples of extra-ordinary items are profits or losses arising from:
   1. The discontinuance of a significant part of a business.
   2. The sale of an investment not acquired with the intention of resale.
   3. Writing off intangibles, such as goodwill, because of unusual events or development during the period; and
   4. The expropriation of assets.
(l) Profit before taxation.
(m) Proposed dividend
(n) Profit after taxation
(o) Earnings per share
(p) Dividend per share
3.4 NOTES TO THE ACCOUNTS
The financial statements should be accompanied by appropriate explanatory notes to the figures in the balance sheet, profit and loss account and cash flow statement.

The Companies and Allied Matters Act, Cap. C20 LFN 2004 specifically requires the disclosure of the following information in the notes to the accounts:

(a) Directors’ emolument stating:
   1. Chairman’s emoluments
   2. Highest paid Director’s emoluments.
   3. Directors’ fees.
   4. Other emoluments; and
   5. Number of directors earning within a stated band of emoluments.
(b) Auditors’ remuneration.
(c) Depreciation charged on fixed assets.
(d) Number of employees and remuneration, stating:
   1. Average number of employees during the period and the related costs; and
   2. Number of employees earning within a stated band of emoluments.
(e) Capital commitments stating value of capital expenditure authorized by the Board but not executed as at balance sheet date. Amount committed out of the unspent amount should also be disclosed.
(f) Contingent liabilities, stating nature of the liabilities, and the Directors’ opinion on the likely loss that may arise from the liability.
(g) Technical service agreement, stating amount payable for the period covered by the financial statements.
(h) Post balance sheet events, stating material effect the events will have on the financial statements (if any).

SELF ASSEMENT EXERCISE
State five explanatory notes that is supposed to accompany the financial statements.

3.5 REPORT
Auditors’ Report
A set of financial statements must contain a signed and dated audit report certifying that:

(a) The company’s books accounts have been properly kept and proper returns for purpose of audit have been received from branches not visited.
(b) The financial statements:
   1. Are in agreement with the books of accounts;
   2. Give a true and fair view of the company’s affairs;
   3. Have been prepared in accordance with relevant Statements of Accounting Standards issued by the Nigerian Accounting Standards Board; and
   4. Have been properly prepared in accordance with the Companies and Allied Matters Act, Cap, C20 LFN 2004.

Directors’ Report
Financial statements must contain a signed and dated report of the Board, highlighting the following:
(a) Directors’ responsibilities in accordance with Sections 334 and 335 of CAMA Cap, C20 LFN 2004.
(b) Principal activities of the company.
(c) Results of the company for the period and appropriation of the profits.
(d) Changes in the Board of Directors during the period.
(e) Directors’ interest in the company’s share.
(f) Directors’ interest in the company’s contracts.
(g) Major shareholdings, disclosing shares held by individuals and organizations holding more than 10% of the company’s issued share capital.
(h) Employment and employees, highlighting company’s policies regarding:
   1. Employment of disabled persons.
   2. Employees’ health, safety and welfare.
   3. Employees’ involvement and training.
(i) Major suppliers and distributors of company’s materials and products respectively.
(j) Research and development efforts of the company; and
(k) Donations and gifts by the company, stating organizations to which the company donated and amount made available.

Audit Committee’s Report
In accordance with Section 359(6) of the Companies and Allied Matters Act, Cap, C20 LFN 2004, every public company is required to elect maximum of six (6) members into the Audit Committee at every Annual General Meeting to function until the next Annual General Meeting when fresh election is conducted.

Three of the members are elected by the shareholders and the remaining three elected by the Board of Directors, from the board members.

The audit Committee is required to:
   (a) Review the external auditors’ scope and planning of the audit requirements;
   (b) Review the external auditors’ memorandum of recommendations on accounting policies and internal controls, together with management responses.
   (c) Ascertain that the accounting and reporting policies of the company are in accordance with legal requirements and agreed ethical practices;
   (d) Recommend to the Board with regard to the appointment, removal and remuneration of the external auditors of the company; and
   (e) Authorise the internal auditor to carry out investigations into any activities of the company which may be of interest or concern to the committee.

The Audit Committee is required to express an opinion on the adequacy or otherwise of the matters stated above and that they are satisfied with the management responses to the external auditors’ findings.

SELF ASSESSMENT EXERCISE
Mention two reports and explain them that should be contained in the financial statements.
3.6 CASH FLOW STATEMENT
This provides information on the derivation and utilisation of funds during the period covered by the financial statements. When cash flow statement is taken together with the balance sheet and profit and loss account, better insight is obtained as to how the activities of an enterprise have been financed.

A cash flow statement should disclose the following:

(a) Cash flows from operating activities
   Profit before taxation for the period covered by the financial statements is appropriately adjusted, for non-cash items such as:
   1. Depreciation and amortization charge on fixed assets;
   2. Profit or loss on disposal of fixed assets; and
   3. Provision for unfunded pension plan.

(b) Changes in Current Assets and liabilities
   Increase or decrease in current assets and liabilities when compared to those in the preceding year is accounted for under this sub-head to reflect:
   1. Increase or decrease in stock;
   2. Increase or decrease in creditors and accruals; and
   3. Increase or decrease in foreign currency deposit for imports;
   4. Increase or decrease in creditors and accruals.

(c) Payments in connection with operations, such as income tax and retirement benefits paid during the period covered by the financial statements are deducted from the addition of (a) and (b) above, before arriving at net cash inflow or outflow from operating activities.

(d) Cash flows from investing activities
   Actual cash outflows or inflows of the following, during the period covered by the financial statements, are disclosed:
   1. Purchase of fixed assets, investment or intangible assets.
   2. Proceeds from sale of assets, investment or intangible assets; and
   3. Dividends and interests received on investments.

(e) Cash flows from financing activities
   Actual cash inflows or outflows on the following during the period covered by the financial statements are disclosed:
   1. Dividends paid to shareholders;
   2. Repayment of debenture stock; and
   3. Proceeds from issue of shares and debenture stock.

(f) Movement in net liquid funds
   The net figure arrived at by pooling together all the net figures obtained in (a) – (e) above, represents net increase or decrease in cash and cash equivalents at the beginning of the period covered by the financial statements are added to the net increase or decrease, we arrive at cash and cash equivalents at the end of the period covered by the financial statements which may consist of:
   1. Cash and bank balances;
   2. Bank overdrafts; and
   3. Investments in commercial papers and other short-term financial instruments.
SELF ASSESSMENT EXERCISE
What should be disclosed by the cash flow statement?

3.7 VALUE-ADDED STATEMENT
Value-added statement reports the additional wealth created by an enterprise on its own and by its employees’ efforts during the period covered by the financial statements. It usually shows how the wealth created is distributed among various interest groups (such as, employees, government, creditors, providers of capital and that retained for the future creation of more wealth).

The concept here is the difference between the cost of inputs (bought-in materials and services) and value of outputs (turnover) is the value added by the operations of the business.

The value added can then be analyzed to show how it has been applied. Note that wages are not included in cost of inputs from third party (outside the business).

Thus, the statement reports the claims of social and economic groups, reaffirming the contemporary belief that enterprises do not exist for the benefit of their owners (shareholders) only; but, also for the society at large.

The statement shows separately, the following:
(a) Sales to outsiders (third parties outside the group).
(b) Purchases of goods and services: distinguishing between imported and local items.
(c) (a) and (b) above represents value added; and
(d) Distribution of value-added to various groups such as:
   1. Employees- salaries, wages and fringe benefits;
   2. Government – company income and education taxes, excise duties;
   3. Providers of finance – dividends, interest, etc;
   4. Retained for the replacement of assets and business growth:
      • To provide for depreciation of fixed assets; and
      • To augment reserves.

SELF ASSESSMENT EXERCISE
State the content of a value-added statement

3.8 FIVE-YEAR FINANCIAL SUMMARY
The five-year financial summary enables an instant comparison for an enterprise’s activities over the five-year period. Information to be disclosed are as follows:

(a) Results
   1. Turnover
   2. Profit before tax
   3. Taxation
   4. Profit after taxation
   5. Dividend
   6. Retained earnings

(b) Assets Employed
   1. Fixed assets
   2. Intangible assets
3. Investments
4. Net current assets
5. Long term liabilities and deferred charges

(c) Funds Employed
1. Issued share capital
2. Share premium
3. Revaluation reserves
4. Other reserves - revenue, bonus issue

(d) Financial Statistic – (per share data)
1. Share price at the end of period
2. Earnings per share
3. Dividend per share
4. Dividend cover
5. Net worth per share
6. Return on capital employed
7. Current assets: Current Liabilities

4.0 CONCLUSION
It can be concluded that an annual report is a document produced annually by companies designed to portray a true and fair view of the company’s annual performance, with audited financial statements prepared in accordance with company law and other regulatory requirements, and also containing other non-financial information.

Directors are responsible for the preparation of the accounts which must give a true and fair view. A true and fair view is one where accounts reflect what has happened and do not mislead the readers. The accounts must be prepared in accordance with relevant accounting standards.

5.0 SUMMARY
This unit explores the statutory framework guiding the contents of financial statements as stipulated in the Companies and Allied Matters Act, Cap C20, LFN 2004. It is pertinent to note that financial statements are expected to be drawn up in conformity with the Generally Accepted Accounting Principles; in accordance with the Statement of Accounting Standards issued by the Nigerian Accounting Standards Board, and in agreement with the books of accounts of the entity. Objectives of the various users of financial statements were reviewed.

6.0 TUTOR MARKED ASSIGNMENT
1. State one item highlighted by the Chairman’s statement in a company’s annual report.
2. Highlight any major difference between Auditors’ report and Audit Committee’s report.
3. State the information usually disclosed in form of notes to the financial statements that may not affect the figures in the accounts.
4. State one use of five-year financial summary.
5. State one report expected to be found in published financial statements of a published quoted company.

7.0 REFERENCES/FURTHER READING

1.0 INTRODUCTION
You must have been familiar with the purpose of trading, profit and loss account and balance sheet which is prepared by the accountant reporting to management the state of affairs of the company. To be specific, the trading account helps to determine the gross profit for the period while the profit and loss account helps determine the net profit, and the balance sheet shows the state of affairs of the company at a point in time.

However, the one you may have been familiar with is for internal purpose. That is different from the one used for external purpose. For external purpose, I mean users of the financial statements that are not the management of the company.

In this unit, you shall be shown the format of published financial statements and see illustrations that would further establish your knowledge base on published financial statements.

2.0 OBJECTIVES
After studying this unit, you should be able to:
1. Identify the formats of published financial statements.
2. Examine illustrations on published financial statements of limited liability companies.

3.0 MAIN CONTENT
3.1 FORMATS OF PUBLISHED FINANCIAL STATEMENTS OF PUBLIC COMPANIES

XYZ NIGERIA PLC
PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 31 DECEMBER 2004

<table>
<thead>
<tr>
<th>NOTE</th>
<th>2004</th>
<th>2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>Turnover</td>
<td>1</td>
<td>x</td>
</tr>
<tr>
<td>Cost of sales</td>
<td>(x)</td>
<td>(x)</td>
</tr>
<tr>
<td>Gross profit</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Distribution expenses</td>
<td>(x)</td>
<td>(x)</td>
</tr>
<tr>
<td>Administrative expenses</td>
<td>(x)</td>
<td>(x)</td>
</tr>
<tr>
<td>Trading profit</td>
<td>xx</td>
<td>xx</td>
</tr>
<tr>
<td>Interest income</td>
<td>x</td>
<td>x</td>
</tr>
</tbody>
</table>


### XYZ NIGERIA PLC
#### BALANCE SHEET AS AT 31 DECEMBER 2004

<table>
<thead>
<tr>
<th>NOTE</th>
<th>2004</th>
<th>2003</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>₦</td>
<td>₦</td>
</tr>
<tr>
<td>Fixed Assets</td>
<td>6</td>
<td>x</td>
</tr>
<tr>
<td>Investments</td>
<td>7</td>
<td>x</td>
</tr>
<tr>
<td>Current Assets:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Stocks and work-in-progress</td>
<td>8</td>
<td>x</td>
</tr>
<tr>
<td>Debtors and prepayments</td>
<td>9</td>
<td>x</td>
</tr>
<tr>
<td>Deposits for imports</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Bank deposits</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Cash and bank balances</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td></td>
<td>Xx</td>
<td>xx</td>
</tr>
<tr>
<td>Current Liabilities:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Creditors: due within one year of balance</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sheet date:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Creditors and accruals</td>
<td>10</td>
<td>(x)</td>
</tr>
<tr>
<td>Bank overdrafts</td>
<td>11</td>
<td>(x)</td>
</tr>
<tr>
<td>Net Current assets/(Liabilities)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Creditors: due after one year of balance</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sheet date:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gratuity and retirement benefit</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Provision for deferred tax</td>
<td>12</td>
<td>x</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(x)</td>
</tr>
<tr>
<td>Total Net Assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Represented by:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Capital and reserves:</td>
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</tr>
<tr>
<td>Share capital</td>
<td>13</td>
<td>x</td>
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<tr>
<td>Capital reserve</td>
<td>14</td>
<td>x</td>
</tr>
<tr>
<td>General reserve</td>
<td>15</td>
<td>x</td>
</tr>
<tr>
<td>Shareholders’ fund</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>XXX</td>
<td>XXX</td>
</tr>
</tbody>
</table>

### SELF ASSESSMENT EXERCISE
Draft the format of a published profit and loss account and a balance sheet on the page of a piece of paper

### 3.2 ILLUSTRATIONS ON PUBLISHED FINANCIAL STATEMENTS OF LIMITED LIABILITY COMPANIES
Having gone through the statutory framework required in preparing financial statements, the best way to demonstrate its practical application is by working through illustrative examples.

ILLUSTRATION 3
Samba Nigeria Plc is an Electrical Components assembly outfit with authorised and issued share capital of ₦200 million, made up of 400 million ordinary shares of 50 kobo each. The following is the company’s trial balance as at 30 April 2008:

<table>
<thead>
<tr>
<th></th>
<th>Dr</th>
<th>Cr</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>₦’000</td>
<td>₦’000</td>
</tr>
<tr>
<td>Freehold land</td>
<td>25,000</td>
<td></td>
</tr>
<tr>
<td>Short-term deposits</td>
<td>50,000</td>
<td></td>
</tr>
<tr>
<td>Sundry debtors</td>
<td>60,820</td>
<td></td>
</tr>
<tr>
<td>Cash and bank</td>
<td>50,862</td>
<td></td>
</tr>
<tr>
<td>Furniture and fittings- cost</td>
<td>44,720</td>
<td></td>
</tr>
<tr>
<td>Accumulated depreciation</td>
<td></td>
<td>11,180</td>
</tr>
<tr>
<td>Machinery and equipment- cost</td>
<td>164,000</td>
<td></td>
</tr>
<tr>
<td>Accumulated depreciation</td>
<td></td>
<td>32,800</td>
</tr>
<tr>
<td>Stock at 1 May 2003</td>
<td>27,160</td>
<td></td>
</tr>
<tr>
<td>Sundry creditors</td>
<td>39,420</td>
<td></td>
</tr>
<tr>
<td>Bank overdraft</td>
<td>25,000</td>
<td></td>
</tr>
<tr>
<td>Wages</td>
<td>97,280</td>
<td></td>
</tr>
<tr>
<td>Postages and telephone</td>
<td>2,100</td>
<td></td>
</tr>
<tr>
<td>General expenses</td>
<td>6,060</td>
<td></td>
</tr>
<tr>
<td>Bad debts written-off</td>
<td>560</td>
<td></td>
</tr>
<tr>
<td>Auditors’ remuneration</td>
<td>2,000</td>
<td></td>
</tr>
<tr>
<td>Distribution expenses</td>
<td>2,140</td>
<td></td>
</tr>
<tr>
<td>Insurance</td>
<td>2,060</td>
<td></td>
</tr>
<tr>
<td>Bank interest paid and received</td>
<td>4,100</td>
<td>1,000</td>
</tr>
<tr>
<td>Electricity</td>
<td>3,800</td>
<td></td>
</tr>
<tr>
<td>Salaries (including directors remuneration N2m)</td>
<td>76,850</td>
<td></td>
</tr>
<tr>
<td>Rates</td>
<td>1,580</td>
<td></td>
</tr>
<tr>
<td>Purchases</td>
<td>306,832</td>
<td></td>
</tr>
<tr>
<td>Sales</td>
<td></td>
<td>640,124</td>
</tr>
<tr>
<td>Dividends (interim)</td>
<td>24,000</td>
<td></td>
</tr>
<tr>
<td>Profit and loss account</td>
<td>2,400</td>
<td></td>
</tr>
<tr>
<td>Share capital</td>
<td></td>
<td>200,000</td>
</tr>
</tbody>
</table>

The following adjustments are necessary for the year ended 30/4/2008:

(a) The directors recommended that 5% of debtors should be set aside for possible bad debts.
(b) Stock was valued at ₦28,648,000 as at 30 April, 2008.
(c) Wages outstanding at 30 April, 2008 amounted to ₦2,400,000 and electricity accrued was ₦280,000.
(d) Depreciation is to be written off machinery and equipment at 10% per annum and furniture and fittings at 5% per annum.
(e) The sales manager is entitled to sales commission of 2% of gross profit. The commission is payable on 1 May 2008.
(f) Insurance has been paid in advance amounting to ₦285,000
(g) Machinery which stood in the books at 1 May, 2007 at ₦8 million has been sold for ₦6 million in part exchange for a new machinery costing ₦12 million. A net invoice for ₦6 million has been posted into the purchases account. No other entry has been made in respect of this transaction. The original cost of the old machinery was ₦10 million. It is the company’s policy to charge a full year’s depreciation in the year of purchase and none in the year of sale.

(h) The directors proposed a final dividend of 8%, making a total of 20% dividend in respect of the year to 30 April, 2008.

(i) Provision for company income tax was ₦35 million.

(j) You are required to prepare the profit and loss account for the year ended 30 April, 2008 and balance sheet as at 30 April, 2008 in a form suitable for publication. Notes to the accounts are not required but you should show your workings.

SUGGESTED SOLUTION

SAMBA NIGERIA PLC
PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 30 APRIL 2008

<table>
<thead>
<tr>
<th></th>
<th>Workings</th>
<th>N’000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Turnover</td>
<td></td>
<td>640,124</td>
</tr>
<tr>
<td>Cost of sales</td>
<td>1</td>
<td>(399,024)</td>
</tr>
<tr>
<td>Gross profit</td>
<td></td>
<td>241,100</td>
</tr>
<tr>
<td>Selling and distribution expenses</td>
<td>2</td>
<td>6,962</td>
</tr>
<tr>
<td>Administrative expenses</td>
<td>3</td>
<td>118,882</td>
</tr>
<tr>
<td>Trading profit</td>
<td></td>
<td>115,256</td>
</tr>
<tr>
<td>Interest income</td>
<td></td>
<td>1,000</td>
</tr>
<tr>
<td>Interest payable and similar charges</td>
<td></td>
<td>(4,100)</td>
</tr>
<tr>
<td>Profit before taxation</td>
<td></td>
<td>112,156</td>
</tr>
<tr>
<td>Taxation</td>
<td></td>
<td>(35,000)</td>
</tr>
<tr>
<td>Profit after tax</td>
<td></td>
<td>77,156</td>
</tr>
<tr>
<td>Interim dividend paid</td>
<td></td>
<td>24,000</td>
</tr>
<tr>
<td>Final dividend proposed</td>
<td></td>
<td>(40,000)</td>
</tr>
<tr>
<td>Retained profit for the year</td>
<td></td>
<td>37,156</td>
</tr>
<tr>
<td>Earnings per share of 50 kobo</td>
<td>4</td>
<td>19 kobo</td>
</tr>
<tr>
<td>Dividend per share of 50 kobo</td>
<td></td>
<td>10 kobo</td>
</tr>
</tbody>
</table>

SAMBA NIGERIA PLC
BALANCE SHEET AS AT 30 APRIL 2008

<table>
<thead>
<tr>
<th></th>
<th>Workings</th>
<th>N’000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fixed Assets</td>
<td>5</td>
<td>174,904</td>
</tr>
<tr>
<td>Current Assets:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Stock</td>
<td></td>
<td>28,648</td>
</tr>
<tr>
<td>Debtors and Prepayment</td>
<td>6</td>
<td>58,064</td>
</tr>
<tr>
<td>Short-term deposit</td>
<td></td>
<td>50,000</td>
</tr>
<tr>
<td>Cash and bank balances</td>
<td></td>
<td>187,574</td>
</tr>
<tr>
<td>Current Liabilities (amount falling due within one year):</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Creditors and accrual</td>
<td>7</td>
<td>(97,922)</td>
</tr>
<tr>
<td>Bank overdrafts</td>
<td></td>
<td>(25,000)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>122,922</td>
</tr>
</tbody>
</table>
Net current assets $\text{N}(187,574 - 122,922) = 64,652$

Net Assets $\text{N}239,556$

Financed by:

**CAPITAL AND RESERVES**

Share capital

400,000 ordinary shares of 50 kobo each = 200,000

Revenue Reserve 8 = 39,556

Shareholders’ fund $\text{N}239,556$

**WORKINGS**

1. **Cost of Sales:**
   
   Opening stock 27,160
   
   Purchases ($\text{N}306,832 - \text{N}6,000) 300,832
   
   Less: closing stock 28,648
   
   Wages ($\text{N}97,280 + \text{N}2,400) 99,680
   
   **Total** 399,024

2. **Selling and distribution expenses:**

   Distribution expenses 2,140
   
   Selling expenses – sales manager’s commission (2% of gross profit of \text{N}241,100) 4,822
   
   **Total** 6,962

3. **Administrative expenses:**

   Salaries 76,850
   
   Bad debt ($\text{N}(60,820 \times 5\%) + 560) 3,601
   
   Depreciation charge:
   
   Plant and machinery ($\text{N}(164,000 - 10,000) + 12,000 \times 10\%) 16,600
   
   Furniture & fittings $\text{N}(44,720 \times 5\%) 2,236
   
   Insurance ($\text{N}(2,060 - 285) 1,775
   
   Loss on disposal of machinery ($\text{N}(8,000 - 6000) 2,000
   
   Electricity ($\text{N}(3,800 + 280) 4,080
   
   Postages & telephone 2,100
   
   General expenses 6,060
   
   Rates 1,580
   
   Auditors’ remuneration 2,000
   
   **Total** 118,882

4. **Earnings per share** = profit after tax/No. Of issued shares = $77,156 \times 100/400,000 = 19.29 kobo

5. **Fixed Assets**

<table>
<thead>
<tr>
<th></th>
<th>Freehold land</th>
<th>Furniture &amp; Fittings</th>
<th>Machinery &amp; equipment</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>COST:</strong></td>
<td>N’000</td>
<td>N’000</td>
<td>N’000</td>
<td>N’000</td>
</tr>
<tr>
<td>At 1 May 2007</td>
<td>25,000</td>
<td>44,720</td>
<td>164,000</td>
<td>233,720</td>
</tr>
<tr>
<td>Addition</td>
<td>-</td>
<td>12,000</td>
<td>12,000</td>
<td></td>
</tr>
</tbody>
</table>
### Disposal

<table>
<thead>
<tr>
<th></th>
<th>Dr</th>
<th>Cr</th>
<th>(10,000)</th>
<th>(10,000)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>At 30 April 2008 (a)</strong></td>
<td>25,000</td>
<td>44,720</td>
<td>166,000</td>
<td>235,720</td>
</tr>
</tbody>
</table>

### Depreciation:

<table>
<thead>
<tr>
<th></th>
<th>Dr</th>
<th>Cr</th>
<th>(2,000)</th>
<th>(2,000)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>At 1 May 2007</strong></td>
<td>-</td>
<td>11,180</td>
<td>32,800</td>
<td>43,980</td>
</tr>
<tr>
<td><strong>Charge for the year</strong></td>
<td>-</td>
<td>2,236</td>
<td>16,600</td>
<td>18,836</td>
</tr>
<tr>
<td><strong>Loss on disposal (b)</strong></td>
<td>-</td>
<td>13,416</td>
<td>47,400</td>
<td>60,816</td>
</tr>
</tbody>
</table>

### Net book value:

<table>
<thead>
<tr>
<th></th>
<th>Dr</th>
<th>Cr</th>
<th>(2,000)</th>
<th>(2,000)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>At 30 April 2008 (a – b)</strong></td>
<td>25,000</td>
<td>31,304</td>
<td>118,600</td>
<td>174,904</td>
</tr>
</tbody>
</table>

### Debtors & prepayments

<table>
<thead>
<tr>
<th></th>
<th>Dr</th>
<th>Cr</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Sundry debtors</strong></td>
<td>60,820</td>
<td></td>
</tr>
<tr>
<td><strong>Less: provision for bad debts</strong></td>
<td>3,041</td>
<td></td>
</tr>
<tr>
<td><strong>Prepaid insurance</strong></td>
<td>285</td>
<td></td>
</tr>
<tr>
<td></td>
<td>57,779</td>
<td></td>
</tr>
<tr>
<td></td>
<td>58,064</td>
<td></td>
</tr>
</tbody>
</table>

### Creditors and accruals:

<table>
<thead>
<tr>
<th></th>
<th>Dr</th>
<th>Cr</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Sundry creditors</strong></td>
<td>39,420</td>
<td></td>
</tr>
<tr>
<td><strong>Accrued sales manager’s commission</strong></td>
<td>4,822</td>
<td></td>
</tr>
<tr>
<td><strong>Accrued wages</strong></td>
<td>280</td>
<td></td>
</tr>
<tr>
<td><strong>Taxation</strong></td>
<td>35,000</td>
<td></td>
</tr>
<tr>
<td><strong>Proposed final dividend</strong></td>
<td>16,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>97,922</td>
<td></td>
</tr>
</tbody>
</table>

### Revenue reserve:

<table>
<thead>
<tr>
<th></th>
<th>Dr</th>
<th>Cr</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Balance brought forward</strong></td>
<td>2,400</td>
<td></td>
</tr>
<tr>
<td><strong>Retained profit for the year</strong></td>
<td>37,156</td>
<td></td>
</tr>
<tr>
<td></td>
<td>39,556</td>
<td></td>
</tr>
</tbody>
</table>

### Tutorial:

The following stages of solving the question are recommended:

(a) Read through the question and note the adjustments required. Identify the figures in the trial balance that will be affected by the adjustments required.

(b) Do your workings on a separate sheet, affecting all adjustments listed. The workings should be submitted as part of your answers.

(c) Prepare the profit and loss account and balance sheet, using the recommended format, slotting in the figures from the trial balance and workings.

### ILLUSTRATION 4

Excel Plc is a manufacturing company. Its trial balance as at 30 April, 2008, is as follows:

<table>
<thead>
<tr>
<th></th>
<th>Dr</th>
<th>Cr</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Goodwill</strong></td>
<td>500</td>
<td></td>
</tr>
<tr>
<td><strong>Land and building</strong></td>
<td>15,950</td>
<td></td>
</tr>
<tr>
<td><strong>Plant and machinery</strong></td>
<td>68,880</td>
<td></td>
</tr>
<tr>
<td><strong>Furniture &amp; fittings</strong></td>
<td>44,530</td>
<td></td>
</tr>
</tbody>
</table>
Accumulated depreciation:
- Land and building: 2,700
- Plant and machinery: 51,350
- Furniture and fittings: 33,500
- Investment – quoted: 2,370
- Unquoted: 3,020
- Ordinary share capital @ 50k/share
- General reserve: 500
- Profit and loss account: 750
- Provision for deferred tax: 3,040
- Stocks - raw material: 10,800
- Work-in-progress: 9,780
- Finished goods: 11,530
- Sales: 73,470
- Rent received: 170
- Investment income: 800
- Other interest received: 600
- Profit on sale of plant: 3,600
- Purchase of raw materials: 28,620
- External charges on raw materials: 180
- Wages and salaries: 9,060
- Pension cost on employees: 1,220
- Depreciation charge for the year:
  - Land and building: 410
  - Plant & machinery: 5,940
  - Furniture and fittings: 3,250
  - Rent, rates and insurance: 3,900
  - Power and lighting: 6,940
  - Distribution expenses: 2,660
  - Audit fees: 320
  - Sundry expenses: 400
  - Interest paid on bank overdraft: 200
  - Bills of exchange payable: 100
  - Trade creditors: 12,850
  - Other creditors: 2,060
  - Company income tax brought forward: 3,080
- Creditors due after one year:
  - 6% debenture 2004 – 2020: 5,550
  - Others: 680
- Rationalization cost: 2,070
- Prepayments: 2,410
- Bank balance: 9,210
- Trade debtors: 13,560
- Other debtors: 90

The following additional information are also relevant:

1. Stocks at 30 April 2008 -.raw materials: 12,810
   - Work-in-progress: 11,050
   - Finished goods: 12,580
2. During the year, additions to fixed assets were as follows:
   
   Plant & machinery                8,530
   Furniture & fittings                  780

   Disposals were made as follows:
   Plant & machinery- at cost (Acc. Depreciation ₦2,670,000) 3,020
   Furniture & fittings- at cost (Acc. Depreciation ₦910,000)   1,250

3. Proposed dividend is 6 kobo per share.

4. Provision in the accounts for company income tax of ₦2,400,000 and capital gains tax on sale of plant of ₦450,000 is made.

5. Under-provision for company income tax in respect of year ended 30/4/07 was ₦250,000.

6. Included in salaries and wages are directors’ fees of ₦0.5 million and executive directors’ salaries of ₦2.5 million.

You are required to prepare the profit and loss account for the year ended 30 April 2008 and balance sheet as at that date in a form suitable for publication in line with CAMA, 2004 for Excel Plc. Show all workings.

**SUGGESTED SOLUTION 4**

**EXCEL PLC**

**PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 30 APRIL 2008**

<table>
<thead>
<tr>
<th>Note</th>
<th>Description</th>
<th>₦’000</th>
<th>₦’000</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Turnover</td>
<td>73,470</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Cost of sales (w1)</td>
<td>(31,410)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Gross profit</td>
<td>42,060</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Distribution expenses</td>
<td>2,660</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Administration expenses (w2)</td>
<td>24,500</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Trading profit</td>
<td>14,900</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>Interest paid on bank overdraft</td>
<td>(200)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Profit on ordinary activities before taxation</td>
<td>16,270</td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>Tax on ordinary activities</td>
<td>(2,650)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Profit on ordinary activities after taxation</td>
<td>13,620</td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>Extra-ordinary item</td>
<td>3,150</td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>Exceptional item</td>
<td>(2,070)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Un-appropriated profit for the year</td>
<td>14,700</td>
<td></td>
</tr>
</tbody>
</table>

**APPROPRIATIONS:**

- Proposed dividend (w3) (7,560)
- Retained profit for the year 7,140

**EXCEL PLC**

**BALANCE SHEET AS AT 30 APRIL 2004**

<table>
<thead>
<tr>
<th>Note</th>
<th>Description</th>
<th>₦’000</th>
<th>₦’000</th>
</tr>
</thead>
<tbody>
<tr>
<td>7</td>
<td>Fixed assets</td>
<td>41,810</td>
<td></td>
</tr>
<tr>
<td>8</td>
<td>Investments</td>
<td>5,390</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Goodwill</td>
<td>500</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Current Assets</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 30 APRIL 2008

1. Turnover represents sales of manufactured products within Nigeria.

2. Other income: ₦'000
   - Rent received 170
   - Investment income 800
   - Other interest received 600
   Total 1,570

3. Profit on ordinary activities before tax
   Is stated after charging directors’ emolument:
   - Fees 500
   - Others 2,500
   - Auditors’ remuneration 320
   - Depreciation of fixed assets 9,600
   Total 14,020

4. Taxation:
   - Tax charged for the year 2,400
   - Under- provision in preceding year 250
   - Per profit and loss account 2,650
   - Balance brought forward 3,080
   - Capital Gains tax 450
   Total 2,650
   Per balance sheet (note 11) 6,180

5. Extra-ordinary items:
   - Profit on sale of plant 3,600
   - Less: capital gains tax 450
   Total 3,150

6. Exceptional items:
   - Rationalization cost 2,070

7. Fixed assets
   Land & Plant & Furniture Total
   5,210 16,060 28,750

8. Debtors and prepayments 10, 16,060
9. Bank 9,210
   Total 61,710

9. Stocks and work-in-progress 9, 36,440
10. Less: current liabilities:
    Creditors: due within one year of
    Balance sheet date: 11, 28,750
    Net current assets 32,960
    Creditors due more than one year of
    Balance sheet date: 12, 9,270
    Net Assets 71,390

11. Financed by:
    Capital and reserves:
    Share capital 13, 63,000
    Reserves 14, 8,390
    Shareholders’ fund 71,390

12. NOTE TO THE ACCOUNTS FOR THE YEAR ENDED 30 APRIL 2008

13. Turnover represents sales of manufactured products within Nigeria.

14. Other income: ₦'000
   - Rent received 170
   - Investment income 800
   - Other interest received 600
   Total 1,570

15. Profit on ordinary activities before tax
   Is stated after charging directors’ emolument:
   - Fees 500
   - Others 2,500
   - Auditors’ remuneration 320
   - Depreciation of fixed assets 9,600
   Total 14,020

16. Taxation:
   - Tax charged for the year 2,400
   - Under- provision in preceding year 250
   - Per profit and loss account 2,650
   - Balance brought forward 3,080
   - Capital Gains tax 450
   Total 2,650
   Per balance sheet (note 11) 6,180

17. Extra-ordinary items:
   - Profit on sale of plant 3,600
   - Less: capital gains tax 450
   Total 3,150

18. Exceptional items:
   - Rationalization cost 2,070

19. Fixed assets
   Land & Plant & Furniture Total
   5,210 16,060 28,750

20. NOTE TO THE ACCOUNTS FOR THE YEAR ENDED 30 APRIL 2008

21. Turnover represents sales of manufactured products within Nigeria.

22. Other income: ₦'000
   - Rent received 170
   - Investment income 800
   - Other interest received 600
   Total 1,570

23. Profit on ordinary activities before tax
   Is stated after charging directors’ emolument:
   - Fees 500
   - Others 2,500
   - Auditors’ remuneration 320
   - Depreciation of fixed assets 9,600
   Total 14,020

24. Taxation:
   - Tax charged for the year 2,400
   - Under- provision in preceding year 250
   - Per profit and loss account 2,650
   - Balance brought forward 3,080
   - Capital Gains tax 450
   Total 2,650
   Per balance sheet (note 11) 6,180

25. Extra-ordinary items:
   - Profit on sale of plant 3,600
   - Less: capital gains tax 450
   Total 3,150

26. Exceptional items:
   - Rationalization cost 2,070

27. Fixed assets
   Land & Plant & Furniture Total
   5,210 16,060 28,750

28. NOTE TO THE ACCOUNTS FOR THE YEAR ENDED 30 APRIL 2008

29. Turnover represents sales of manufactured products within Nigeria.

30. Other income: ₦'000
   - Rent received 170
   - Investment income 800
   - Other interest received 600
   Total 1,570

31. Profit on ordinary activities before tax
   Is stated after charging directors’ emolument:
   - Fees 500
   - Others 2,500
   - Auditors’ remuneration 320
   - Depreciation of fixed assets 9,600
   Total 14,020

32. Taxation:
   - Tax charged for the year 2,400
   - Under- provision in preceding year 250
   - Per profit and loss account 2,650
   - Balance brought forward 3,080
   - Capital Gains tax 450
   Total 2,650
   Per balance sheet (note 11) 6,180

33. Extra-ordinary items:
   - Profit on sale of plant 3,600
   - Less: capital gains tax 450
   Total 3,150

34. Exceptional items:
   - Rationalization cost 2,070

35. Fixed assets
   Land & Plant & Furniture Total
   5,210 16,060 28,750
<table>
<thead>
<tr>
<th>Building machinery &amp; fittings</th>
<th>Building machinery &amp; fittings</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cost:</strong></td>
<td><strong>Cost:</strong></td>
</tr>
<tr>
<td>At 1/5/2007</td>
<td>15,950</td>
</tr>
<tr>
<td>Additions</td>
<td>-</td>
</tr>
<tr>
<td>Disposals</td>
<td>(3,020)</td>
</tr>
<tr>
<td>At 30/04/2008 (a)</td>
<td>15,950</td>
</tr>
<tr>
<td>Depreciation</td>
<td></td>
</tr>
<tr>
<td>At 1/5/2007</td>
<td>2,290</td>
</tr>
<tr>
<td>Charge for the year</td>
<td>410</td>
</tr>
<tr>
<td>Eliminated on disposal</td>
<td>(2,670)</td>
</tr>
<tr>
<td>At 30/04/2008 (b)</td>
<td>2,700</td>
</tr>
<tr>
<td>Net book value: (a – b)</td>
<td>13,250</td>
</tr>
<tr>
<td><strong>Investment:</strong></td>
<td><strong>Investment:</strong></td>
</tr>
<tr>
<td>Quoted</td>
<td>2,370</td>
</tr>
<tr>
<td>Unquoted</td>
<td>3,020</td>
</tr>
<tr>
<td><strong>Stocks and work-in-progress:</strong></td>
<td></td>
</tr>
<tr>
<td>Raw materials</td>
<td>12,810</td>
</tr>
<tr>
<td>Work-in-progress</td>
<td>11,050</td>
</tr>
<tr>
<td>Finished goods</td>
<td>12,580</td>
</tr>
<tr>
<td></td>
<td>36,440</td>
</tr>
<tr>
<td><strong>Debtors and prepayments:</strong></td>
<td></td>
</tr>
<tr>
<td>Trade debtors</td>
<td>13,560</td>
</tr>
<tr>
<td>Other debtors</td>
<td>90</td>
</tr>
<tr>
<td>Prepayments</td>
<td>2,410</td>
</tr>
<tr>
<td></td>
<td>16,060</td>
</tr>
<tr>
<td><strong>Creditors due within year:</strong></td>
<td></td>
</tr>
<tr>
<td>Trade creditors</td>
<td>12,850</td>
</tr>
<tr>
<td>Other creditors</td>
<td>2,060</td>
</tr>
<tr>
<td>Taxation (note 4)</td>
<td>6,180</td>
</tr>
<tr>
<td>Bills payable</td>
<td>100</td>
</tr>
<tr>
<td>Proposed dividend</td>
<td>7,560</td>
</tr>
<tr>
<td></td>
<td>28,750</td>
</tr>
<tr>
<td><strong>Creditors due after one year:</strong></td>
<td></td>
</tr>
<tr>
<td>6% debenture (2004 – 2020)</td>
<td>5,550</td>
</tr>
<tr>
<td>Other long-term creditors</td>
<td>680</td>
</tr>
<tr>
<td>Deferred tax</td>
<td>3,040</td>
</tr>
<tr>
<td></td>
<td>9,270</td>
</tr>
<tr>
<td><strong>Share Capital:</strong></td>
<td></td>
</tr>
<tr>
<td>Authorized, issued and fully paid:</td>
<td></td>
</tr>
<tr>
<td>126,000,000 ordinary shares of 50K each</td>
<td>63,000</td>
</tr>
<tr>
<td><strong>Reserves:</strong></td>
<td></td>
</tr>
<tr>
<td>General reserve</td>
<td>500</td>
</tr>
<tr>
<td>Revenue reserve:</td>
<td></td>
</tr>
</tbody>
</table>
Balance brought forward 750
Retained profit for the year 7,140 7,890 8,390

WORKINGS
1. Cost of sales: N'000
   Opening stock – N(10,800+9,780+11,530) 32,110
   Add: Purchases of raw material 28,620
      External charges on raw material 180
      Less: closing stock N(12,810+11,050+12580) (36,440)
   Power and lighting 6,940

2. Administrative expenses consist of:
   Directors’ emoluments 3,000
   Wages & salaries 6,060
   Pension cost 1,220
   Rent, rates & insurance 3,900
   Audit fees 320
   Sundry expenses 400
   Depreciation charge 9,600
   Total 24,500

3. Proposed dividend
   6 kobo per 126,000,000 ordinary shares
   = 126,000,000 x 6/100 = 7,560

SELF ASSESSMENT EXERCISE
Without looking at the solution given above, try and solve the same questions and compare it with the solution.

4.0 CONCLUSION
In this unit, you learnt the wider base of published financial statements which would help you in presenting published financial statements whether in exams or in practice.

5.0 SUMMARY
In this unit, you were shown the presentation of published financial statement by looking at the format of financial statements. In addition, we looked at illustrations that would help you appreciate in practical terms the presentation of published financial statements.
6.0 TUTOR MARKED ASSIGNMENT
1. The stock in the trial balance shows ₦7,000,000 and stock in additional information shows ₦16,000,000. What would be the value of stock in the balance sheet?

2. The format in which the final accounts of a limited liability company should be published in Nigeria is prescribed by what?

3. The salaries of accountants are classified under what expenses?

4. The commission of sales men are classified under what expenses?

7.0 REFERENCES/FURTHER READING

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


Nigerian Accounting Standard Board, Statement of Accounting Standard
1.0 INTRODUCTION

In this unit, you are introduced to SAS number 10 and 15 as a guide on the accounting policies and methods that should be followed by banks and non-bank financial institutions in the preparation of their financial statements.

These statements focus on three main areas of concern relating to the accounting practices which should be followed, namely:

(a) Income recognition
(b) Loss recognition and
(c) Balance sheet classification and disclosures in financial statements.

Banks include:

(a) Commercial and merchant banks (now merged under universal banking guidelines of CBN).
(b) Community banks.
(c) Development banks such as Bank of Industry and Federal Mortgage Bank.

Non-bank financial institutions include:

(a) Finance companies
(b) Bureaux de change
(c) Mortgage institutions
(d) Discount houses
(e) Stock broking firms
(f) Other capital market operators such as issuing houses, etc.
Banks and other financial institutions are also required to comply with the accounting requirements of Banks and Other Financial Institutions Act, 1991 (as amended), in preparing their financial statements.

2.0 OBJECTIVES
After studying this unit, you should be able to:
1. Identify the disclosure requirements for banks.
2. Identify the disclosure requirements for non-bank financial institutions.
3. Identify the accounting policies peculiar to banks
4. Solve questions relating to the presentation of published financial statements of banks.

3.0 MAIN CONTENT
3.1 DISCLOSURE REQUIREMENTS FOR BANKS
Banks: In addition to the disclosure requirements of SAS No 2- information to be disclosed in financial statements, banks should also disclose the following:

(a) Accounting policies in respect of identification and provision for losses of non-performing loans, nature of off-balance sheet engagements, such as letters of credits, bonds, guarantees, indemnities, acceptances, and trade related contingencies such as documentary credits and methods used to recognise income thereon.

(b) Income statements, stating each principal revenue item:
   1. Interest income, split between bank and non-bank sources.
   2. Interest expenses, split between bank and non-bank sources.
   3. Credit related fee income and expense.

A bank should not offset one item of revenue or expense by deducting it from another item of revenue or expense.

(c) Assets and liabilities in the balance sheets to be grouped according to their nature and listed in the order of their liquidity and maturity. Assets should start with cash and short-term funds while liabilities with loan stock.

(d) A maturity profile of risk assets and deposit liabilities classified into the following categories:
   Under 1 month
   1 – 3 months
   3 – 6 months
   6 – 12 months
   Over 12 months

   The above maturity profile should be based on the expected normal repayment periods of the assets and liabilities.

(e) The amount of provision for loan losses, segregated between principal and interest. Provision for losses of “off-balance sheet” engagements should be shown separately as component of other liabilities.

(f) An analysis of the movements in the various categories of loan loss provision should be disclosed.

(g) One item of asset or liability should not be offset by deducting another asset or liability unless a legal right of ‘set-off’ exists.

(h) An analysis of loans and advances between “performing” and “non-performing” loans.
(i) The nature and amount of contingencies and commitments arising from the “off balance sheet” engagements which the bank has undertaken and analysis between the different classes of contingencies. “off balance sheet” engagements should not form part of balance sheet totals.

(j) The major items that make up its “other assets” and “other liabilities” in the form of notes to the accounts.

3.2 DISCLOSURE REQUIREMENTS FOR NON-BANK FINANCIAL INSTITUTIONS (NBFIS)

In addition to the disclosure requirements of SAS No 2, all NBFIs should also disclose the following:

(a) Accounting policies in respect of:
   1. The methods and bases by which provisions for losses on loans or securities are made.
   2. The nature of “off-balance sheet” engagements and the method used to recognise income or loss thereon.

(b) Income statement to include all important revenue items and expenses as applicable to ‘NBFIs’.

(c) Grouping of assets and liabilities in the balance sheet according to their nature, liquidity and maturity.

(d) “off-balance sheet” engagements should not form part of balance sheet totals.

(e) A loan granting NBFI should disclose an analysis of the facilities given, distinguishing between “performing” and “non-performing”, and their maturity profiles.

Specific Requirements – NBFIs

In addition to the above disclosure requirements, all NBFIs should disclose the following, in their financial statements, as they relate to their specific activities:

(a) Brokers/Dealers
   1. Value of outstanding deliveries at the ruling market price.
   2. Value of share box load (that is, aggregate value of shares held in stock-broker’s portfolio) at the ruling market price.
   3. Investment profile- that is, the amount of money market/capital market assets of the company.
   4. Balances on clients’ accounts.

(b) Capital Market Underwriters should disclose: Value of securities underwritten but not yet disposed of, distinguished between “listed” and those awaiting listing.

(c) Discount Houses
   1. Deposits, split between call and term deposits, with their maturity profiles.
   2. Securities, analysed into treasury bills and certificates, other government securities and private sector securities.
   3. Deposits, split between call and term deposits, with their maturity profiles.

(d) Finance Houses
   1. Total value of placements with other finance houses with analysis of the period to maturity/period from maturity.
   2. Schedule of sectorial allocation of risk assets such as trade finance, lease, and money and capital market instruments.
   3. Breakdown of items that constitute “other assets” and “other liabilities”.

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(e) Bureaux De Change (BDC)

1. BDC establishments should treat their foreign currencies as stocks. The stock of foreign currencies as stocks. The stock of foreign currencies held at the balance sheet date should be valued at the lower of cost and market value.
2. Quantity and naira equivalent of the different foreign currencies traded in, during the period.
3. Value of foreign currencies held and conversion rates used at the balance sheet date.

(f) Mortgage Institutions

1. Total liabilities to National Housing Fund.
2. Total value of mortgage assets and movements thereon, showing:
   - Assets brought forward
   - Additions during the year/period
   - Disposals and realisations during the year
   - Balance carried forward.
3. Other sources of funds, apart from share capital and National Housing Fund.
4. Classification of mortgage loans receivable and mortgage backed securities into those for sale and those for long-term investments.
5. Detailed breakdown of servicing rights acquired during the year, stating the:
   - The amount capitalised;
   - The method of amortization; and
   - The amount amortized.

SELF ASSESSMENT EXERCISE
State what should be disclosed in the financial statements regarding finance houses and mortgage institutions

3.3 ACCOUNTING POLICIES PECULIAR TO BANKS

(a) Loans and Advances

Loan and advances are stated net of provision for doubtful debts. This provision is determined from a specific assessment of each customer’s account, in accordance with the prudential guidelines, as summarized below:

1. Credit facilities should be classified as either “performing” or “non-performing”.
2. A credit facility is deemed to be performing if payments of both principal and interest are up-to-date in accordance with the agreed terms.
3. A credit facility should be deemed as “non-performing when interest or principal is due and unpaid for 90 days or more.
4. “Non-performing credit” facilities should be classified into three categories, namely: sub-standard, doubtful or los on the following criteria:
   - Sub-standard- unpaid principal and/or interest remain outstanding for more than 90 days, but less than 180 days after due date. 10% provision is made for facilities in this category.
   - Doubtful- unpaid principal and/or interest which remain outstanding for at least 180 days, but less than 360 days, after due date and are not secured by legal title to lease assets or perfected realisable collateral in the process of collection or realisation. 50% provision is made for facilities in this category.

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Lost unpaid principal and/or interest which remain outstanding for 360 days or more and are not secured by legal title to leased assets or perfected realisable collateral in the course of collection or realization. 100% provision is made for facilities in this category.

5. A general provision of at least 1% is made on risk assets not specifically provided for.

6. Each microfinance bank is expected to review, at least once a month, its loans and advances, and make appropriate provisions for loan losses, as follows:

<table>
<thead>
<tr>
<th></th>
<th>Performing</th>
<th>1%</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Perform</td>
<td>1%</td>
</tr>
<tr>
<td>1 – 30 days</td>
<td>Pass and watch</td>
<td>5%</td>
</tr>
<tr>
<td>31 – 60 days</td>
<td>Substandard</td>
<td>20%</td>
</tr>
<tr>
<td>61 – 90 days</td>
<td>Doubtful</td>
<td>50%</td>
</tr>
<tr>
<td>91 or more days and / or restructured loans</td>
<td>Lost</td>
<td>100%</td>
</tr>
</tbody>
</table>

(b) Income Recognition
Interest income is recognised on accrual basis. Interest overdue for more than 90 days is suspended and recognised on cash basis only.

(c) Foreign Currency:
1. Transactions in foreign currencies are translated to naira at the rate of exchange ruling at the date of the transaction.
2. Balances in overseas branches are converted to naira at the rate of exchange ruling at the balance sheet date.

**SELF ASSESSMENT EXERCISE**
State how “non-performing” loan should be classified?

**3.4 FORMAT OF PUBLISHED FINANCIAL STATEMENT OF BANKS**

**ABC BANK PLC**

**PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 31 DECEMBER 2008**

<table>
<thead>
<tr>
<th>NOTE</th>
<th>2008</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross Earnings</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Interest expenses</td>
<td>(x)</td>
<td>(x)</td>
</tr>
<tr>
<td>Net income from operations</td>
<td>xx</td>
<td>xx</td>
</tr>
<tr>
<td>Operating expenses</td>
<td>(x)</td>
<td>(x)</td>
</tr>
<tr>
<td>Provision for risk assets</td>
<td>(x)</td>
<td>(x)</td>
</tr>
<tr>
<td>Depreciation</td>
<td>(xx)</td>
<td>(xx)</td>
</tr>
<tr>
<td>Profit before taxation</td>
<td>xxx</td>
<td>xxx</td>
</tr>
<tr>
<td>Taxation</td>
<td>(x)</td>
<td>(x)</td>
</tr>
<tr>
<td>Profit after taxation</td>
<td>xx</td>
<td>xx</td>
</tr>
</tbody>
</table>

**APPROPRIATIONS:**

<table>
<thead>
<tr>
<th></th>
<th>2008</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Transfer to Statutory reserve</td>
<td>(x)</td>
<td>(x)</td>
</tr>
<tr>
<td>Transfer to small scale industries Reserve</td>
<td>(x)</td>
<td>(x)</td>
</tr>
<tr>
<td>Proposed dividend</td>
<td>(x)</td>
<td>(x)</td>
</tr>
<tr>
<td>Retained profit for the year</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Transfer to general reserve</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Earnings per share (kobo)</td>
<td>x</td>
<td>x</td>
</tr>
</tbody>
</table>
### ABC BANK PLC

**BALANCE SHEET AS AT 31 DECEMBER 2008**

<table>
<thead>
<tr>
<th>ASSETS</th>
<th>NOTE</th>
<th>2008</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash and short-term funds</td>
<td>10</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Placements with other banks And financial institutions</td>
<td>11</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Bills discounted</td>
<td>12</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Other investments</td>
<td>13</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Loans and advances</td>
<td>14</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Advances under finance lease</td>
<td>15</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Other assets</td>
<td>16</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Equipment on lease</td>
<td>17</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Fixed assets</td>
<td>18</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Total assets</td>
<td>xx</td>
<td>xx</td>
<td></td>
</tr>
</tbody>
</table>

**Financed by:**

**Liabilities:**

| Deposits, current and other accounts      | 19   | x     | x     |
| Taxation                                  | 20   | x     | x     |
| Deferred Taxation                         | 21   | x     | x     |
| Other liabilities                         | 22   | x     | x     |
| Capital and Reserves:                     |     | xx    | xx    |
| Called-up share capital                   | 23   | x     | x     |
| Share premium                             | 24   | x     | x     |
| Statutory reserve                         | 25   | x     | x     |
| Small scale industries reserve            | 26   | x     | x     |
| Fixed assets revaluation surplus          | 27   | x     | x     |
| General reserve                           | 28   | x     | x     |
| Shareholders’ fund                        | xx   | xx    |
| Total liabilities                         | xx   | xx    |
| Acceptances and guarantees                 | 29   | x     | x     |

**FINANCIAL STATEMENTS OF BANKS**

**ILLUSTRATION 5**

The following balances were extracted from the books of Reliable Bank Plc as at 31 March, 2008:

<table>
<thead>
<tr>
<th></th>
<th>₦’000</th>
<th>₦’000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Land and building</td>
<td>322,850</td>
<td></td>
</tr>
<tr>
<td>Plant and machinery</td>
<td>183,000</td>
<td></td>
</tr>
<tr>
<td>Motor vehicles</td>
<td>120,000</td>
<td></td>
</tr>
<tr>
<td>Furniture &amp; fittings</td>
<td>118,500</td>
<td></td>
</tr>
<tr>
<td>Computer equipment</td>
<td>325,000</td>
<td></td>
</tr>
<tr>
<td>Accumulated depreciation:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Building</td>
<td>99,020</td>
<td></td>
</tr>
<tr>
<td>Plant and machinery</td>
<td>80,710</td>
<td></td>
</tr>
<tr>
<td>Motor vehicle</td>
<td>30,930</td>
<td></td>
</tr>
<tr>
<td>Furniture</td>
<td>55,360</td>
<td></td>
</tr>
<tr>
<td>Description</td>
<td>Amount</td>
<td></td>
</tr>
<tr>
<td>----------------------------------------------------------</td>
<td>----------</td>
<td></td>
</tr>
<tr>
<td>Computer equipment</td>
<td>31,540</td>
<td></td>
</tr>
<tr>
<td>Interest paid on call money</td>
<td>172,350</td>
<td></td>
</tr>
<tr>
<td>Interest on staff current accounts</td>
<td>68,270</td>
<td></td>
</tr>
<tr>
<td>Interest on short term fixed deposits</td>
<td>393,550</td>
<td></td>
</tr>
<tr>
<td>Interest on savings accounts</td>
<td>98,820</td>
<td></td>
</tr>
<tr>
<td>Interest on sundry operations</td>
<td>10,800</td>
<td></td>
</tr>
<tr>
<td>Bad debts</td>
<td>39,250</td>
<td></td>
</tr>
<tr>
<td>Salaries &amp; allowances</td>
<td>521,400</td>
<td></td>
</tr>
<tr>
<td>General statutory expenses</td>
<td>143,240</td>
<td></td>
</tr>
<tr>
<td>Computer stationery expenses</td>
<td>204,140</td>
<td></td>
</tr>
<tr>
<td>Printing of cheque booklets</td>
<td>62,100</td>
<td></td>
</tr>
<tr>
<td>Legal fees</td>
<td>3,710</td>
<td></td>
</tr>
<tr>
<td>Transport &amp; travelling expenses</td>
<td>38,960</td>
<td></td>
</tr>
<tr>
<td>Advertisement &amp; public relations</td>
<td>89,330</td>
<td></td>
</tr>
<tr>
<td>Deposit insurance</td>
<td>124,840</td>
<td></td>
</tr>
<tr>
<td>Property insurance</td>
<td>39,720</td>
<td></td>
</tr>
<tr>
<td>Loans &amp; advances</td>
<td>3,682,630</td>
<td></td>
</tr>
<tr>
<td>Social insurance charges</td>
<td>14,990</td>
<td></td>
</tr>
<tr>
<td>Suspense account</td>
<td>210,610</td>
<td></td>
</tr>
<tr>
<td>Investment in debenture stocks</td>
<td>350,000</td>
<td></td>
</tr>
<tr>
<td>Investment in commercial papers</td>
<td>210,000</td>
<td></td>
</tr>
<tr>
<td>Investment in associated company</td>
<td>623,350</td>
<td></td>
</tr>
<tr>
<td>Cash in hand</td>
<td>112,300</td>
<td></td>
</tr>
<tr>
<td>CBN current account</td>
<td>3,958,390</td>
<td></td>
</tr>
<tr>
<td>Cash reserve at CBN</td>
<td>1,500,000</td>
<td></td>
</tr>
<tr>
<td>Foreign bank current account</td>
<td>5,500,000</td>
<td></td>
</tr>
<tr>
<td>Call money with local banks</td>
<td>4,113,500</td>
<td></td>
</tr>
<tr>
<td>Treasury bills</td>
<td>220,000</td>
<td></td>
</tr>
<tr>
<td>CBN stabilization securities</td>
<td>193,460</td>
<td></td>
</tr>
<tr>
<td>Ordinary share capital of N1 per share</td>
<td>2,200,000</td>
<td></td>
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<tr>
<td>Reserve for bonus issue</td>
<td>2,800,000</td>
<td></td>
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<tr>
<td>Profit and loss account</td>
<td>750,660</td>
<td></td>
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<tr>
<td>Statutory reserve</td>
<td>812,210</td>
<td></td>
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<tr>
<td>Small-scale industry reserve</td>
<td>220,500</td>
<td></td>
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<tr>
<td>Domiciliary account</td>
<td>5,837,250</td>
<td></td>
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<tr>
<td>Customers deposits for foreign currencies</td>
<td>217,300</td>
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</tr>
<tr>
<td>Savings account balances</td>
<td>1,385,330</td>
<td></td>
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<tr>
<td>Current account balances</td>
<td>3,285,140</td>
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<td>Deposit account balances</td>
<td>621,350</td>
<td></td>
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<td>Call money with local balances</td>
<td>1,428,840</td>
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</tr>
<tr>
<td>Company income tax over-provision</td>
<td>2,360</td>
<td></td>
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<tr>
<td>Deferred taxation</td>
<td>2,000</td>
<td></td>
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<tr>
<td>Interest on treasury bills</td>
<td>681,600</td>
<td></td>
</tr>
<tr>
<td>Interest on call money</td>
<td>896,020</td>
<td></td>
</tr>
<tr>
<td>Interest on discounted bills</td>
<td>153,890</td>
<td></td>
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<tr>
<td>Interest on advance and overdraft</td>
<td>1,004,120</td>
<td></td>
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<tr>
<td>Commission on discounted bill</td>
<td>28,130</td>
<td></td>
</tr>
<tr>
<td>Commission on bill collected</td>
<td>4,930</td>
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<tr>
<td>Commission on turnover</td>
<td>107,090</td>
<td></td>
</tr>
<tr>
<td>Commission on guarantee/bonuses</td>
<td>6,580</td>
<td></td>
</tr>
<tr>
<td>Commission on NITEL bills collected</td>
<td>2,210</td>
<td></td>
</tr>
</tbody>
</table>
Forex earnings 650,540
Other sundry income 111,710
Interest suspense account 3,720
Bad debts recovered 78,610
Provision for bad and doubtful debts 179,410

The following additional information was provided:
1. Loans and advances were made up of: ₦'000
   - Loans secured against real estate 1,120,650
   - Otherwise secured 1,641,320
   - Unsecured 920,660
   - Total 3,682,630

2. Performance of loans and advances are analysed as follows:
   - Performing loans 70.5%
   - Sub-standard facilities 21.0%
   - Doubtful facilities 8.0%
   - Lost facilities 0.5%
   - Total 100%

   Provision for bad and doubtful debts should be made on loans and advances in accordance with the provisions of the prudential guidelines.

3. Salaries and allowances include directors' emolument of ₦25 million.

4. The balance on reserves for bonus issue should be transferred to ordinary share capital account.

5. Make the necessary transfers to statutory and small-scale industries reserve.

6. A dividend of 12 kobo per share should be paid, based on the new share capital.

7. Accruals include the following:
   - Legal fees – ₦2,290,000
   - Audit fees – ₦12,000,000

8. Fixed assets are to be depreciated, applying the following rates:
   - Building – 2%
   - Plant & machinery – 10%
   - Motor Vehicles – 20%
   - Furniture & fittings – 12%
   - Computer equipment – 15%

9. A provision of ₦330,640,000 should be made in the profit and loss account to cover companies income and education taxes while ₦20 million should be set aside for deferred tax.

10. ₦5 million out of interest on loans and advances should be transferred to suspense account.

You are required to prepare the company’s profit and loss account for the year ended 31 March 2008 and balance sheet as at that date, in a form suitable for publication.
Interests income                                                                  1                                2,730,630
Less: interest expenses                                                           2                                743,790
Net interest income                                                              1,986,840
Provision for risk assets                                                          3                                (50,250)
1,936,590
Other income                                                                      4                                911,190
Operating income                                                                 4                                2,847,780
Operating expenses (w1)                                                           5                                (1,368,450)
Profit on ordinary activities before tax                                        5                                1,479,330
Tax on profit on ordinary activities                                              6                                (348,280)
Profit on ordinary activities after tax                                            1,131,050
Appropriations:
Transfer to statutory reserve (30% x N1,131,050)                                 7                                339,315
Transfer to small-scale industries reserve                                       8                                147,933
Proposed dividend (5,000,000,000 x 12 kobo)                                       9                                600,000
1,087,248
Retained profit transferred to general reserve                                    10                               43,802
1,131,050
Earnings per share (adjusted)                                                     11                               22 kobo
Dividend per share                                                               12                               12 kobo

RELIABLE BANK PLC
BALANCE SHEET AS AT 31 MARCH 2008

ASSETS
NOTE  ₦’000
Cash and short-term funds         11   15,597,650
Investments                        12   1,183,350
Loans and advances                13   3,404,890
Other assets                       14   210,610
Fixed assets                       15   660,060
Total assets                      21   21,056,560

LIABILITIES

Deposits and other customers’ accounts  16   12,775,210
Other liabilities                  17   944,930
Deferred taxation                  18   22,000
13,742,140
CAPITAL AND RESERVES:
Authorized and issued share capital  18   5,000,000
Statutory reserve                  7    1,151,525
Small-scale industries reserve     8    368,433
General reserve                    19    794,462
Shareholders’ fund                 (b)   7,314,420
(a + b)                            21,056,560

NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2004

1. Interest income: ₦’000
   Advances and overdrafts           1,004,120
   Treasury bills                   681,600
   Call money                       896,020
   Discounted bills                 153,890

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2. Interest expense:
   - Call money: 172,350
   - Staff current account: 68,270
   - Short-term fixed deposits: 393,550
   - Savings accounts: 98,820
   - Sundry operations: 10,800
   Total interest expense: 743,790

3. Provision for risk assets:
   - Performing (1% x 70.5% x N3,682,630): 25,960
   - Sub-standard (10% x 21% x N3,682,630): 77,340
   - Doubtful (50% x 8% x N3,682,630): 147,310
   - Lost (100% x 0.5% x N3,682,630): 18,410
   Total provision: 269,020

   Old provision brought forward: (179,410)
   Increase in provision for the year: 89,610
   Add: bad debts written off: 39,250
   Less: recoveries during the year: (78,610)
   For P&L a/c: 50,250

4. Other income:
   - Commission on turnover: 107,090
   - Commission on discounted bills: 28,130
   - Commission on bills collected: 4,930
   - Commission on guarantees & bonds: 6,580
   - Commission on NITEL bills collected: 2,210
   - Foreign exchange earnings: 650,540
   - Other sundry income: 111,710
   Total other income: 911,190

5. Profit before tax is stated after charging:
   - Directors’ emolument: 25,000
   - Auditors’ remuneration: 12,000
   - Insurance premium on deposit liabilities: 124,840
   - Depreciation of fixed assets: 111,730
   Total profit before tax: 318,800

6. Taxation:
   - Company income & education taxes
     Based on profit for the year: 330,640
     Less: over-provision in previous year: 2,360
     Total tax: 328,280
     Add: deferred tax provision: 20,000
     Total tax: 348,280

7. Statutory reserve:
   - Balance brought forward: 812,210
   - Transfer from profit & loss account: 339,315
   Total statutory reserve: 1,151,520
Per balance sheet $1,151,525

8. Small scale industries reserve:
   Balance brought forward $220,500
   Transfer from profit and loss account $147,933
   Per balance sheet $368,433

9. Proposed dividend:
   The dividend proposed is 12 kobo per share, for 5 billion ordinary shares issued.

10. Earnings per share:
    Earnings per share is calculated using profit after tax for the year on the 5 billion ordinary shares issued as at 31 March 2008.

11. Cash and short-term funds (₦'000)
   - Cash in hand 112,300
   - CBN current account 3,958,390
   - Cash reserve at CBN 1,500,000
   - Foreign bank current account 5,500,000
   - Call money with local bank 4,113,500
   - Treasury bills 220,000
   - CBN stabilization securities 193,460
   **Total** $15,597,650

12. Investments:
    - Debenture stocks 350,000
    - Commercial papers 210,000
    - Associated company 623,350
    **Total** $1,183,350

13. Loans and advances
    (i) Analysis by securities and quality
        - Secured against real estate 1,120,650
        - Otherwise secured 1,641,320
        - Unsecured 920,660
        **Total** $3,682,630

        Less: provision for
        - Doubtful accounts (note 3) 269,020
        **Total** $3,413,610

        Less: interest in suspense N(3,720 + 5,000) 8,720
        **Total** $3,404,890

    (ii) Analysis by performance:
        Performing 2,596,254

        Non-performing: N
        - Sub-standard 773,352
        - Doubtful 294,610
        - Lost 18,414

54
14. Other assets

Suspense Account 210,610

15. Fixed Assets

<table>
<thead>
<tr>
<th></th>
<th>Land &amp; Building</th>
<th>Plant &amp; Machinery</th>
<th>Motor vehicle</th>
<th>Furniture &amp; fittings</th>
<th>Computer equipment</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost:</td>
<td>₦’000</td>
<td>₦’000</td>
<td>₦’000</td>
<td>₦’000</td>
<td>₦’000</td>
<td>₦’000</td>
</tr>
<tr>
<td>At 1/4/2007</td>
<td>322,850</td>
<td>183,000</td>
<td>120,000</td>
<td>118,500</td>
<td>325,000</td>
<td>1,069,350</td>
</tr>
<tr>
<td>Additions</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Disposals</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>At 31/03/2008 (a)</td>
<td>322,850</td>
<td>183,000</td>
<td>120,000</td>
<td>118,500</td>
<td>325,000</td>
<td>1,069,350</td>
</tr>
</tbody>
</table>

Depreciation:

|                      | ₦’000           | ₦’000             | ₦’000         | ₦’000                | ₦’000             | ₦’000       |
| Charge for the year  | 6,460           | 18,300            | 24,000        | 14,220               | 48,750            | 111,730     |
| At 31/03/2008 (b)    | 105,480         | 99,010            | 54,930        | 69,580               | 80,290            | 409,290     |

Net book value:

|                      | ₦’000           | ₦’000             | ₦’000         | ₦’000                | ₦’000             | ₦’000       |
| At 31/03/2008 (a – b)| 217,370         | 83,990            | 65,070        | 48,920               | 244,710           | 660,060     |

16. Deposits

<table>
<thead>
<tr>
<th></th>
<th>₦’000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Savings accounts</td>
<td>1,385,330</td>
</tr>
<tr>
<td>Current accounts</td>
<td>3,285,140</td>
</tr>
<tr>
<td>Deposit accounts</td>
<td>621,350</td>
</tr>
<tr>
<td>Deposits for foreign currencies</td>
<td>217,300</td>
</tr>
<tr>
<td>Call money from local bank</td>
<td>1,428,840</td>
</tr>
<tr>
<td>Domiciliary accounts</td>
<td>5,837,250</td>
</tr>
<tr>
<td></td>
<td>12,775,210</td>
</tr>
</tbody>
</table>

17. Other liabilities

<table>
<thead>
<tr>
<th></th>
<th>₦’000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accrued charges N(12,000 – 2,290)</td>
<td>14,290</td>
</tr>
<tr>
<td>Tax payable</td>
<td>330,640</td>
</tr>
<tr>
<td>Proposed dividend</td>
<td>600,000</td>
</tr>
<tr>
<td></td>
<td>944,930</td>
</tr>
</tbody>
</table>

18. Authorized and issued share capital:

(a) At April, 2007

2,200,000,000 ordinary shares of N1 each 2,200,000
Bonus issue: transfer from bonus issue reserve
2,800,000,000 ordinary shares of N1 each 2,800,000
5,000,000

(b) Bonus issue reserve:

Balance brought forward 2,800,000
Transfer to issued share capital (2,800,000) 0

19. General reserve:

<table>
<thead>
<tr>
<th></th>
<th>₦’000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance brought forward</td>
<td>750,660</td>
</tr>
<tr>
<td>Transfer from profit and loss account</td>
<td>43,802</td>
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</tbody>
</table>

55
WORKINGS
1. Operating expenses comprises: ₦’000
   Legal fees (3,710 + 2,290) 6,000
   Audit fees 12,000
   Depreciation 111,730
   Salaries and allowances 521,400
   General stationery expenses 143,240
   Computer stationery expenses 204,140
   Printing of cheque booklets 62,100
   Transport & travelling expenses 38,960
   Advertisement & public relations 89,330
   Deposit insurance 124,840
   Property insurance 39,720
   Social insurance charges 14,990
   1,368,450

SELF ASSESSMENT EXERCISE
After studying the above illustration, solve the same questions without looking at the solution and compare your answers to the solutions of these questions.

4.0 CONCLUSION
We shall conclude the unit by stating that the Nigerian Financial System comprises of bank and non-bank financial institutions which are regulated by the Federal Ministry of Finance, Central Bank of Nigeria, Nigeria Deposit Insurance Corporation, Security and Exchange Commission, Federal Mortgage Bank of Nigeria and the National Board for Community Banks.

5.0 SUMMARY
In this unit, we discussed the disclosure requirements for banks and non-bank financial institutions. We also discussed the accounting policies peculiar to banks. And finally, we observe the format of published financial statements of a banks and show illustrations of how such format is presented.

6.0 TUTOR MARKED ASSIGNMENT
1. One item of asset or liability should not be offset by deducting another asset or liability unless a _______ exists.
2. _______ engagements should not form part of balance sheet totals.
3. A loan granting NBFI should disclose an analysis of the facilities given, distinguishing between “performing” and “non-performing”, and their ________

7.0 REFERENCES/FURTHER READING
1.0 INTRODUCTION
SAS No 16 establishes financial accounting and reporting standards for the financial statements of non-life and life assurance undertakings. This standard is applicable to only financial statements prepared in accordance with the provisions of the Insurance Act 2003 and CAMA 2004.

Classification of Insurance Business

(a) General Insurance Business: This is also referred to as non-life business. It indemnifies the policy holder against losses, which may result from occurrence of events within specified periods covered by the contracts.

(b) Life Assurance Business: It is an insurance business in which the benefits due to the policy holder become payable on the attainment of a stipulated age, at death or on the occurrence of a specified event. It is a long-term insurance business.

2.0 OBJECTIVES
After studying this unit, you should be able to:

1. Identify the provision of SAS 16 as it relates with general insurance and life assurance business.
2. Discuss the accounting policies peculiar to insurance companies.
3. Note the format of published financial statements of insurance companies.
4. Discuss abridged financial statements

3.0 MAIN CONTENT
3.1 GENERAL INSURANCE BUSINESS

Basis of Accounting
There are several bases of accounting for insurance transactions. However, three bases commonly adopted are as follows:

(a) Annual Accounting: This is used where it is possible to determine the underwriting result of an insurance business written in an accounting period at the end of that period. The underwriting results that are disclosed in the financial statements, under this basis, usually include the result of the current accounting period and adjustments, if any, made to estimates used in determining results of the previous accounting period.

(b) Deferred Annual: This is adopted where it is not possible to determine the underwriting result of an insurance business until the following accounting period.

(c) Fund Accounting: This is adopted where it takes a long time to determine the underwriting result with a reasonable degree of certainty. Under this basis, a fund is created for each underwriting year. Premiums or business written during the year and the related claims or expenses are posted to the fund. The fund for each underwriting year will remain open until there is enough information to determine the underwriting result. No profit is recognized for ‘open years’ but provision is usually made for any anticipated losses.

General Business

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

(b) Disclosure Requirements
In addition to the disclosure requirement of SAS No 2, general insurers should disclose the following:
1. Revenue Account:
   - Gross income
   - Direct premiums
   - Inward re-insurance premiums
   - Gross written premiums
   - Net written premiums
   - Decreased in provision for unexpired risks, and
   - Commission received
2. Deductions from income:
   - Outward re-insurance premium, and
   - Increase in provision for unexpired risks.
3. Expenses
   - Direct claims paid
Inward re-insurance claims paid
Increase in provision for outstanding claims

4. Recoveries from expenses
   - Outward re-insurance recoveries, and
   - Decrease in provision for outstanding claim

5. Underwriting expenses
   - Acquisition; and
   - Maintenance
   Outward re-insurance expenses should be reported separately as a deduction from premium revenue, while re-insurance and other recoveries should be reported separately as a deduction from claims expense.

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

   **Income**
   - Gross written premiums
   - Outward re-insurance premiums
   - Earned premiums
   - Net investment income
   - Commissions received

   **Expense**
   - Underwriting expenses
   - Claims incurred
   - Management expenses
   - Provision for bad and doubtful debts.

7. 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 captions:

   **Assets**
   - Cash and bank balances
   - Short-term investments
   - Debtors & prepayments
   - Deferred acquisition expense
   - Long-term investments
   - Statutory deposits
   - Fixed assets

   **Liabilities**
   - Creditors and accruals
• Insurance funds (including provision for unearned premiums, outstanding claims and unexpired risks).

Shareholders’ fund

• Authorised and issued share capital
• Statutory contingency reserves
• Capital reserve
• General reserve

SELF ASSESSMENT EXERCISE
Mention and explain three bases of accounting for insurance transactions

3.2 LIFE ASSURANCE BUSINESS
Life assurance business transactions should be accounted for on the fund accounting basis.

Disclosure requirements

In addition to the disclosure requirements of SAS No 2, life assurers should disclose the following:

(a) Revenue account
1. Income:
   • Direct premiums;
   • Inward re-insurance premiums
   • Gross written premiums
   • Net written premiums
   • Commission received.
2. Deduction from income
   • Outward re-insurance premiums
3. Claims incurred
   • Direct claims
   • Inward re-insurance claims
   • Re-insurance recoveries
   • Surrenders
4. Underwriting expenses
   • Acquisition
   • Maintenance.

(b) Profit and loss account
The following should be disclosed in the profit and loss account, unless they have been disclosed in the revenue account:
1. Income:
   • Gross written premiums
   • Earned premiums
   • Net investment income
   • Commission received
   • Shareholders’ portion of life assurance surplus/deficit
   • Other income
2. Deductions from income
   - Outward re-insurance premiums

3. Expenses:
   - Claims incurred;
   - Underwriting expenses;
   - Management expenses;
   - Provision for bad and doubtful debts.

(c) Balance sheet
   Balance sheet items should be arranged in the order of liquidity to include the following:
   Assets:
   - Cash and bank balances
   - Short-term investments
   - Debtors & prepayments
   - Loans to policy holders
   - Long-term investments
   - Statutory deposit
   - Fixed assets.

Liabilities:
   - Creditors and accruals.
   - Outstanding claims;
   - Insurance fund;
   - Deposit administration.

Shareholders' fund:
   - Called-up share capital;
   - Statutory contingency reserves;
   - General reserves;
   - Retained earnings/accumulated losses.

Composite Business (Life and General)

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

SELF ASSESSMENT EXERCISE
What should be disclosed under revenue in life assurance financial statement?

3.3 ACCOUNTING POLICIES PECULIAR TO INSURANCE COMPANIES
(a) Investment income:
   Credit is taken for all dividends when received while interest receivable on unquoted investments are credited to income when due for payment. Interests on doubtful investments are not credited to the profit & loss account until the investments are realised.
(b) Statutory reserves:
1. Reserve for unexpired risks:
   In accordance with the Insurance Act, 2003, the reserve for unexpired risk for all the classes of general business is provided at the rate of 45% of net premium.

2. Outstanding claims:
   Provision is made for the expected loss to the company up to the date of the balance sheet, plus additional provision of 10% of net outstanding claims, in accordance with Insurance Act, 2003.

3. Contingency reserve:
   The reserve is calculated in accordance with the insurance Act, 2003 at the higher of 3% of total premium or 20% of the net profit.

4. General reserve for life business:
   General reserve is calculated as the net liabilities on policies in force at the time of the actuarial valuation.

5. Contingency reserve for life business:
   The reserve is calculated in accordance with the Insurance Act, 2003, at the higher of 1% of gross premium or 10% of net profit.

Agents/Brokers Balances

Agents/Brokers balances are stated net of commissions after deduction of provision for debts considered to be doubtful of collection.

**SELF ASSESSMENT EXERCISE**

State and explain the peculiar accounting policies of the insurance companies

**3.4 FORMATS OF PUBLISHED FINANCIAL STATEMENTS OF INSURANCE COMPANIES**

**EFG INSURANCE PLC**

**COMPANY BALANCE SHEET AS AT 31 DECEMBER 2008**

<table>
<thead>
<tr>
<th>ASSETS</th>
<th>NOTE</th>
<th>2008</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash and bank balances</td>
<td>x</td>
<td>₦</td>
<td>₦</td>
</tr>
<tr>
<td>Short-term investments</td>
<td>1</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Debtors and prepayments</td>
<td>2</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Loans to policy holders</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Long term investments</td>
<td>3</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Statutory deposit</td>
<td>4</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Fixed assets</td>
<td>5</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td><strong>TOTAL ASSETS</strong></td>
<td></td>
<td>(a)</td>
<td>(a)</td>
</tr>
</tbody>
</table>

| Liabilities:               |      |      |      |
| Creditors and accruals     | 6    | x    | x    |
| Outstanding claims         | 7    | x    | x    |
| Insurance fund             | 8    | x    | x    |
| Taxation                   | 9    | x    | x    |
| Deferred taxation          | 10   | x    | x    |
| Dividend payable           | 11   | x    | x    |
| **Total liabilities**      | (b)  | xx   | xx   |

**Net assets** (a – b) x x

**Financed by:**

**CAPITAL AND RESERVES:**
**EFG INSURANCE PLC**  
**BALANCE SHEET FOR LIFE BUSINESS AS AT 31 DECEMBER 2008**

<table>
<thead>
<tr>
<th>Note</th>
<th>2008</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>ASSETS</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash and bank balances</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Short term investments</td>
<td>1</td>
<td>x</td>
</tr>
<tr>
<td>Debtors and prepayments</td>
<td>2</td>
<td>x</td>
</tr>
<tr>
<td>Loans to policy holders</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Long term investments</td>
<td>3</td>
<td>x</td>
</tr>
<tr>
<td>Statutory deposit</td>
<td>4</td>
<td>x</td>
</tr>
<tr>
<td>Fixed assets</td>
<td>5</td>
<td>x</td>
</tr>
<tr>
<td>Total Assets (a)</td>
<td>xxx</td>
<td>xxx</td>
</tr>
<tr>
<td><strong>Liabilities:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Creditors and accruals</td>
<td>6</td>
<td>x</td>
</tr>
<tr>
<td>Outstanding claims</td>
<td>7</td>
<td>x</td>
</tr>
<tr>
<td>Insurance fund</td>
<td>8</td>
<td>x</td>
</tr>
<tr>
<td>Taxation</td>
<td>9</td>
<td>x</td>
</tr>
<tr>
<td>Deferred taxation</td>
<td>10</td>
<td>x</td>
</tr>
<tr>
<td>Dividend payable</td>
<td>11</td>
<td>x</td>
</tr>
<tr>
<td>Total liabilities (b)</td>
<td>xx</td>
<td>xx</td>
</tr>
<tr>
<td><strong>Net Assets</strong> (a – b)</td>
<td>x</td>
<td>x</td>
</tr>
</tbody>
</table>

**Financed by:**

**Capital and reserves:**

<table>
<thead>
<tr>
<th></th>
<th>2008</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Called-up share capital</td>
<td>12</td>
<td>x</td>
</tr>
<tr>
<td>Share premium</td>
<td>13</td>
<td>x</td>
</tr>
<tr>
<td>Contingency reserve</td>
<td>14</td>
<td>x</td>
</tr>
<tr>
<td>Fixed assets revaluation reserve</td>
<td>15</td>
<td>x</td>
</tr>
<tr>
<td>Quoted investment revaluation reserve</td>
<td>16</td>
<td>x</td>
</tr>
<tr>
<td>General reserve</td>
<td>17</td>
<td>x</td>
</tr>
<tr>
<td>Shareholders’ funds</td>
<td>x</td>
<td>x</td>
</tr>
</tbody>
</table>

**EFG INSURANCE PLC**  
**COMPANY PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 31 DECEMBER 2008**

<table>
<thead>
<tr>
<th>Note</th>
<th>2008</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Premium</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Deposit</td>
<td>18</td>
<td>x</td>
</tr>
<tr>
<td>Investment and other income</td>
<td>19</td>
<td>x</td>
</tr>
<tr>
<td>Re-insurance</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Maturities, surrenders and bonuses</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Claims paid and admitted</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Description</td>
<td>2008</td>
<td>2007</td>
</tr>
<tr>
<td>----------------------------------------------------------------------------</td>
<td>------</td>
<td>------</td>
</tr>
<tr>
<td>Premium</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Life-re-insurance</td>
<td>(x)</td>
<td>(x)</td>
</tr>
<tr>
<td>less: direct expenses</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Claims paid</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Maturities, surrenders &amp; bonuses</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Commission</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other direct expenses</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Increase/(decrease) in insurance fund</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Increase/(decrease) in outstanding claims</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Transfer to profit and loss account</td>
<td>x</td>
<td>x</td>
</tr>
</tbody>
</table>

**NON-LIFE REVENUE ACCOUNT FOR THE YEAR ENDED DECEMBER 2008**

<table>
<thead>
<tr>
<th>Description</th>
<th>2008</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross premium</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Outward re-insurance</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Net premium</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Commission received</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Direct expenses:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Claims paid less:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Increase/(decrease) in</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Unexpired premium</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Increase/(decrease) in</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Outstanding claims res.</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Commission paid</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Other direct expenses</td>
<td>x</td>
<td>x</td>
</tr>
</tbody>
</table>

65
ILLUSTRATION 6

NORTH-SOUTH ASSURANCE PLC is a company in the Non-life insurance business with authorised ordinary share capital of ₦80 million. The following balances were extracted from its ledger as at 31 December 2008.

<table>
<thead>
<tr>
<th>Account</th>
<th>₦’000</th>
<th>₦’000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ordinary share capital of N1 per share</td>
<td>80,000</td>
<td></td>
</tr>
<tr>
<td>General reserve</td>
<td>3,625</td>
<td></td>
</tr>
<tr>
<td>Contingency reserve at 1/1/2008</td>
<td>11,287.5</td>
<td></td>
</tr>
<tr>
<td>Reserve for outstanding claims at 1/1/2008</td>
<td>14,017.7</td>
<td></td>
</tr>
<tr>
<td>Premium</td>
<td>69,432</td>
<td></td>
</tr>
<tr>
<td>Re-insurance premium</td>
<td>5,000</td>
<td></td>
</tr>
<tr>
<td>Claims</td>
<td>23,007.25</td>
<td></td>
</tr>
<tr>
<td>Investment income</td>
<td>4,356.5</td>
<td></td>
</tr>
<tr>
<td>Interest on loan granted</td>
<td>6,258.84</td>
<td></td>
</tr>
<tr>
<td>Sundry income</td>
<td>5,238.62</td>
<td></td>
</tr>
<tr>
<td>Premium</td>
<td>69,432</td>
<td></td>
</tr>
<tr>
<td>Balances due from/to agents</td>
<td>14,178.97</td>
<td></td>
</tr>
<tr>
<td>Commission receivable</td>
<td>12,459.67</td>
<td></td>
</tr>
<tr>
<td>Provision for bad debts</td>
<td>4,366.50</td>
<td></td>
</tr>
<tr>
<td>Property at cost</td>
<td>14,000</td>
<td></td>
</tr>
<tr>
<td>Provision for depreciation on property</td>
<td>4,500</td>
<td></td>
</tr>
<tr>
<td>Audit fees</td>
<td>535</td>
<td></td>
</tr>
<tr>
<td>Actuary consulting fees</td>
<td>2,358</td>
<td></td>
</tr>
<tr>
<td>Commission paid</td>
<td>4,221.50</td>
<td></td>
</tr>
<tr>
<td>Advertising &amp; publicity</td>
<td>2,500</td>
<td></td>
</tr>
<tr>
<td>Entertainment</td>
<td>900</td>
<td></td>
</tr>
<tr>
<td>Vehicle running expenses</td>
<td>1,850</td>
<td></td>
</tr>
<tr>
<td>Electricity</td>
<td>625</td>
<td></td>
</tr>
<tr>
<td>Telephone &amp; postages</td>
<td>489</td>
<td></td>
</tr>
<tr>
<td>Rent &amp; rates</td>
<td>2,356</td>
<td></td>
</tr>
<tr>
<td>Salaries &amp; wages</td>
<td>5,487.25</td>
<td></td>
</tr>
<tr>
<td>Transport &amp; travelling</td>
<td>1,625</td>
<td></td>
</tr>
<tr>
<td>Repairs &amp; renewals</td>
<td>875</td>
<td></td>
</tr>
<tr>
<td>Statutory deposit</td>
<td>25,000</td>
<td></td>
</tr>
<tr>
<td>Directors’ fees &amp; expenses</td>
<td>1,978</td>
<td></td>
</tr>
<tr>
<td>Depreciation</td>
<td>842</td>
<td></td>
</tr>
<tr>
<td>Legal &amp; other professional fees</td>
<td>3,475</td>
<td></td>
</tr>
<tr>
<td>Staff pension</td>
<td>1,658</td>
<td></td>
</tr>
<tr>
<td>Federal Govt. Development stock</td>
<td>23,781.2</td>
<td></td>
</tr>
<tr>
<td>Treasury bills &amp; certificates</td>
<td>15,000</td>
<td></td>
</tr>
<tr>
<td>Cash at bank</td>
<td>8,725</td>
<td></td>
</tr>
<tr>
<td>Loans on policies</td>
<td>65,005</td>
<td></td>
</tr>
<tr>
<td></td>
<td>225,472.17</td>
<td>225,472.17</td>
</tr>
</tbody>
</table>

The following additional information are provided:

1. The estimated income tax liability of ₦2.5 million is to be provided for on the profit of the year.
2. The following analysis was provided:

<table>
<thead>
<tr>
<th></th>
<th>Fire</th>
<th>Motor</th>
<th>General Accident</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Claims</strong></td>
<td>6,258,000</td>
<td>10,257,000</td>
<td>6,492,250</td>
<td>23,007,250</td>
</tr>
<tr>
<td><strong>Premiums</strong></td>
<td>20,844,380</td>
<td>34,855,890</td>
<td>13,731,730</td>
<td>69,432,000</td>
</tr>
<tr>
<td><strong>Agent commission</strong></td>
<td>875,500</td>
<td>2,316,000</td>
<td>1,030,000</td>
<td>4,221,500</td>
</tr>
<tr>
<td><strong>Re-insurance premium</strong></td>
<td>1,492,540</td>
<td>2,537,310</td>
<td>970,150</td>
<td>5,000,000</td>
</tr>
<tr>
<td><strong>Commission receivable</strong></td>
<td>2,624,710</td>
<td>5,621,380</td>
<td>4,213,580</td>
<td>12,459,670</td>
</tr>
<tr>
<td><strong>Outstanding reserves- 31/12/2008:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Contingency</strong></td>
<td>3,624,000</td>
<td>5,682,120</td>
<td>1,981,380</td>
<td>11,287,500</td>
</tr>
<tr>
<td><strong>Outstanding claims</strong></td>
<td>855,600</td>
<td>1,382,520</td>
<td>1,008,480</td>
<td>3,246,600</td>
</tr>
<tr>
<td><strong>Unexpired risk</strong></td>
<td>3,726,700</td>
<td>7,580,600</td>
<td>2,710,400</td>
<td>14,017,700</td>
</tr>
</tbody>
</table>

3. Provision for bad debts is to be increased to ₦7,641,300.
4. Unallocated management expenses to be apportioned on the basis of premium received.
5. Dividend of 10K per ordinary share is proposed on the ordinary share capital.
6. The following transfers are to be made:

<table>
<thead>
<tr>
<th></th>
<th>Fire</th>
<th>Motor</th>
<th>General Accident</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Contingency</strong></td>
<td>1,875,000</td>
<td>3,724,500</td>
<td>824,000</td>
<td>6,423,500</td>
</tr>
<tr>
<td><strong>Outstanding claims</strong></td>
<td>245,050</td>
<td>423,150</td>
<td>203,800</td>
<td>872,000</td>
</tr>
<tr>
<td><strong>Unexpired risks</strong></td>
<td>1,872,000</td>
<td>2,650,050</td>
<td>898,000</td>
<td>5,420,050</td>
</tr>
</tbody>
</table>

Required:
Prepare profit and loss account for the year ended 31 December 2008 and a balance sheet as at that date in a form suitable for publication.

**SUGGESTED SOLUTION 6**

**NORTH-SOUTH ASSURANCE PLC**

**PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 31 DECEMBER 2008**

<table>
<thead>
<tr>
<th>NOTE</th>
<th>Premium income</th>
<th>Commission income</th>
<th>Investment income</th>
<th>Other income</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>59,011.95</td>
<td>12,459.67</td>
<td>4,356.50</td>
<td>87,325.58</td>
</tr>
<tr>
<td>2</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>11,497.46</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>23,879.25</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>4,221.50</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>30,828.05</td>
<td>(58,928.80)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>28,396.78</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>8</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**APPROPRIATIONS:**

- Proposed dividend: 8,000
- Transfer to contingency reserve: 6,423.5
NORTH-SOUTH ASSURANCE PLC
BALANCE SHEET AS AT 31 DECEMBER 2008

<table>
<thead>
<tr>
<th>ASSETS</th>
<th>NOTE</th>
<th>₦’000</th>
<th>₦’000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash and bank balances</td>
<td></td>
<td>8,725.00</td>
<td></td>
</tr>
<tr>
<td>Short-term investments</td>
<td>9</td>
<td>15,000.00</td>
<td></td>
</tr>
<tr>
<td>Debtors &amp; prepayments</td>
<td>10</td>
<td>6,537.67</td>
<td></td>
</tr>
<tr>
<td>Loan to policy holders</td>
<td></td>
<td>65,005.00</td>
<td></td>
</tr>
<tr>
<td>Long-term investment</td>
<td>11</td>
<td>23,781.20</td>
<td></td>
</tr>
<tr>
<td>Statutory deposit</td>
<td></td>
<td>25,000.00</td>
<td></td>
</tr>
<tr>
<td>Fixed assets</td>
<td>12</td>
<td>9,500.00</td>
<td></td>
</tr>
<tr>
<td>Total Assets (a)</td>
<td></td>
<td>153,548.87</td>
<td></td>
</tr>
</tbody>
</table>

LIABILITIES

| Amount due to agents         |      | 6,683.24|         |
| Taxation                     |      | 2,500.00|         |
| Proposed dividend            | 8    | 8,000.00|         |
| Insurance funds              | 13   | 41,267.35|         |
| Total Liabilities (b)        |      | 58,450.59|         |

NET ASSETS (a – b)          |      | 95,098.25|         |

CAPITAL AND RESERVE

| Call-up share capital        |      | 80,000.00|         |
| General reserve              | 15   | 15,098.28|         |
|                              |      | 95,098.28|         |

NORTH-SOUTH ASSURANCE PLC
NOTES TO THE FINANCIAL STATEMENTS

1. Premium income:

<table>
<thead>
<tr>
<th>Insurance</th>
<th>Fire</th>
<th>Motor</th>
<th>General</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Premium receivable</td>
<td>20,844,380</td>
<td>34,855,890</td>
<td>13,731,730</td>
<td>69,432,000</td>
</tr>
<tr>
<td>Re-insurance premium payable</td>
<td>(1,492,540)</td>
<td>(2,537,310)</td>
<td>(970,150)</td>
<td>(5,000,000)</td>
</tr>
<tr>
<td>Transfer to unexpired risk</td>
<td>(1,872,000)</td>
<td>(2,650,050)</td>
<td>(898,000)</td>
<td>(5,420,050)</td>
</tr>
<tr>
<td></td>
<td>17,479,840</td>
<td>29,668,530</td>
<td>11,863,580</td>
<td>59,011,950</td>
</tr>
</tbody>
</table>

2. Commission receivable

<table>
<thead>
<tr>
<th></th>
<th>Fire</th>
<th>Motor</th>
<th>General</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2,624,710</td>
<td>5,621,380</td>
<td>4,213,580</td>
<td>12,459,670</td>
</tr>
</tbody>
</table>

3. Other income:

<p>| | | | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest on loan granted</td>
<td></td>
<td></td>
<td>6,258,840</td>
<td></td>
</tr>
<tr>
<td>Sundry income</td>
<td></td>
<td></td>
<td>5,238,620</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>11,497,460</td>
<td></td>
</tr>
</tbody>
</table>

4. Claims:

<p>| | | | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Amount paid</td>
<td>6,258,000</td>
<td>10,257,000</td>
<td>6,492,250</td>
<td>23,007,250</td>
</tr>
<tr>
<td>Transfer to outstanding claims</td>
<td>245,050</td>
<td>423,150</td>
<td>203,800</td>
<td>872,000</td>
</tr>
<tr>
<td></td>
<td>6,503,050</td>
<td>10,680,150</td>
<td>6,696,050</td>
<td>23,879,250</td>
</tr>
</tbody>
</table>

5. Agents’ commission

<p>| | | | | |</p>
<table>
<thead>
<tr>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>875,000</td>
<td>2,316,000</td>
<td>1,030,000</td>
<td>4,221,500</td>
</tr>
</tbody>
</table>

6. Management expenses:

<p>| | | | | |</p>
<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Provision for bad debts (₦7,641,300 – ₦4,366,500)</td>
<td>3,274.8</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Audit fees</td>
<td></td>
<td></td>
<td>535</td>
<td></td>
</tr>
<tr>
<td>Actuary consulting fees</td>
<td></td>
<td></td>
<td>2,358</td>
<td></td>
</tr>
</tbody>
</table>

Retained profit transferred to general reserve | (14,423.50) | 11,473.28 |
Advertising & publicity 2,500
Entertainment 900
Vehicle running expenses 1,850
Legal & other professional fees 3,475
Electricity 625
Telephone & postages 489
Rents & postages 2,356
Salaries & wages 5,487.25
Transport & travelling 1,625
Staff pension 1,658
Repairs & renewals 875
Directors’ fees & expenses 1,978
Depreciation charge 842

30,828.05

7. PROFIT BEFORE TAX is stated after charging:
   Directors’ emoluments 1,978
   Auditors’ remuneration 535
   Depreciation of fixed assets 842

8. Proposed dividend: 10 kobo on 80,000,000 ordinary shares 8,000

9. Short-term investment- treasury bills & certificates 15,000

10. Debtors & prepayments:
   Amount due from agents 14,178.97
   Less: provision for bad debts 7,641.30
   6,537.67


12. Fixed assets:
   Property at cost 14,000
   Less: accumulated depreciation 4,500
   9,500

13. Insurance fund:
   Unexpired Outstanding Contingency Total
   Risk Claim Reserve N N N
   Bal. B/fwd 14,017,700 3,246,600 11,287,500 28,551,800
   Transfer in the year 5,420,050 872,000 6,423,500 12,715,550
   Bal. Carried forward 19,437,750 4,118,600 17,711,000 41,267,350

14. Share capital
   Authorised, issued and fully paid 80,000,000 ordinary shares of N1 each 80,000,000

15. General reserve
   Balance brought forward at January 1, 2004 3,625,000
   Transfer from profit & loss account 11,473,280
   15,098,280

SELF ASSESSMENT EXERCISE
Solve the above questions and compare with the solution
3.5 ABRIDGED FINANCIAL STATEMENTS

Introduction

(a) Annual reports and financial statements are the means of communicating to the shareholders and other interested parties information on the financial resources, obligations and performance of a reporting entity or enterprise. Annual report refers to the Chairman’s statement, Directors’ report, Auditors’ report, Audit Committee’s report, information communicated on accounting policies, balance sheet, profit and loss account (income statement). Cash flow statement, value added statement, notes on the accounts, five-year financial summary, and notice of annual general meeting. Such a report usually assists shareholders and other interested parties in assessing the financial, liquidity, profitability and viability of enterprise.

(b) In recent years, there has been demand by groups of shareholders and some companies in Nigeria to reduce the size of annual reports and financial statements, as well as curtail the high cost of printing and mailing the glossy information.

(c) Section 355 of the Companies and Allied Matters Act, Cap. C20 LFN 2004 allows companies to published abridged financial statements. The Act, however, does not specify any minimum disclosure requirement of such statements.

SAS No 20 (Abridged Financial Statements)

(a) The objectives of statement of Accounting Standard No. 20 are:
1. To specify the minimum contents of abridged financial statements.
2. To standardize formats for presentation of abridged financial statements; and
3. To improve comparability and usefulness of abridged financial statements.

(b) Abridged financial statements should carry a declaration that:
1. They are abridged financial statements;
2. The financial statements and specific disclosures included in them have been derived from the financial statements of the company;
3. The abridged financial statements cannot be expected to provide understanding of the financial performance, financial position, financing and investing activities of the organization as the full financial statements; and
4. Copies of the full financial statements can be obtained from the Registrar of Companies.

(c) Abridged financial statements should include the following, as in the full financial statements;
1. Accounting policies;
2. Profit and loss account for the financial year;
3. Balance sheet as at end of the financial year;
4. Statement of cash flows for the financial year;
5. Notes in relation to exceptional and extra-ordinary items;
6. Five-year financial summary; and
7. Any other information necessary to ensure that the abridged financial statements are consistent with the full accounts and reports for the year.

Other information to be included in abridged financial statements are:
1. Notice of annual general meeting;
2. Names of directors during the year and their shareholding;
3. Report of the audit committee, which should confirm that the auditors’ report is unqualified.
4. Financial highlights (result at a glance); and
5. Dividends paid or proposed and date of payment.

(d) A company whose auditors’ report on the financial statement for a period are qualified should not publish abridged financial statements for that period.

Disclosure Requirements

The following information should be disclosed in abridged financial statements:

(a) Material events occurring after the balance sheet date and where there is a change in accounting policies or estimates from those used in the preceding 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 extra ordinary items and prior year adjustments.
(b) Where a company is a parent company, the statement in above 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 information for the preceding financial year, which corresponds to the disclosures made in accordance with this standard for the current financial year, should be disclosed.

SELF ASSESSMENT EXERCISE
State the information that should be disclosed in abridged financial statements.

4.0 CONCLUSION

We shall conclude that the insurance business is technical and complex when compared to other industries. The major differences in accounting for life insurance as compared with other industries derive from the long time period between receipt of premiums and the payment of claims. This gives rise to the need for actuarial estimates of the liability in order to determine both the solvency and the profitability of life business.

5.0 SUMMARY

As a follow-up to the regulatory framework in the earlier unit, this unit illustrates with typical examination questions, practical application of the theoretical background on the preparation of financial statements insurance companies, including relevant notes to the financial statements in the recommended formats.

Companies in Nigeria are allowed to publish abridged financial statements under Section 355 of CAMA 2004 Cap C20 LFN. Such statements should comply with the requirements of SAS 20: Abridged Financial Statements

6.0 TUTOR MARKED ASSIGNMENT

1. In the process of preparing the financial statements of your client, you were informed that about a quarter of the company’s workforce were laid off, resulting in payment of
substantial severance package to the staff laid-off. How would you treat the amount paid in the financial statements for the period?

2. In what way are extraordinary and exceptional items different?

3. List any one disclosure required in notes to the financial statements in respect of directors’ emolument.

4. State how contingency reserve for life assurance business is calculated.

5. On what basis is interest on loan recognised by banks in their profit and loss accounts?

7.0 REFERENCES/FURTHER READING


MODULE 2: CASH FLOW STATEMENT AND INTERPRETATION OF FINANCIAL STATEMENTS

Unit 1: Basic Principles Governing the Preparation of Cash Flow Statements and the Approved Formats

Unit 2: Format of Cash Flow Statement for Banks and Insurance Companies

Unit 3: Analysis and Interpretation of Financial Statements

Unit 4: Accounting Ratio Interpretation, Value Added Statement and Report Writing

UNIT 1: BASIC PRINCIPLES GOVERNING THE PREPARATION OF CASH FLOW STATEMENTS AND THE APPROVED FORMATS

CONTENT
1.0 Introduction
2.0 Objectives
3.0 Main Content
   3.1 Usefulness of a Cash Flow Statement
   3.2 Preparation of Cash Flow Statement
   3.3 The format of Cash flow statement for a Limited Liability Company
4.0 Conclusion
5.0 Summary
6.0 Tutor Marked Assignment
7.0 References/Further Reading

1.0 INTRODUCTION

Statement of Accounting Standards No. 18 (SAS) deals with the approved format for preparing statement of cash flows.

A statement of cash flows provides information about the cash receipts and payments of an enterprise over a given period. It indicates the pattern of cash generation and utilization. It also reveals how cash is generated from operations through new capital raised and how it is disbursed for capital expenditure, taxes, and dividends to investors, new investments and debt repayments. It is designed to shed light on an enterprise’s financial strength and illuminate the balance sheet and profit and loss account.

2.0 OBJECTIVES

After studying this unit, you be able to:
   1. State the usefulness of cash flow statement.
   2. Outline the steps required in preparing a cash flow statement.
   3. Familiarize yourself with the format of cash flow statement for a limited liability company.

3.0 MAIN CONTENT

3.1 USEFULNESS OF A CASH FLOW STATEMENT
The information provided in this statement, if used with related disclosure and other information in the financial statements, will assist users to:

(a) Assess the impact of its transactions; that is, operating, investing and financing activities of its performance and financial position;
(b) Assess the ability of an enterprise to meet its debt obligations, pay dividends and meet other claims;
(c) Assess the ability of an enterprise to finance on-going operations and growth from internal sources and determine the amount of external financing required;
(d) Reconcile profit or loss and net cash flows; and
(e) Assess the ability of the enterprise to generate positive net future cash flows.

SELF ASSESSMENT EXERCISE
What is the usefulness of a cash flow?

3.2 PREPARATION OF A CASH FLOW STATEMENT
(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 inflows 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 they should be grouped under the broad headings of:
   Operating activities
   Investing activities
   Financing activities
(d) An enterprise should adopt either the direct or indirect method in preparing its statement of cash flow.
   1. Direct method highlights cash received from customers, payments made to suppliers, employees, tax authority and other service providers, to arrive at cash inflow/outflow from operating activities.
   2. Indirect method arrives at cash inflow/outflow from operating activities by stating the profit or loss before taxation, which is adjusted for items not involving movement of funds such as depreciation charge, provision for doubtful debts, profit on sale of fixed assets; and net changes in working capital, debtors, creditors, stock etc between the current and the preceding years.
(e) The statement of cash flows should report gross cash flows except in the instances where net cash flows will be more relevant and meaningful, such as:
   1. Where the enterprise is, in substance, holding or disbursing cash on behalf of its customers, and
   2. Where turnover of investments and loans is repaid and the total volume of transactions is large.
(f) Interest paid and received
   1. Interest paid should be classified as cash flow from financing activities while interest received should be classified as cash flow from investing activities, under direct method.
The interest element of finance lease rental payments should be shown separately by the lessees; and
2. Interest received or paid should be reported gross of taxes. Interest capitalized should also be reported in the statement of cash flows.

(g) Dividends paid and received
1. Dividends received should be classified as cash flows from investing activities except in cases where the investor company has significant influence over the investee company and holds at least 20% of the equity. In such cases, dividends received should be classified as cash flow from operating activities.
2. Dividends paid and other distributions to owners should be classified as cash flows from financing activities.

(h) Foreign currency cash flows
Cash flows resulting from foreign currency transactions should be translated, using the rates applicable at the time they occurred. A weighted average exchange rate for a period should be used for transaction, if the result is substantially the same as if the rates applicable at the dates of the cash flow were used:

(i) Taxation
1. The total amount of income taxes paid should be classified as operating cash outflow.
2. The net amount paid or received with respect to value-added tax or other sales taxes should be shown separately as cash flows from operating activities.
3. 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.

SUMMARY OF THE COMPONENTS OF A CASH FLOW STATEMENT

<table>
<thead>
<tr>
<th>SOURCES OF CASH GENERATED</th>
<th>UTILISATION OF CASH GENERATED</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Operating activities: Profit for the year before provisions for tax, dividend and depreciation.</td>
<td>Taxes paid</td>
</tr>
<tr>
<td>2. Downward movement in current assets</td>
<td>Upward movement in current assets</td>
</tr>
<tr>
<td>3. Upward movement in current liabilities</td>
<td>Downward movement in current liabilities</td>
</tr>
<tr>
<td>4. Financing activities: proceeds of fresh issue of shares or debenture (net of cost issue)</td>
<td>Redemption of preference shares and debentures, dividend paid.</td>
</tr>
<tr>
<td>5. New loans obtained</td>
<td>Loans and interest repayments</td>
</tr>
<tr>
<td>6. Investing activities: investment income received, proceeds from sale of fixed assets and investment disposed of</td>
<td>Fixed assets purchased. Investment purchase</td>
</tr>
</tbody>
</table>

NOTE: Cash inflow (or sources of cash generated) is reflected in positive figures while cash outflow (or utilization of the cash generated) is shown as negative figure in brackets.

3.3 FORMAT OF CASH FLOW STATEMENT FOR A LIMITED LIABILITY COMPANY
XYZ NIGERIA PLC
CASH FLOW STATEMENT
For the year ended 31 December 2004
2004 2003
CASH FLOWS FROM OPERATING ACTIVITIES
Profit before taxation \( x \) \( x \)
Depreciation of fixed assets \( x \) \( x \)
Profit/(loss) on disposal of fixed assets \( x \) \( x \)
Net interest expense/(income) \( x \) \( x \)
Cash flow before changes in working capital \( xx \) \( xx \)

CHANGES IN WORKING CAPITAL:
(increase)/decrease in stock & work-in-progress \( x \) \( x \)
(increase)/decrease in debtors & prepayments \( x \) \( x \)
Increase/(decrease) in creditors & accruals \( xx \) \( xx \)
Increase/(decrease) in gratuities & retirement benefits \( xx \) \( xx \)
Tax paid \( (x) \) \( (x) \)
Net cash flows from operating activities \( xxx \) \( xxx \)

CASH FLOWS FROM INVESTING ACTIVITIES
Interest received \( x \) \( x \)
Purchase of fixed assets \( (x) \) \( (x) \)
Proceeds on disposal of fixed assets \( xx \) \( xx \)
Net cash used in investing activities \( xx \) \( xx \)

CASH FLOW FROM FINANCING ACTIVITIES
Proceeds from sale of shares \( x \) \( x \)
Dividend paid \( (x) \) \( (x) \)
Interest paid \( xx \) \( xx \)
Net cash inflow/(outflow) in financing activities \( xx \) \( xx \)
Net increase/(decrease) in cash and cash equivalents \( xx \) \( xx \)
Cash and cash equivalents at January 1 \( xx \) \( xx \)
Cash and cash equivalents at December 31 \( xx \) \( xx \)

Cash and cash equivalent comprises of:
Cash and bank balances \( xx \) \( xx \)
Bank deposit \( xx \) \( xx \)
Bank overdraft \( (x) \) \( (x) \)

ILLUSTRATION 7
The balance sheets of Chuks Plc at 31 December 2007 and 2008 are given below:

\[
\begin{array}{cccc}
\text{2008} & \text{₦’000} & \text{2007} & \text{₦’000} \\
\hline
\text{Fixed assets:} & & & \\
\text{Land and buildings} & 3,585 & & 3,470 \\
\text{Plant, equipment and vehicles} & 2,702 & & 3,107 \\
\text{Goodwill and patents} & 852 & & 785 \\
\hline
\text{Total} & 6,287 & & 6,577 \\
\text{Current assets:} & & & \\
\text{Stock & work-in-progress} & 5,717 & & 5,735 \\
\text{Debtors & prepayments} & 4,935 & & 4,697 \\
\text{Cash and bank balances} & 465 & & 115 \\
\hline
\text{Total} & 11,117 & & 10,547 \\
\text{Deduct: current liabilities:} & & & \\
\text{Creditors and accruals} & 2,795 & & 2,672 \\
\text{Current taxation} & 895 & & 985 \\
\hline
\text{Cash and cash equivalents} & 8,437 & & 7,793 \\
\end{array}
\]
Bank overdraft                  272     705
Proposed dividend              637     505
                        4,599     4,867
Net current assets           (a – b)     6,518     5,680
Deferred taxation            (1,555)   (1,545)      12,102      11,497
Represented by:
Capital and reserves:
Ordinary share capital      4,400     4,400
Share premium account              517     517
Other capital reserves       1,100     1,100
Revenue reserves             6,085     5,480      12,102      11,497

Notes to the accounts show that:
(a) Depreciation has been charged for year 2008 as follows:

          N
Land and building         87,000
Plant, machinery & vehicles   600,000
Goodwill and patents         23,000

(b) Plant sold during year 2008 realised N40,000. It was included at cost in the balance sheet for
year 2007 at N152,000, with depreciation accumulated at N132,000. The difference between
realisation and written value of the asset was in the profit and loss account.

(c) The balance of profit for year 2008 after taxation charged and dividend appropriation has
been transferred to revenue reserve.
Further enquires revealed that during year 2008, the company made cash payment for total
dividend amounting to N927,000 and income and education taxes of N1,130,000.

You are required to prepare a cash flow statement for the year ended 31 December 2008.

SUGGESTED SOLUTION 7

CHUKS PLC
CASH FLOW STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2008
N’000    N’000

Cash flows from operating activities:
Profit before taxation (w1)                2,714
Depreciation of fixed assets N(87 + 600 + 23)      710
(Profit)/loss on disposal of fixed assets      (20)
Cash flows before changes in working capital    3,404

Changes in working capital:
Decrease in stock                       18
Increase in debtors                  (238)
Increase in creditors 123 (97)
Taxes paid (w5) (1,130)
Net cash from operating activities 2,177
Cash flows from investing activities:
Purchase of fixed assets [(202 + 212 (w2, w3)] (417)
Purchase of goodwill and patents (w4) (90)
Proceeds from disposal of fixed assets (w3b) 40
Net cash used in investing activities (467)
Cash flows from financing activities:
Dividend paid (w6) (927)
Net increase in cash and cash equivalents 783
Cash and cash equivalents at January 1 (115 – 705) (590)
Cash and cash equivalents at December 31 193
Cash and cash equivalents comprises:
Cash and bank balances 465
Bank overdraft (272)
193

WORKINGS
CHUKS PLC

1. PROFIT BEFORE TAXATION
   Increase in revenue reserves ₦ (6,085 – 5,480) 605
   Deferred tax charged for 2008 written back to P & L ₦ (1,555 – 1,545) 10
   Tax charge for the year- (see working 5) 1,040
   Dividends charged to P & L (see workings 6) 1,059
   2,714

2. Land and Buildings
   ₦’000 ₦’000
   Opening balance 3,470 Depreciation change 87
   Balance representing
   Assets purchased 202 Closing Balance 3,585
   3,672 3,672

3. (a) Plant and Machinery
   ₦’000 ₦’000
Opening balance               3,107  Depreciation charge                600
Disposal a/c (deprec.)       132  Disposal a/c (cost)                   152
Balance- representing
Purchases                   215  Closing balance                   2,702
                                    3,454  3,454
3 (b) Plant Disposal
   ₦'000                        ₦'000
   Plant a/c - cost            152  Plant a/c - depreciation   132
   Profit on sale              20  Sales proceeds             40
                                      172       172
4. Goodwill & Patients
   ₦'000                        ₦'000
   Opening balance             785  Depreciation charge        23
   Balance- goodwill
   Purchased                   90  Closing balance            852
                                      875       875
5. Taxation
   ₦'000                        ₦'000
   Taxes paid- bank            1,130  Opening balance        985
   Closing balance            895  charged to P & L a/c     1,040
                                      2,025      2,025
6. Dividend
   ₦'000                        ₦'000
   Dividends paid- bank        927  Opening balance        505
   Closing balance            637  Charged to P & L a/c      1,059
                                      1,564      1,564

SELF ASSESSMENT EXERCISE
After studying the illustrations, solve the same questions and compare with the suggested solution.

4.0 CONCLUSION
Because of time constraint under examination condition, you are advised to approach the question, as follows:

(a) Read through the question, including the additional information, noting on the question paper, the figures on the balance sheet that will be affected.
(b) Open T – accounts for the balance sheet items that will be affected by the notes and title them “WORKINGS”. Record necessary entries in the T – accounts.
(c) Prepare the cash flow statement using the approved format, first slotting in items that require no adjustment, by simply deducting 2007 figures from 2008 figures; followed by figures obtained from your “WORKINGS” schedules, which must be attached to your answer.

Workings sometimes carrying as much mark as the answer to the question, as the examiner will be interested in knowing how you arrived at the figures in your solution.
5.0 SUMMARY
In this unit, we discussed cash flow statement which was discussed under the usefulness of a cash flow statement, preparation of a cash flow statement and a format of cash flow statement for a limited liability company along with an illustration.

6.0 TUTOR MARKED ASSIGNMENT
1. A reporting enterprise should prepare a statement of cash flows in line with the provisions of the Standard as an integral part of its __________.
2. The statement of cash flows should include all cash inflows and outflows of the enterprise, during a reporting period, it should, however, exclude cash inflows arising from the purchase and liquidation of __________.
3. An enterprise should adopt either the ________ or _______ method in preparing its statement of cash flow.
4. ________ method highlights cash received from customers, payments made to suppliers, employees, tax authority and other service providers, to arrive at cash inflow/outflow from operating activities.
5. ________ method arrives at cash inflow/outflow from operating activities by stating the profit or loss before taxation, which is adjusted for items not involving movement of funds such as depreciation charge, provision for doubtful debts, profit on sale of fixed assets; and net changes in working capital, debtors, creditors, stock etc between the current and the preceding years.
6. List one objective of preparing cash flow statements

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


Nigerian Accounting Standard Board, Statement of Accounting Standard
1.0 INTRODUCTION
In the previous unit, we discussed cash flow statement and ended with the illustration of cash flow statement for a limited liability company. However, this unit is a continuation of the previous unit, as we shall be looking at the format and illustrations of cash flow statements for banks and insurance companies.

2.0 OBJECTIVES
After studying this unit, you should be able to:
1. Identify the format of cash flow statement of a bank.
2. Solve questions on the preparation of cash flow statement for banks.
3. Identify the format of cash flow statement of insurance companies.
4. Solve questions on the preparation of cash flow statement for insurance companies.

3.0 MAIN CONTENT
3.1 FORMAT OF CASH FLOW STATEMENT FOR BANKS

ABC BANK PLC
CASH FLOW STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2008

<table>
<thead>
<tr>
<th></th>
<th>2008</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>CASH FLOWS FROM OPERATING ACTIVITIES</td>
<td>N</td>
<td>N</td>
</tr>
<tr>
<td>Interest and commission received</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Interest expenses</td>
<td>(x)</td>
<td>(x)</td>
</tr>
<tr>
<td>Loss/(profit) on disposal of fixed and leased assets</td>
<td>(x)</td>
<td>(x)</td>
</tr>
<tr>
<td>Provision for risk assets</td>
<td>(x)</td>
<td>(x)</td>
</tr>
<tr>
<td>Payments to employees and suppliers</td>
<td>(x)</td>
<td>(x)</td>
</tr>
<tr>
<td>Operating profit before changes in:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Operating assets and liabilities</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Changes in operating assets &amp; liabilities:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loans and advances</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Advances under finance lease</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Other assets</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Deposits</td>
<td>x</td>
<td>x</td>
</tr>
</tbody>
</table>
Other liabilities x x
Foreign currency denominated liabilities x x
Income & education taxes paid (x) (x)
Net cash from operating activities xx xx

CASH FLOWS FROM INVESTING ACTIVITIES:
Purchase of fixed/leased assets x x
Proceeds from sale of fixed/leased assets x x
Net additions to investment x x
Investment income x x
Net cash used in investing activities (x) (x)

CASH FLOWS FROM FINANCING ACTIVITIES:
Proceeds from sale of shares x x
Dividends (x) (x)
Net cash inflow/(outflow) in financing activities x x
Net increase in cash and cash equivalent x x
Cash and cash equivalents at January 1 x x
Cash and cash equivalents at December 31 xx xx

3.2 ILLUSTRATION OF CASH FLOW STATEMENT FOR BANKS

ILLUSTRATION 8

The balance sheet and profit and loss accounts of MEGABANK PLC as at 31 December 2008, together with the comparative figures for year 2007 are as follows:

<table>
<thead>
<tr>
<th>ASSETS:</th>
<th>2008</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash and short-term fund</td>
<td>₦59,532,100</td>
<td>₦26,750,860</td>
</tr>
<tr>
<td>Bills discounted</td>
<td>₦15,300,360</td>
<td>₦9,420,000</td>
</tr>
<tr>
<td>Investments</td>
<td>₦1,206,980</td>
<td>₦9,700,880</td>
</tr>
<tr>
<td>Loans and advances</td>
<td>₦44,790,880</td>
<td>₦26,900,060</td>
</tr>
<tr>
<td>Other assets</td>
<td>₦11,702,200</td>
<td>₦143,871,120</td>
</tr>
<tr>
<td>Equipment on lease</td>
<td>₦1,998,740</td>
<td>₦3,687,920</td>
</tr>
<tr>
<td>Fixed assets</td>
<td>₦11,702,200</td>
<td>₦9,700,880</td>
</tr>
<tr>
<td></td>
<td>₦143,871,120</td>
<td>₦83,729,640</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>LIABILITIES:</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Deposits and current accounts</td>
<td>₦91,498,660</td>
<td>₦51,123,320</td>
</tr>
<tr>
<td>Taxation</td>
<td>₦662,260</td>
<td>₦431,320</td>
</tr>
<tr>
<td>Dividend payable</td>
<td>₦1,362,160</td>
<td>₦1,267,340</td>
</tr>
<tr>
<td>Other liabilities</td>
<td>₦34,050,980</td>
<td>₦15,418,400</td>
</tr>
<tr>
<td></td>
<td>₦127,574,060</td>
<td>₦68,240,380</td>
</tr>
</tbody>
</table>

22% floating rate redeemable
Debenture stock | ₦522,920 | ₦597,620 |

| 128,096,980 | 68,838,000 |

CAPITAL AND RESERVE: | | |
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Called-up share capital</td>
<td>₦11,304,520</td>
<td>₦11,268,520</td>
</tr>
<tr>
<td>Share premium</td>
<td>₦318,500</td>
<td>₦290,300</td>
</tr>
<tr>
<td>Statutory reserves</td>
<td>₦3,219,740</td>
<td>₦2,635,140</td>
</tr>
<tr>
<td>Debenture redemption reserve</td>
<td>₦522,920</td>
<td>₦364,840</td>
</tr>
</tbody>
</table>

82
MEGABANK PLC
PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 31 DECEMBER, 2008

Interest income
  18,422,560
Interest expense
  (9,728,840)
  8,693,720
Other income – Commissions & fees
  14,486,960
  23,180,680

Expenses:
General & Admin Overheads
  12,481,980
Provision for risk assets
  4,064,420
Depreciation on leased assets
  2,141,320
Depreciation on fixed assets
  1,844,200

Profit before taxation
  2,648,760
Taxation
  (700,000)
Profit after taxation
  1,948,760

Appropriations:
Transfer to statutory reserve
  584,620
Debenture redemption reserve fund
  158,080
Proposed dividend
  1,130,460

Retained profit transferred to general reserve
  75,600

The following additional information are given:

1. The profit before taxation is after charging/(crediting):
   - Deposit for insurance premium
     633,220
   - Directors’ emoluments: fees
     19,800
     Others
     29,000
   - Auditors’ remuneration
     60,000
   - Debenture interest
     170,240
   - Profit on sale of fixed assets
     (66,600)

2. During the year, the provision made for risk assets is arrived at as follows:
   - Provision for loans & advances
     3,237,720
   - Other provisions
     947,120

3. During the year, the bank purchased fixed assets costing ₦3,923,840,000 and leased equipment at the cost of ₦456,020,000. Similarly, fixed assets and leased equipment with a net book value of ₦82,200.00 were disposed of at a value of ₦148,800,000.
4. General and administration overheads are made of payments to employees and suppliers of the bank.

You are required to prepare a cash flow statement of MEGABANK PLC using the direct method.

**SUGGESTED SOLUTION 8**

**MEGABANK PLC**

**CASH FLOW STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2008**

<table>
<thead>
<tr>
<th>Description</th>
<th>₦'000</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>CASH FLOW FROM OPERATING ACTIVITIES:</strong></td>
<td></td>
</tr>
<tr>
<td>Interest received</td>
<td>18,422,560</td>
</tr>
<tr>
<td>Fees &amp; commission received</td>
<td>14,486,960</td>
</tr>
<tr>
<td>Interest expenses paid</td>
<td>(9,728,840)</td>
</tr>
<tr>
<td>Profit on disposal of fixed assets</td>
<td>N(148,800,000 - 82,200,000)</td>
</tr>
<tr>
<td>Provision for risk assets</td>
<td>(4,064,420)</td>
</tr>
<tr>
<td>Cash payments to employees &amp; suppliers</td>
<td>(12,481,980)</td>
</tr>
<tr>
<td><strong>Operating profit before changes in operating assets</strong></td>
<td>6,567,680</td>
</tr>
<tr>
<td>Changes in operating assets/liabilities:</td>
<td></td>
</tr>
<tr>
<td>Loans and advances</td>
<td>(18,070,820)</td>
</tr>
<tr>
<td>Other assets</td>
<td>(3,491,340)</td>
</tr>
<tr>
<td>Deposit and current accounts</td>
<td>40,375,340</td>
</tr>
<tr>
<td>Other liabilities</td>
<td>18,632,580</td>
</tr>
<tr>
<td><strong>Net Cash Flow from Operating Activities before Taxation</strong></td>
<td>37,445,760</td>
</tr>
<tr>
<td><strong>Tax paid (w1)</strong></td>
<td>(469,060)</td>
</tr>
<tr>
<td><strong>Net Cash from Operating Activities</strong></td>
<td>43,544,380</td>
</tr>
<tr>
<td><strong>Cash flows from investing activities:</strong></td>
<td></td>
</tr>
<tr>
<td>Purchase of fixed assets</td>
<td>(3,923,840)</td>
</tr>
<tr>
<td>Purchase of leased equipment</td>
<td>(456,020)</td>
</tr>
<tr>
<td>Proceeds from sale of fixed assets</td>
<td>148,800</td>
</tr>
<tr>
<td><strong>Net change in investment</strong></td>
<td>394,420</td>
</tr>
<tr>
<td><strong>(3,836,640)</strong></td>
<td>39,707,740</td>
</tr>
<tr>
<td><strong>Cash flows from financing activities:</strong></td>
<td></td>
</tr>
<tr>
<td>Proceeds from issue of shares</td>
<td>64,200</td>
</tr>
<tr>
<td>Redemption of debenture</td>
<td>(74,700)</td>
</tr>
<tr>
<td><strong>Dividends paid (w2)</strong></td>
<td>(1,035,640)</td>
</tr>
<tr>
<td><strong>Net increase in cash and cash equivalents</strong></td>
<td>(1,046,140)</td>
</tr>
<tr>
<td><strong>Cash and cash equivalents at January 1, 2008</strong></td>
<td></td>
</tr>
<tr>
<td>N(26,750,860 + 9,420,000)</td>
<td>36,170,860</td>
</tr>
<tr>
<td><strong>Cash and cash equivalents at December 31, 2008</strong></td>
<td>74,832,460</td>
</tr>
<tr>
<td>N(59,532,100 + 15,300,360)</td>
<td></td>
</tr>
<tr>
<td><strong>WORKINGS</strong></td>
<td></td>
</tr>
<tr>
<td>1. Taxation</td>
<td>₦'000</td>
</tr>
<tr>
<td>Opening balance 1/1/08</td>
<td>431,320</td>
</tr>
<tr>
<td>Change for the year per P &amp; L account</td>
<td>700,000</td>
</tr>
<tr>
<td><strong>1,131,320</strong></td>
<td></td>
</tr>
</tbody>
</table>
Closing balance at 31/12/08 662,260
Tax paid 469,060

2. Dividend
Opening balance 1/1/08 1,267,340
Add: proposed dividend per P & L account 1,130,460
2,397,800
Less: closing balance at 31/12/04 1,362,160
Dividend paid 1,035,640

SELF ASSESSMENT EXERCISE
After studying this sub-unit, solve the questions and compare them with the solutions in the illustrations.

3.3 FORMAT OF CASH FLOW STATEMENT FOR INSURANCE COMPANIES

EFG INSURANCE PLC
CASH FLOW STATEMENT FOR THE YEAR ENDED 31 DECEMBER, 2008

<table>
<thead>
<tr>
<th>2008</th>
<th>2007</th>
<th>₦</th>
<th>₦</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit before taxation</td>
<td>x</td>
<td>x</td>
<td></td>
</tr>
<tr>
<td>Adjustment for:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Depreciation</td>
<td>x</td>
<td>x</td>
<td></td>
</tr>
<tr>
<td>Increase/(decrease) in insurance funds</td>
<td>x</td>
<td>x</td>
<td></td>
</tr>
<tr>
<td>(profit)/loss on disposal of investments</td>
<td>x</td>
<td>x</td>
<td></td>
</tr>
<tr>
<td>(profit)/loss on sale of fixed assets</td>
<td>x</td>
<td>x</td>
<td></td>
</tr>
<tr>
<td>Cash flows before changes in working capital</td>
<td>x</td>
<td>x</td>
<td></td>
</tr>
<tr>
<td>CHANGES IN WORKING CAPITAL:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(Increase)/decrease in debtors &amp; prepayments</td>
<td>x</td>
<td>x</td>
<td></td>
</tr>
<tr>
<td>(Increase)/decrease in policy loans</td>
<td>x</td>
<td>x</td>
<td></td>
</tr>
<tr>
<td>Increase/(decrease) in creditors and accruals</td>
<td>x</td>
<td>x</td>
<td></td>
</tr>
<tr>
<td>Increase/(decrease) in outstanding claims</td>
<td>x</td>
<td>x</td>
<td></td>
</tr>
<tr>
<td>Cash inflow/(outflow) from operations</td>
<td>xx</td>
<td>xx</td>
<td></td>
</tr>
<tr>
<td>Income &amp; education taxes paid</td>
<td>(x)</td>
<td>(x)</td>
<td></td>
</tr>
<tr>
<td>Net cash generated from operations</td>
<td>xx</td>
<td>xx</td>
<td></td>
</tr>
</tbody>
</table>

CASH FLOWS FROM INVESTING ACTIVITIES

| Proceeds of disposal of investments | x | x |
| Proceeds from sale of fixed assets | x | x |
| Purchase of investments | (x) | (x) |
| Purchase of fixed assets | (x) | (x) |
| Net cash used in investing activities | xx | xx |

CASH FLOWS FROM FINANCING ACTIVITIES:

| Proceeds from sale of shares | x | x |
| Dividends paid | (x) | (x) |
| Net cash inflow/(outflow) in financing activities | xx | xx |
| Net increase in cash and cash equivalents | x | x |
| Cash and cash equivalents at January 1 | x | x |
| Cash and cash equivalent at December 31 | xx | xx |

3.4 ILLUSTRATION OF CASH FLOW STATEMENT FOR INSURANCE COMPANIES
ILLUSTRATION 9

The information provided below is extracted from the books and records of:

SAFEGUARD ASSURANCE PLC

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 31 DECEMBER, 2008

₦

Underwriting profits 150,503,000
Investment income 233,004,860
Other income 2,410,000
Profit before taxation 385,917,860
Taxation 41,082,990
Profit after taxation 344,834,870
Accretion to contingency reserve 78,677,920
Reserve for bonus issue (110,000,000)
Proposed dividend (150,000,000)
Retained profit for the year 6,156,950

BALANCE SHEET AS AT 31 DECEMBER, 2008

<table>
<thead>
<tr>
<th></th>
<th>2008</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>ASSETS</td>
<td>₦</td>
<td>₦</td>
</tr>
<tr>
<td>Cash and bank balance</td>
<td>74,942,630</td>
<td>113,995,420</td>
</tr>
<tr>
<td>Short-term investments</td>
<td>612,097,190</td>
<td>452,088,770</td>
</tr>
<tr>
<td>Other debtors</td>
<td>875,837,570</td>
<td>877,270,310</td>
</tr>
<tr>
<td>Loans to policy holders</td>
<td>27,825,210</td>
<td>34,317,800</td>
</tr>
<tr>
<td>Long-term investments</td>
<td>1,514,942,430</td>
<td>1,233,565,440</td>
</tr>
<tr>
<td>Statutory deposit</td>
<td>105,000,000</td>
<td>105,000,000</td>
</tr>
<tr>
<td>Fixed assets</td>
<td>318,262,430</td>
<td>283,201,670</td>
</tr>
<tr>
<td></td>
<td>3,528,907,460</td>
<td>3,099,439,410</td>
</tr>
<tr>
<td>LIABILITIES</td>
<td>₦</td>
<td>₦</td>
</tr>
<tr>
<td>Creditors and accruals</td>
<td>556,901,310</td>
<td>582,203,560</td>
</tr>
<tr>
<td>Insurance funds</td>
<td>1,518,229,200</td>
<td>1,301,361,380</td>
</tr>
<tr>
<td>Taxation</td>
<td>78,522,260</td>
<td>65,454,650</td>
</tr>
<tr>
<td></td>
<td>2,153,652,770</td>
<td>1,949,019,590</td>
</tr>
<tr>
<td>Total assets less liabilities (a – b)</td>
<td>1,375,254,690</td>
<td>1,150,419,820</td>
</tr>
</tbody>
</table>

CAPITAL AND RESERVES

<table>
<thead>
<tr>
<th></th>
<th>₦</th>
</tr>
</thead>
<tbody>
<tr>
<td>Called-up share capital</td>
<td>880,490,160</td>
</tr>
<tr>
<td>Share premium account</td>
<td>32,981,670</td>
</tr>
<tr>
<td>Capital reserve</td>
<td>120,000,000</td>
</tr>
<tr>
<td>Contingency reserve</td>
<td>195,467,260</td>
</tr>
<tr>
<td>Reserve for bonus issue</td>
<td>110,000,000</td>
</tr>
<tr>
<td>General reserve</td>
<td>36,315,600</td>
</tr>
<tr>
<td></td>
<td>1,375,254,690</td>
</tr>
</tbody>
</table>

The following additional information are relevant:

1. Fixed assets: cost at 1/1/08 553,085,590
   Cost at 31/12/08 674,239,380
   Accumulated depreciation at 1/1/08 269,880,650

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Accumulated depreciation at 31/12/08 355,976,950

2. An item of fixed assets, which costs ₦10,850,000 and has been fully depreciated, was sold during the year for ₦2,410,000.

3. Creditors and accrual are made up of:
   - Re-insurance payable 294,324,680
   - Commission payable 15,279,060
   - Obligations under financial lease 14,824,020
   - Dividends payable 150,000,000
   - Accruals 65,882,230
   - Other payables 16,591,320
   - Total 556,901,310

Dividends payable for the year ended 31 December, 2007 and paid in 2008 was ₦124,760,400.

You are required to prepare cash flow statement for the year ended 31 December 2008.

**SUGGESTED SOLUTION 9**

**SAFEGUARD ASSURANCE PLC**

**CASH FLOW FROM OPERATING ACTIVITIES:**

<table>
<thead>
<tr>
<th>Description</th>
<th>₦</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit before taxation</td>
<td>385,917,860</td>
</tr>
<tr>
<td>Depreciation (w1)</td>
<td>96,946,300</td>
</tr>
<tr>
<td>Profit on sale of fixed assets</td>
<td>(2,410,000)</td>
</tr>
<tr>
<td>Increase in insurance funds</td>
<td>216,867,820</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>311,404,120</td>
</tr>
</tbody>
</table>

Cash flows from operating activities before

Changes in working capital 679,321,980

Changes in operating assets/liabilities
   - Decrease in agents, brokers & debtors balances 1,432,740
   - Decrease in policy loans 6,492,590
   - Decrease in creditors and accruals (w2) (50,545,120)

Income tax paid (w3) 28,015,380

Net cash generated from operations 626,686,810

**Cash Flows from Investing Activities:**

<table>
<thead>
<tr>
<th>Description</th>
<th>₦</th>
</tr>
</thead>
<tbody>
<tr>
<td>Purchase of fixed assets (w4)</td>
<td>(132,003,790)</td>
</tr>
<tr>
<td>Proceeds from sale of fixed assets</td>
<td>2,410,000</td>
</tr>
<tr>
<td>Purchase of investments (w5)</td>
<td>(441,385,410)</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>(570,979,200)</td>
</tr>
</tbody>
</table>

**Cash Flows from Financing Activities:**

<table>
<thead>
<tr>
<th>Description</th>
<th>₦</th>
</tr>
</thead>
<tbody>
<tr>
<td>Issue of shares (w6)</td>
<td>30,000,000</td>
</tr>
<tr>
<td>Dividends paid</td>
<td>(124,760,400)</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>(94,760,400)</td>
</tr>
</tbody>
</table>

Net decrease in cash and cash equivalents (39,052,790)

Cash and cash equivalents at Jan. 2008 113,995,420

Cash and cash equivalents at Dec. 31, 2008 74,942,630

**WORKINGS**

1. Depreciation: opening balance 269,880,650
2. Creditors & Accruals

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Creditors</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008</td>
<td>₦556,901,310</td>
<td>₦532,202,550</td>
</tr>
<tr>
<td>2007</td>
<td>(₦150,000,000)</td>
<td>(₦124,757,130)</td>
</tr>
<tr>
<td></td>
<td>₦406,901,310</td>
<td>₦259,446,420</td>
</tr>
</tbody>
</table>

3. Income Tax Account

<table>
<thead>
<tr>
<th>Source</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank-payment</td>
<td>₦28,015,380</td>
</tr>
<tr>
<td>1/1 Balance B/fwd</td>
<td>₦65,454,650</td>
</tr>
<tr>
<td>31/12 Balance C/fwd</td>
<td>₦78,522,260</td>
</tr>
<tr>
<td>P&amp;L Account</td>
<td>₦41,082,990</td>
</tr>
<tr>
<td></td>
<td>₦106,537,640</td>
</tr>
</tbody>
</table>

4. Fixed Assets Account

<table>
<thead>
<tr>
<th>Source</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank-payment</td>
<td>₦441,385,410</td>
</tr>
<tr>
<td>1/1 Balance B/fwd</td>
<td>₦553,085,590</td>
</tr>
<tr>
<td>Disposal</td>
<td>₦10,850,000</td>
</tr>
<tr>
<td>Bank-additions</td>
<td>₦132,003,790</td>
</tr>
<tr>
<td>Balance C/fwd</td>
<td>₦674,239,380</td>
</tr>
<tr>
<td></td>
<td>₦685,089,380</td>
</tr>
</tbody>
</table>

5. Investment Account

<table>
<thead>
<tr>
<th>Source</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bal. B/fwd-Short-term</td>
<td>₦452,088,770</td>
</tr>
<tr>
<td>Bal. C/fwd-Short-term</td>
<td>₦612,097,190</td>
</tr>
<tr>
<td>Long-term</td>
<td>₦1,233,565,440</td>
</tr>
<tr>
<td>Long-term</td>
<td>₦1,518,229,200</td>
</tr>
<tr>
<td>Bank</td>
<td>₦441,385,410</td>
</tr>
<tr>
<td></td>
<td>₦2,127,039,620</td>
</tr>
</tbody>
</table>

6. Share Capital & Reserves

<table>
<thead>
<tr>
<th>Source</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bal. C/fwd-Share capital</td>
<td>₦880,490,160</td>
</tr>
<tr>
<td>Bal. b/fwd-share capital</td>
<td>₦810,490,160</td>
</tr>
<tr>
<td>Share premium</td>
<td>₦32,981,670</td>
</tr>
<tr>
<td>Reserve for bonus</td>
<td>₦50,000,000</td>
</tr>
<tr>
<td>Issue of share bank</td>
<td>₦30,000,000</td>
</tr>
<tr>
<td></td>
<td>₦913,471,830</td>
</tr>
</tbody>
</table>

7. Dividends Account

<table>
<thead>
<tr>
<th>Source</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank</td>
<td>₦124,760,400</td>
</tr>
<tr>
<td>Bal. b/fwd</td>
<td>₦124,760,400</td>
</tr>
<tr>
<td>Bal. C/fwd</td>
<td>₦150,000,000</td>
</tr>
<tr>
<td>Profit &amp; Loss account</td>
<td>₦150,000,000</td>
</tr>
<tr>
<td></td>
<td>₦274,760,400</td>
</tr>
</tbody>
</table>

4.0 CONCLUSIONS
Cash flow statements provide information about the cash receipts and cash usefulness and formats of cash flow statement of limited liability companies, banks and insurance companies, in accordance with SAS No 18.

5.0 SUMMARY
Preparation of cash flow statement which adopts the direct and indirect methods for companies, banks and insurance businesses were illustrated in this unit with standard examination questions, showing detailed workings of the figures in the cash flow statements.

6.0 TUTOR MARKED ASSIGNMENT
1. State a broad heading under which cash flow statements are prepared.
2. State one source of cash generated from operating activities
3. How would you treat expenditure on leased equipment in the cash flow statement of a bank?
4. How would you treat increase or decrease in insurance funds in the cash flow statement of an insurance company?

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


Nigerian Accounting Standard Board, Statement of Accounting Standard
1.0 INTRODUCTION
The analysis of financial statement is for the benefits of users of financial statement. You would recall that financial statements are prepared to satisfy the needs of its users. The financial statements are prepared to serve not just one user but several of them. Basically, these users are classified into two, which are internal users and external users.

Financial statement analysis is used by internal users for planning, evaluating and controlling company operations. On the other hand, financial statement analysis is used by external users for assessing past performance and current financial position, and making predictions about the future profitability and solvency of the company as well as evaluating the effectiveness of management.

Fundamentally, analysis and interpretation of financial statements are the basic tools to meet the need for information by the users of financial statements.

2.0 OBJECTIVES
After studying this unit, you should be able to:
1. Outline the areas of interest to various users of financial statement,
2. Make analysis based on the use of ratio analysis.
3. State the limitation of ratio analysis.

3.0 MAIN CONTENT
3.1 NATURE AND OBJECTIVES OF ACCOUNTING RATIOS
An accounting ratio is a proportion or fraction or percentage, expressing a relationship between one item in a set of financial statements and another item in the same financial statements.

For example, the relationship between gross profit and sales is expressed by the accounting ratio known as “gross profit %” or gross margin, which is computed as follows:

\[ \text{Gross profit} \% = \frac{\text{Gross profit}}{\text{Sales}} \times 100 = \% \]
When preparing financial statements, the objective is to convey information to the readers and others who are interested parties with diverse interests, which may include:

(a) Company management;
(b) Present and potential shareholders;
(c) Present and potential loan creditors;
(d) Trade suppliers and customers;
(e) Employees;
(f) Financial analysts and journalists; and
(g) Government agencies (inland revenue and regulatory authorities like CBN, Nigerian Stock Exchange, Securities and Exchange Commission).

The matters which are likely to concern these parties, varying according to emphasis, are:

(a) Profitability
(b) Liquidity
(c) Management efficiency
(d) Gearing
(e) Financial stability
(f) Investment appraisal

The essence of any interpretation of financial statements is comparison. Comparison of the current figures of a company with its own past performance and with its budget or forecast, and comparison with the performance of other companies in similar trades or industries. For a potential shareholder, a broader comparison between companies involved in completely different trades may be necessary.

In order to facilitate this important device for interpreting the performance of companies from their financial statements. Other tools used in the analysis and interpretation of financial statements include:

(a) Cash flow statements
(b) Value added statement.

**SELF ASSESSMENT EXERCISE**
List the matters that may interest users of the financial statement.

**3.2 RATIO ANALYSIS**
Each of the areas of interest highlighted above will now be examined in detail, using, where possible, the following specimen set of accounts:

**ILLUSTRATION 10**

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ABC PLC
BALANCE SHEET AS AT 31 DECEMBER, 2008

₦’000  ₦’000  ₦’000

FIXED ASSETS (at cost less depreciation)  260,000
CURRENT ASSETS:
Stock (Opening stock N50 million)  60,000
Debtors  90,000
```
Cash 10,000
160,000

CURRENT LIABILITIES:
Trade creditors 40,000
Other liabilities 40,000 80,000

NET CURRENT ASSETS 80,000

NET ASSETS 340,000

FINANCED BY:
SHARE CAPITAL
100 million ordinary shares of ₦1 each 100,000
20 million preference shares of ₦1 each 20,000
120,000

Revenue reserve 80,000 200,000

Loan capital
Debenture stock 140,000 340,000

ABC PLC
PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 31 DECEMBER 2008

₦’000
Turnover 600,000
Cost of sales (450,000)
Gross profit 150,000
Administrative & distribution expenses (116,000)
Profit before interest and taxation 34,000
Debenture interest payable (7,400)
Profit before tax 26,600
Taxation 10,600
Profit after tax 16,000
Preference dividend (1,000)
15,000
Ordinary dividend (10,000)
Retained profit 5,000

SUGGESTED SOLUTION 10

Profitability

Profitability may be expressed in relation to capital employed (profit as a percentage of assets used to earn that it) or in relation to sales (gross or net profit as a percentage of sales).

(a) Return on Capital Employed (ROCE)

This is perhaps the most important ratio in assessing a company’s performance. it is simply profit, expressed as a percentage of capital employed.

In ratio analysis, the analyst simply obtains the profit figure from the profit and loss account and the capital employed from the balance sheet. There are two major pitfalls. First of all, remembering that the objective of calculating the ratios is to compare figures for different companies or for different periods, one should ensure that the figures have been arrived at on consistent basis, and that asset values are up to date. It may well be necessary to eliminate from the accounts non-trading income and the assets producing it.
Secondly, compare like with like. When capital employed means, shareholders’ fund plus long-term loans, that should be compared with profit, before deducting interest paid on these loans.

If bank borrowings become a major source of long-term finance, then they should be included in the capital employed and the profit figure used, should be before charging interest paid on such borrowings. This should be established from the facts of the case.

ROCE can be calculated in several ways as shown below

<table>
<thead>
<tr>
<th>Definition of capital employed</th>
<th>Relevant profit figure</th>
<th>Ratio using ABC Plc’ figures</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Shareholders’ fund plus long-term loan plus current liabilities</td>
<td>Profit before loan interest and bank overdraft interest</td>
<td>( \frac{34,000}{420,000} ) = 8.1%</td>
</tr>
<tr>
<td>2. Shareholders’ funds plus long-term loans</td>
<td>Profit before loan interest</td>
<td>( \frac{34,000}{340,000} ) = 10%</td>
</tr>
<tr>
<td>3. Shareholders’ funds only, that is, equity + preference shares + reserves.</td>
<td>Profit after tax and before preference dividend</td>
<td>( \frac{16,000}{200,000} ) = 8%</td>
</tr>
<tr>
<td>4. Equity shareholders’ funds</td>
<td>Profit after tax and after preference dividend</td>
<td>( \frac{15,000}{180,000} ) = 8.3%</td>
</tr>
</tbody>
</table>

Tutorial:

For examination purposes, the most important definitions are probably 2 and 4 above. Use 2 if looking for overall profitability of the company, and use 4 if looking at the position from the point of view of a prospective shareholder. Note that the definition of profit in 4 is that used for calculating earnings per share (EPS) and price/earnings (P/E) ratios.

(b) Return on Sales

1. Gross profit percentage

   The percentage of gross profit on sales can be calculated only if a trading account is available. Fluctuations in it, can be very informative, especially if a fixed mark-up on cost, is used to arrive at selling prices.

   Illustrations of the uses of the parameter are:
   - Detection of errors and fraud affecting items in trading account.
   - Used by inland revenue officials to detect suppression of sales.
   - Head office control over branches.

   For ABC PLC, gross profit percentage
   \( = \frac{150,000}{600,000} = 25\% \)

2. Net profit percentage

   For ABC PLC, Net profit percentage \( = \frac{34,000}{600,000} = 5.7\% \)

   This is a useful yardstick for comparing results of a company against its performance in previous years or those of other companies in similar trade.

   This ratio discloses something about the company’s sales philosophy.
A company may try to maximize its profit by cutting prices and going for sales volume; for example, motor parts stores- or by putting on a higher mark up and aiming for the luxury market such as boutique.

(c) Asset Turnover

Asset turnover = sales/capital employed = 600,000/340,000 = 1.8 times

A low asset turnover rate shows that a company is not generating sufficient volume of business for the size of the assets invested. This may be rendered by attempting to increase sales or by disposing of some assets or both.

To prove that the two ratios (b) and (c) are a sub-division of return on capital employed, multiply profit margin (that is, net profit %) by asset turnover. (5.7% x 1.8 times) = 10% approximately = return on capital employed. The asset turnover ratio may be further subdivided into fixed assets turnover ratio and the net current assets turnover ratio (or working capital turnover ratio). These ratios help to measure efficiency in the use of capital, since the higher the indices, the greater the utilization of assets.

Fixed assets turnover (times per year)

= sales/fixed assets = 600,000/260,000 = 2.3 times

The importance of the net current asset turnover ratio is that it provides an early warning of strained liquidity, since a very high ratio may mean that the company is short of funds needed to pay creditors.

Working Capital Turnover (times per year)

= sales/net current assets = 600,000/80,000 = 7.5 times

Liquidity

The standard measures of liquidity are:

(a) Current ratio = current assets/current liabilities

For ABC PLC = 160,000/80,000 = 2:1

(b) Acid test or quick ratio = \( \frac{\text{current assets} - \text{stock}}{\text{current liabilities}} \)

For ABC PLC = 100,000/80,000 = 1.25:1

When interpreting liquidity ratios, you should bear the following points in mind:

1. Companies and trades vary greatly in their working capital requirements (working capital is current assets less current liabilities). A retail company with rapid stock turnover with mainly cash sales basis, does not have to invest capital in stocks and debtors, in the way that a manufacturing company probably does.

The current ratio might be anything from about 1.4:1 up to maybe 3:1, depending on the trade. Be weary of the statement often seen in textbooks that the ideal ratio should be 2:1. The liquid ratio is, however expected to have a value not less than 1:1, otherwise the company could have difficulty in meeting its debts as they fall due.

2. If the current ratio or liquid ratio is unnecessarily high, having regard to the nature of the business, this may indicate that the company is not using its resources as efficiently as it ought to be. Further explanation could be that the company has built up its current assets at the balance sheet date for a major project, or seasonal sales which is to begin shortly afterwards.
3. Many blue chip companies rely on bank overdraft as a permanent source of finance, although often times stated as part of their current liabilities. This may well give rise to a very low current and liquid ratios, although no liquidity problem as such exists. There is need to know the terms of the overdraft and the amount of the facility, so that one could form a more reasoned conclusion.

4. Current and liquid ratios imply an immediate conversion of assets into cash and an immediate settlement of current liabilities. This may not be the real problem. Only a cash flow projection would produce an exhaustive answer to an analysis of working capital.

However, although creditors and debtors are likely to change daily, a tax liability or a proposed dividend will be payable at a future determined date, which will be disclosed in the accounts. The importance of this, is that, the company may have a period of credit, probably for a significant length of time, in which to achieve the cash or credit necessary to make the payment.

**Management Efficiency**

Here, the skill with management looks after the assets, under its control, especially stock, debtors, and the use of cash to pay its creditors is analysed.

The following ratios are relevant, and are frequently expressed in terms of days. For example, the number of day’s credit given is calculated as: Trade debtors/credit sales x 365

(a) Stock ratios

1. Raw materials stock holding = raw material stock /annual raw material consumption x 365
2. Number of days work-in-progress = work-in-progress/annual cost of sales x 365
3. Number of days sales covered by finished goods = finished goods stock/annual cost of sales x 365

Information is inadequate to calculate these three ratios separately for ABC PLC, but it may still be relevant to calculate the overall stock ratio, also called stock turnover period.

Stock ratio = stock/cost of sales x 365

For ABC PLC 60,000/450,000 x 365 = 49 days

The significance of these ratios is in the detection of undesirable upward trend in stock levels and in evaluating relative management efficiency by comparing them with those in similar companies. Obviously, the optimal level is entirely dependent upon the trade being carried on. Stock ratio may also be expressed in terms of the number of times that stock is turned over in the year.

Using ABC PLC (illustration)

Stock turnover ratio = cost of sales/stock = 450,000/60,000 = 7.5 times

(b) Debtors ratio

Illustration ABC PLC
= trade debtors/credit sales x 365
= 90,000/600,000 x 365 = 55 days
Trade debtors should be net of provision for bad and doubtful debts, if the figure is given.
There is assumption all the debtors are trade debtors and that all sales are credit sales.

Tutorial
Students are advised to state whatever assumption is made, in the examination environment.

Another problem which may also affect the stock and creditors ratio is that we may be dealing with a seasonal trade and those debtors are abnormally high or abnormally low at the balance sheet date. In this case, it may be more informative to take the average debtors level, or better still, compare debtors at the balance sheet date with actual sales of the months immediately, if known.
Assuming no abnormal factors, a figure of about 60 days (2 months credit) is regarded as satisfactory for debtor ratio.

(c) Creditors ratio
Using illustration ABC PLC
= trade creditors/credit purchase x 365
For ABC PLC 40,000/460,000 x 365 = 32 days
Notes: credit purchases is arrived at thus: cost of sales + closing stock – opening stock
= N(450,000 + 60,000 – 50,000) = N460,000
This ratio appears to indicate very prompt settlement of creditors, subject to special factors discussed for debtors.

Gearing
Capital gearing is the term used to describe the extent to which a company’s total capital is provided by fixed interest securities, such as debentures.

For example, ordinary share capital N100,000
Loan capital N900,000

Gearing ratio is being expressed as

1. Loan capital/equity capital: 9/1 or 9:1
2. Loan capital/total capital x 100: 9/10 x 100 = 90%

This is high gearing situation in which N100,000 worth of equity capital controls N1 million of total capital.

In the case of ABC PLC, the gearing ratio is:

1. Preference shares + debentures
   Ordinary shares + reserves
   fixed interest capital
   total capital
   = 160,000/180,000 = 0.9:1

2. = 160,000/340,000 = 47%

The ratio above reveals a moderate gearing situation for many companies.
Gearing ratio is important for two reasons. First, it is one measure of risk being taken by an equity investor. An ordinary shareholder in a highly geared company stands to gain disproportionately in good times (because the investor has the benefit of all the profit in excess of fixed interest charged), but losses disproportionately in bad times (because the fixed interest must be paid regardless of profit).

Secondly, it assist a prospective lender, who may hesitate before lending a company more than (say) twice the equity stake in it. The borrowing power of a company are frequently restricted by its Articles of Association.

**Financial Stability**

Tangible net asset value per share: that is net worth per share. This is calculated by dividing the net tangible assets by the number of ordinary shares in issue. Care has to be taken to exclude goodwill (an intangible asset) and to deduct the preference shares before arriving at the figure of net tangible assets attributable to the ordinary shareholders. Assuming no goodwill in the illustration, the net tangible assets of ABC PLC are:

<table>
<thead>
<tr>
<th></th>
<th>₦’000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fixed assets</td>
<td>260,000</td>
</tr>
<tr>
<td>Net current assets</td>
<td>80,000</td>
</tr>
<tr>
<td>Less: loan capital</td>
<td>140,000</td>
</tr>
<tr>
<td>Preference capital</td>
<td>20,000</td>
</tr>
<tr>
<td><strong>Net tangible assets</strong></td>
<td><strong>180,000</strong></td>
</tr>
</tbody>
</table>

In this case, the net tangible asset is the same as the ordinary share capital (₦100million) plus the reserve (₦80million); but this is a shortcut, which will not always work in a more complex set of figures.

The asset value per share is therefore:

\[ \frac{₦180,000,000}{₦100,000,000} \times 100 = 180\text{kobo} \]

The importance of assets per share figure is that it provides a “long step” that is, realizible value per share if the company ceases operations. It is unlikely that the assets will realise their balance sheet values exactly a fact which partly explains the differentials between quoted companies’s net worth per share and its share market price,

**Investment Appraisal**

A prospective or an existing investor will look at the following ratios in deciding whether to buy or sell shares in a company:

(a) Earnings per share
(b) Price/earnings ratio (P/E ratio)
(c) Dividend yield
(d) Dividend cover

The ratios are discussed as follows:

(a) Earnings per share (EPS)
Statement of Accounting Standard (SAS) No. 21 was issued to underline its importance and explain the various factors involved in arriving at earnings per share.

1. Earnings per share (EPS) refers to earnings per ordinary share. Basically, EPS is calculated by dividing the operating profit after tax of a company for a financial year by the number of issued ordinary shares of the company.

2. Operating profit or loss after income tax is the figure for the financial year before extra ordinary items and after applicable income tax expense. It is an amount of profit or loss that includes exceptional items but excludes extra-ordinary items.

3. EPS is a performance indicator that is primarily of interest to existing and potential shareholders, and their advisers. An appropriate method of calculating EPS plays a major role in arriving at earnings growth over time, and the price/earnings (P/E ratio). These are crucial indices to financial decisions.

4. Statement of Accounting Standards (SAS No 21)
   - In calculating EPS, an enterprise should not include extra-ordinary items before arriving at profit after tax.
   - 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.
   - The amount of net profit attributable to preference shareholders including preference dividend for the period, should be deducted from the net profit or loss for the period attributable to ordinary shares.
   - 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.
   - A weighted average number of shares outstanding during the period should be used as a denominator for the EPS calculation. Shares issued during the year included the weighted average number of shares which should reflect the date the consideration was received.
   - In calculating diluted earnings per share (EPS), the number of shares, should be determined as the total of the following:
     1. The weighted average number of ordinary shares.
     2. 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.
     3. 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 as proportion of the total number of days in the financial year.
     4. Potential ordinary shares issued outstanding during the financial year that are dilutive and have been converted or have lapsed or cancelled during the financial year, weighted by reference to the number of days to the date of conversion, lapse or cancellation.
• The computation of convertible potential ordinary shares that are dilutive should assure the most advantages conversion rate or exercise price from the standpoint of the holders of potential ordinary shares.

• Where the financial statements have been adjusted as a result of the introduction of fresh capital during the year or between the balance sheet dates of publication, an enterprise should not adjust its EPS figures for the previous years and should not present adjusted EPS.

• The weighted average number of ordinary shares outstanding during the period and for the immediate preceding year should be adjusted only when ordinary shares outstanding is increased or reduced without a corresponding change in resources.

5. Disclosure Requirements

• An enterprise should present basic and diluted EPS on the face of the income statement, and the historical financial summary with equal prominence.

• An enterprise should present basic and diluted EPS, even if the amount disclosed are negative (i.e. loss per share).

• An enterprise should present basic and diluted EPS statistics for EPS before extra-ordinary items.

• An enterprise should disclose the following:
  - The amount used as the numerator in calculating basic and diluted EPS, and a reconciliation of those amounts to the net profit or loss for the period.
  - Disclose any changes in the number of shares used to compute EPS.
  - The financial effect on diluted EPS of any adjustment resulting from changes in accounting policy applied in preparing and presenting the financial report.
  - Any conversion to calling of, or subscription for, ordinary shares that occurs between the reporting date and the time of completion of the financial report.

• An enterprise should disclose, by way of notes ordinary share or potential ordinary share transactions that occur after the balance sheet date when they are of such importance that non-disclosure would affect the ability of the users of the financial statements to make proper evaluations and decisions.

Using the Illustration of ABC

\[ \text{Basic EPS} = \frac{\text{Profit after tax and preference dividend}}{\text{Ordinary share capital}} \]

\[ = \frac{100}{100,000} \times 15,000 = 15\text{k/share} \]

(b) Price Earnings Ratio (P/E ratio)

As the name implies, this ratio measures the relationship between earnings per share and the market price per share.

In ABC PLC, the market price is not given, but assume that the market value is the same as the par value of each ordinary share.
P/E ratio market value per share
Basic EPS = 100k/15k = 6.7times

The significance of P/E ratio of a particular company can be judged only in relation to the ratios of other companies in the same kind of business. If the median P/E ratio is less than 7, it can be deduced that the investing members of the public do not favour the company, either because of poor past performance or growth prospects.

A P/E ratio higher than that of other comparative companies, on the other hand, indicates greater demand for the company’s shares presumably because a rapid growth in earnings is expected.

(c) Dividend Yield
This measures the return to a shareholder on the amount of his investments. In the case of a quoted share, the yield is calculated by reference to the current market value.
Using the illustration
\[
\text{Dividend yield} = \frac{\text{gross dividend per share}}{\text{market value per share}} = \frac{10 \times 100}{100} = 10\%
\]
Since income is an important aspect of an investment for most investors, the dividend yield is key criterion.

(d) Dividend Cover
The shareholder is interested in knowing whether his investment will continue to yield his required return. For this reason, dividend cover is appropriate since it indicates the amount of profit cover for an ordinary dividend and the amount of profit retained in the business:
For ABC PLC, dividend cover will be:
\[
\frac{\text{net profit for the year after interest and preference dividend}}{\text{dividend on ordinary shares}}
\]
That is: \(=15,000/10,000 = 1.5\)times
Therefore, the profit of the company will have to be reduced by more than half, before the ordinary shareholders’ dividends will be unrecovered by current earnings.

SELF ASSESSMENT EXERCISE
Explain what you understand by return on capital employed.

3.3 LIMITATIONS OF RATIO ANALYSIS
In spite of the obvious benefits of ratio analysis, there are some limitations to the usefulness of ratios. They include the following:

(a) The major limitation arises from the fact that they are mostly computed from historical accounts. Consequently, they suffer from the same limitations which historical accounts have, one of which is, the fact that historical information is of little use in assessing future prospects of a company.

(b) Another limitation is the fact that ratios are quantifiable data. They cannot provide non-quantifiable information like competence of management and staff and changes in the operating environment.

(c) Some of the ratios, for example, do not have universally accepted uniform parameters.

(d) When carrying out inter-company analysis, different accounting policies adopted by the companies could distort ratios calculated. For example, different depreciation policies adopted by different companies will influence the carrying amounts of fixed assets which
will influence ratios like ROCE. For inter-company analysis to be meaningful therefore, cognizance must be taken of the different accounting policies so that necessary adjustments are made where the need arises.

**SELF ASSESSMENT EXERCISE**

What are the limitations to the usefulness of ratios?

**4.0 CONCLUSION**

Tutorial: Techniques for examination questions

Examination questions on interpretation may be:

(a) Written- asking for explanation of terms or ratios used:
(b) Computational- required to calculate ratios;
(c) Request to state conclusions drawn from ratios calculated; and
(d) A combination of a, b, and c above

*Hint 1*

Do not be dogmatic in what you say. There are often several possible reasons for any divergence from “normal” in a ratio.

*Example:*

Where you find the debtors ratio showing a period of credit of 120 days, some candidates will jump to the conclusion that, the period of credit of 120 days is too high indicating a serious weakness in credit control, which may or may not be true.

A well-informed candidate will conclude as follows:

Using the figures in the published accounts, the debtors ratio shows a period of credit of 120 days, indicating possible weakness in credit control;

The ratio could be distorted, however, by one or more of the following factors:

(a) Existence of large non-trade debtors;
(b) Seasonal trade, with high sales in the period immediately before the balance sheet date;
(c) A special sale on long-term payment terms; and
(d) Sales to an associated company on favourable credit terms.

Further investigation to eliminate these factors is necessary before a firm conclusion can be drawn.

*Hint 2*

State your assumption

Taking the same situation as in the illustration on debtors ratio, (Hint 1), an alternative way to answer would be:

Debtors ratio = period of credit of 120 days
On the assumption that no special factor affects the figures in the published accounts, that is, seasonal trade, inclusion of non-trade debtors, special sales on long-term credit terms, this ration indicates serious weakness in the company’s credit control procedures and the existence of a potential bad debt.

Hint 3

Note the nature of business

Do not expect a retailer, with rapid stock turnover and most sales for cash, to have the same current ratio, as a manufacturer with high stocks and sales normally on monthly credit terms.

5.0 SUMMARY
In this unit, you would recall that we discussed the analysis and interpretations of financial statements. This was discussed considering the nature and objectives of accounting ratios, computation of ratio analysis and the limitation of ratio analysis.

6.0 TUTOR MARKED ASSIGNMENT
1. __________ is calculated by dividing the operating profit after tax of a company for a financial year by the number of issued ordinary shares of the company.
2. __________ the figure for the financial year before extra ordinary items and after applicable income tax expense.
3. __________ is a performance indicator that is primarily of interest to existing and potential shareholders, and their advisers.
4. What is the formula for determining creditor’s ratio?
5. What is the formula for determining gearing ratio?

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


Nigerian Accounting Standard Board, Statement of Accounting Standard
1.0 INTRODUCTION
In this unit, we shall proceed further to complete what has been done in the previous unit. Besides the computation and interpretation of accounting ratios, we shall proceed in discussing value added statement and report writing.

You may presume that the interpretation of financial statements merely requires the calculation of ratios; and consequently, ignore the aspect of report writing. The need to change this notion, coupled with the need to improve communication skills of would-be accounting personnel in practice, industry and commerce, informs the specific inclusion of this topic at this level.

2.0 OBJECTIVES
After studying this unit, you shall be able to:

1. Compute ratios.
2. Comment on ratios computed in respect of strength or weakness in an organization.
3. Prepare the statement of value added of a typical company.
4. Write a report

3.0 MAIN CONTENT

3.1 COMPUTATION & INTERPRETATION OF ACCOUNTING RATIOS

ILLUSTRATION 11

The balance sheet of Funfair Limited, a toy manufacturer, as at 31 December, 2008 was as follows:

<table>
<thead>
<tr>
<th></th>
<th>₦’000</th>
</tr>
</thead>
<tbody>
<tr>
<td>FIXED ASSETS (net)</td>
<td>12,000</td>
</tr>
<tr>
<td>Investments</td>
<td>500</td>
</tr>
<tr>
<td>Goodwill</td>
<td>1,900</td>
</tr>
<tr>
<td><strong>Total Assets</strong></td>
<td>14,400</td>
</tr>
<tr>
<td><strong>CURRENT ASSETS:</strong></td>
<td></td>
</tr>
<tr>
<td>Stocks &amp; work-in-progress</td>
<td>11,900</td>
</tr>
</tbody>
</table>
Debtors 11,700  
Bank and cash balances 300  
**23,900**  
**DEDUCT: CURRENT LIABILITIES**  
Creditors 8,900  
Bank overdraft 7,200  
Tax payable 400  
Dividends payable 700  
**17,200**  
**NET CURRENT ASSETS** 6,700  
**NET ASSETS** 21,100  
**FINANCED BY:**  
**CAPITAL & RESERVES**  
Ordinary share capital- issued & fully paid 10,000  
Revenue reserves 3,900  
Shareholders’ fund 13,900  
Deferred tax 1,200  
Long-term loan 6,000  
**21,100**  
Turnover during the year 2007 was N39 million, (2006 – N42 million) and that in the first half of 2008 was N12 million (2007- N13 million). Stock at December 31, 2006 was N2.1 million. stock is stated at cost (including appropriate production overheads), which is approximately 60% of selling price.  

**Required:**  
(a) Compute the current ratio of funfair ltd at December 31, 2007.  
(b) Briefly explain the purpose of current ratios and how it may vary with the nature of the business concerned.  
(c) What subsidiary ratios may usefully be computed which will enable an analyst to form a judgment as to the working capital structure? Illustrate their computation using the balance sheet and other data for funfair ltd.  
(d) On the basis that turnover in 2007 was N39 million and debtors were N11.7 million, the average collection period for funfair ltd was 109.5 days, which is clearly excessive, comment on this analysis.  
(e) Comment on the major weakness (apart from debt collection) apparent from the accounts of funfair ltd.  

**SUGGESTED SOLUTION 11**  
(a) Current ratio = current assets/current liabilities = 23.9/17.2 = 1.39:1  
(b) 1. Purpose of current ratio  
The current ratio is an indicator of the financial soundness and stability of a business. The priority of a business is survival and it cannot survive unless it is able to meet its debts as they become due for payment.  
Current assets are defined as those held for conversion into cash in the ordinary course of business while current liabilities are obligations to pay money at a future date, usually within 12 months.
By relating these two figures at a particular date, one can assess the company’s ability to pay debts due within 12 months, out of assets which are to be converted to cash in approximately within the same time scale.

Current assets include stocks and work-in-progress. They are perhaps the most difficult current assets to convert quickly to cash. It is, therefore, common to measure the company’s immediate ability to pay its debts by computing the “liquidity ratio” (or acid test ratio as it is otherwise known) as follows:

\[
\frac{\text{current assets less stock & WIP}}{\text{current liabilities}} = \frac{23.9 - 11.9}{17.2} = 12/17.2 = 0.7:1
\]

Attempts are frequently made to establish a norm for these ratios. It is difficult to state an absolute figure in isolation, for example, stock and debtors levels required in one industry may be quite different from those in another.

The ratios should be compared year by year within the same company and one would look for a consistent pattern. An industry average would be a useful indicator for a company, as it would enable comparison to be made with other companies in the same sector.

Ratios do not usually provide a final answer: they only assist in the better understanding of financial reports. It is, therefore, always necessary to relate the figures to previous performance or some external standards.

2. Effect of the nature of the business

The crucial effect of the nature of the business on the current ratio can be illustrated by reference to two elements of working capital:

Stocks – Manufacturing companies hold stocks of raw materials, work-in-progress and finished goods, whereas service companies tend not to do so.

Debtors – Business which sell for cash (such as supermarkets) will not have material figures for trade debtors compared with business whose sales are principally on credit terms, for example, heavy engineering firms.

Clearly, the current ratios in these types of operation are significantly affected by the nature of the business and this explains why it is essential to compare current ratios from year to year within the same company or with other companies in the same industry.

(c) Working Capital Ratios

It is possible to take an overall of the level of working capital by computing ratios which link working capital or its constituent elements to other aspects of the business. Having established normal or desired relationships, one can monitor deviations from the norm. The objective is to establish the cause and effects of these deviations (which may be justified).

1. Working capital/capital employed = 6.7/21.1 = 0.32:1

Or

Working capital/fixed assets = 6.7/12 = 0.56:1

The implication is that a high proportion of working capital to total capital employed, gives the business freedom to adapt to changing circumstances. For example, it might enable a company to boost sales by a temporary reduction of liquidity or to realise assets and invest the proceeds in the most profitable way.

2. Stock turnover ratio = \( \frac{\text{sales}}{\text{stock & WIP}} \) = 39/11.9 = 3.3times 42/2.1 = 20times
By relating sales to year-end stocks and work-in-progress, the analyst who only has access to published information, attempts to, assess the effectiveness of the company’s control over its stock levels and its ability to generate sales in relation to stocks held. Published information in this question is deficient in two principal aspects:

1. No information is disclosed as to cost of goods sold. Such information would be useful in computing stock turnover ratio, because sales include a profit element whereas stocks are usually stated at cost. Comparisons between companies are distorted by the discrepancy between gross profit margin earned by different businesses. It would therefore be better to relate stocks to cost of goods sold.

2. No information is disclosed about the pattern of sales during the year, or about the average levels of stocks held or about cost of goods sold.

In the example, we can re-compute the ratio using cost of goods sold as being 60% of sales.

<table>
<thead>
<tr>
<th></th>
<th>2007</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost of goods sold/(stock + WIP)</td>
<td>23.4/11.9 = 1.97 times</td>
<td>25.2/2.1 = 12 times</td>
</tr>
</tbody>
</table>

3. Average collection period

Trade debtors/sales per day = ₦11.7m/₦106.850 = 109.5 days
Sales per day = ₦106,850 (3.9m/365)

This ratio, when compared with those of previous years and with other similar companies, indicates the effectiveness of the company’s credit control procedures and adverse movements may suggest the inclusion of bad and doubtful debts in the trade debtors figure. When calculated on the basis of published accounts, this ratio requires qualification.

(d) Comment on the average collection period

Funfair Ltd has a collection period of 105.5 days based on annual turnover of N39million and year-end trade debtors of ₦11.7 million. This appears to be excessive, but like all ratios, it must be related to other information. If other toy manufacturers have a similar collection period, Funfair’s 109.5 days may appear very long, but that may be the norm for that industry.

This question provides information about the seasonal nature of the company’s business, sales in the first half of 2007 were ₦13million and doubled in the second half to ₦26million (N39m – N13m). for example, if it could be established that the company’s normal terms of credit were for 2 months and that sales for the forth quarter of 2007 were ₦18million, we could re-compute the ratio as follows:

Sales per day over the last quarter = ₦18m/90 = ₦200,000

Collection period = ₦11.7m/₦200,000 x 365 = 58.5 days

This calculation demonstrates that the collection period is almost exactly in line with the company’s policy, whereas using the year-end debtor and annual turnover, the collection period extends to 109.5 days. This does not mean that credit control is not weak in Funfair Ltd, but it is not possible from the published accounts of one year, to make a categorical statement about credit control.

(e) Major weaknesses apparent from the accounts of funfair ltd.
The company is a toy manufacturer and one would have expected its stock levels to be relatively low at its year-end, because of the seasonal nature of the business. At 31 December, 2006, stocks were valued at ₦2.1million and one year later, it had risen to ₦11.9million.

This occurred in a year when turnover fell from ₦42million to ₦39million.

One might conclude that the company had been over-producing in 2007 and the stock/turnover ratio based on year-end stocks and cost of goods sold, tends to give credence to that conclusion.

One possible explanation for building stocks at the year-end, would be to meet expected demand in the early months of the following year, perhaps to coincide with the launch of a new product or an advertising campaign. However, it is unlikely to be the case with Funfair Ltd, because its seasonal peak of sales would fall in the last quarter of the year and not in the first quarter.

The question gives a sales figure of ₦12million for the first 6 months of 2008. Provided that cost represents the quoted 60% of selling price, the cost of goods sold in the period is ₦7.2million. This suggests that the stocks valued at ₦11.9million will easily last the company until the second half of 2008.

Therefore, it is likely that the company will have to reduce production drastically in 2008, to avoid holding excessive stocks, which are expensive to finance in terms of bank overdraft interest. Redundancies would be an inevitable consequence of major cuts in production and this situation represents a serious threat to the future of the business.

**ILLUSTRATION 12**
The summarized balance sheets and operating results of Landers Plc for the two years ended 31 December 2007 and 2008 were as follows:

**BALANCE SHEET AS AT 31 DECEMBER 2008**

<table>
<thead>
<tr>
<th></th>
<th>2008</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fixed assets (net)</td>
<td>162,220</td>
<td>69,410</td>
</tr>
<tr>
<td>Stock &amp; work-in-progress</td>
<td>622,940</td>
<td>521,960</td>
</tr>
<tr>
<td>Debtors &amp; prepayments</td>
<td>548,590</td>
<td>500,520</td>
</tr>
<tr>
<td>Bank &amp; cash balances</td>
<td>72,340</td>
<td>145,650</td>
</tr>
<tr>
<td></td>
<td>1,243,870</td>
<td>1,168,130</td>
</tr>
<tr>
<td>Current Liabilities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Creditors &amp; accruals</td>
<td>470,550</td>
<td>428,850</td>
</tr>
<tr>
<td>Taxation</td>
<td>41,540</td>
<td>32,190</td>
</tr>
<tr>
<td>Dividends</td>
<td>25,000</td>
<td>22,500</td>
</tr>
<tr>
<td></td>
<td>537,090</td>
<td>483,540</td>
</tr>
<tr>
<td>Net Current Assets</td>
<td>706,780</td>
<td>684,590</td>
</tr>
<tr>
<td>Net Assets</td>
<td>869,000</td>
<td>754,000</td>
</tr>
<tr>
<td>Financed by:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ordinary shares of N1 each</td>
<td>125,000</td>
<td>125,000</td>
</tr>
<tr>
<td>Revenue reserve</td>
<td>358,740</td>
<td>297,870</td>
</tr>
<tr>
<td>Shareholders’ fund</td>
<td>483,740</td>
<td>422,870</td>
</tr>
<tr>
<td>10% debenture stock 2010-12</td>
<td>250,000</td>
<td>250,000</td>
</tr>
<tr>
<td>Deferred taxation</td>
<td>135,260</td>
<td>81,130</td>
</tr>
<tr>
<td></td>
<td>869,000</td>
<td>754,000</td>
</tr>
</tbody>
</table>
Operating Results for the year ended 31/12/2008

<table>
<thead>
<tr>
<th></th>
<th>2008</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>₦'000</td>
<td>₦'000</td>
</tr>
<tr>
<td>Sales</td>
<td>6,729,440</td>
<td>5,590,710</td>
</tr>
<tr>
<td>Profit before interest and taxation</td>
<td>234,120</td>
<td>208,820</td>
</tr>
<tr>
<td>Interest payable</td>
<td>25,000</td>
<td>25,000</td>
</tr>
<tr>
<td>Taxation</td>
<td>105,060</td>
<td>87,470</td>
</tr>
<tr>
<td>Dividend</td>
<td>37,500</td>
<td>35,000</td>
</tr>
</tbody>
</table>

The shares of the company were quoted at N1.20 at 31 December 2008.

You are required to:

(a) Calculate

1. Two ratios of interest to creditors
2. Two ratios of interest to management and
3. Two ratios of interest to shareholders.

(b) Comment briefly upon the changes between 2007 and 2008.

SUGGESTED SOLUTION 12

LANDERS PLC

<table>
<thead>
<tr>
<th></th>
<th>2008</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>₦</td>
<td>₦</td>
</tr>
<tr>
<td>(a) 1. Two ratios of interest to creditors:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current or working capital ratio = 1,243,870/537,090/537,090 = 2.3:1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Liquid or quick asset ratio = 1,243,870−622,940/537,090 = 1.2:1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>521,960/483,540 = 1.3:1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Two ratios of interest to management:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Return on capital employed = 234,120/869,000 x 100 = 26.9%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net profit margin = 234,120/6,729,440 x 100 = 3.5%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. Two ratios of interest to shareholders</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Earnings per share = 234,120−25,000−105,060/125,000 = 83 kobo</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dividend Cover = 234,120−25,000−105,060/37,500 = 2.8times</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

(b) Comments on changes in ratios between years 2003 and 2004

1. Ratios of interest to creditors
Both current and liquid ratios dropped slightly. In the absence of specific information on the industry in which the company operates, we can only compare these ratios against the generally accepted ideal of 2:1 for current ratio and 1:1 for liquid ratio. When compared against these ideals, it can be seen that the current liquid ratios of the company (in spite of slight deterioration) indicate that the company’s liquidity is still relatively satisfactory.

2. Ratios of interest to management
Return on capital employed dropped slightly due to the slight reduction in net profit margin from 3.7% to 3.5%. The decrease in profit margin, despite the increase in sales and profit, may have been due to:
- Drop in selling price as dictated by the market: or
- Increase in costs which could not be fully passed on to consumers.

3. Ratios of interest to shareholders
Earnings per share increased because, while the number of issued ordinary shares remained the same, the absolute amount of profits increased. This is an indication of growth, even though the growth is not matched by increase in profitability. The dividend cover remains unchanged obviously because the dividend increased in proportion to the increase in earnings.

**SELF ASSESSMENT EXERCISE**
What is the purpose of current ratio?

**3.2 VALUE-ADDED STATEMENT**
Value-added statement represents the additional wealth which an entity has been able to create by its own and its employees’ effort. This statement shows the allocation of that wealth among employees, providers of finance, government and that retained in the business for future creation of more wealth.

**ILLUSTRATION 13**
Set below is the profit and loss account of XYZ PLC, a manufacturing company, for the year ended 31 December 2008, together with its comparative figures.

<table>
<thead>
<tr>
<th></th>
<th>2008</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Turnover</td>
<td>8,074,458</td>
<td>5,201,750</td>
</tr>
<tr>
<td>Cost of sales</td>
<td>(5,015,397)</td>
<td>(3,021,246)</td>
</tr>
<tr>
<td>Gross profit</td>
<td>3,059,061</td>
<td>2,180,513</td>
</tr>
<tr>
<td>Distribution costs</td>
<td>(520,162)</td>
<td>(364,475)</td>
</tr>
<tr>
<td>Administrative costs</td>
<td>(1,366,742)</td>
<td>(681,787)</td>
</tr>
</tbody>
</table>
Trading profit 1,172,157 1,134,251
Interest payable (net) (386,079) (235,739)
Profit before exceptional items & taxation 786,078 898,512
Exceptional items 113,169 -
Taxation (314,138) (335,520)
Profit after taxation 358,771 562,992
Proposed dividend (351,000) (234,000)
Retained profit 7,771 328,992

The following notes are relevant:

1. Included in cost of sales is excise duty amounting to ₦2,095,631,000 (2007 ₦1,028,900,000) charged on the manufactured goods.
2. Included in distribution and administration costs are staff salaries wages and fringe benefit totalling ₦495,872,000 (2007 ₦306,062,000) and depreciation charged on fixed assets of ₦200,264,000 (2007 - ₦132,397,000).
3. Taxation comprises:
   | 2008     | 2007     |
   | ₦’000    | ₦’000    |
Income tax 34,982 314,479
Educational tax 17,117 21,041
Deferred tax 262,039 -
   | 314,138  | 335,520  |

Required:

Prepare the statement of value added of the company for the year ended 31 December, 2008 as it will appear in its published financial statements.

SUGGESTED SOLUTION 13

XYZ PLC
STATEMENT OF VALUE ADDED FOR THE YEAR ENDED 31 DECEMBER 2008

<table>
<thead>
<tr>
<th></th>
<th>2008</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>₦’000</td>
<td>%</td>
</tr>
<tr>
<td>Turnover</td>
<td>8,074,458</td>
<td>5,201,759</td>
</tr>
<tr>
<td>Bought-in-materials and services</td>
<td>(4,223,703)</td>
<td>(2,600,149)</td>
</tr>
<tr>
<td>Value added</td>
<td>3,850,755</td>
<td>100</td>
</tr>
<tr>
<td>Distribution of value added:</td>
<td></td>
<td>100</td>
</tr>
<tr>
<td>To Government:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Excise duty</td>
<td>2,095,631</td>
<td>54.4</td>
</tr>
<tr>
<td>Tax on company profit</td>
<td>52,099</td>
<td>1.4</td>
</tr>
<tr>
<td>To Employees:</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

110
Salaries, wages and fringe benefits 495,872 12.9 306,062 11.8
To Providers of Finance:
Dividends to shareholders 351,000 9.1 234,000 9.0
Interest on borrowings 386,079 10.0 235,739 9.0
Retained in Business:
To maintain and replace fixed assets 200,264 5.2 132,397 5.1
To augment reserves 7,771 0.2 328,992 12.6
Deferred taxation 262,039 6.8 - 3,850,755 100 2,601,610 100

SELF ASSESSMENT EXERCISE
Using the same question in the illustration, prepare a value-added statement and compare your result to the solution in this sub-unit.

3.3 REPORT WRITING

Elements of a Report

A report usually consists of the following elements:

(a) Headings
(b) Terms of Reference
(c) Main body of the Report:
   1. Facts
   2. Recommendations

Headings

A convenient format for examination use may be in internal memo form:

To: The Directors, XYZ Limited
From: Mr, Ade Wazobia Date:

Subject ________________

The heading needs to give:

1. The names of the recipient and the writer
2. The date; and
3. The subject being reported on.
   If the question does not contain names, invent some names but avoid use of names or real companies or persons. Above all, do not use your name.

Terms of Reference

Terms of reference are easily picked up by quoting from the question. Feel free to use a little constructive imagination by referring to previous letters or meetings.

Main Body of the Report
1. Use of Appendices

In an accounting examination, candidates will probably have to make some calculations perhaps ratios, proposals for amalgamation or absorption etc before you know what you are going to write in your report. Instead of wasting time making these calculations in a working sheet and later recopy into the body of the report, it is advisable to attached the working sheet to your report as an appendix, and refer to the appendix in the main report. In the report you write:

“Detailed calculations of the ratios are to be found in appendix 1 to this report”. You then write appendix 1 at the top of your working sheet, ad by this achieve two objectives:

- A saving of time
- Removal of details from the main report. This, in itself, is a good reporting style.

2. Tabulation

In writing a report, or indeed in writing the answer to any non-computational question, the problem always arises as to whether to tabulate or not to tabulate. By “tabulation”, we mean the presentation of information in a tabular form.

Format of Tabulation

<table>
<thead>
<tr>
<th>Month</th>
<th>No. Of Accounts</th>
<th>Students</th>
<th>Marks Scored</th>
</tr>
</thead>
<tbody>
<tr>
<td>January</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>February</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>March</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The above shows the details of marks scored by accounting students in tests conducted in January, February and March of a particular year.

The alternative is to write a paragraph of prose incorporating the same information.

Tabulation has advantages and disadvantages. It is particularly suitable for use when listing a fairly large number of facts, each of which can be stated briefly.

It is not so suitable for a question, which asks for discussion. It can be used here to state the arguments for and against a course of action.

The advantages of tabulation are:

- English construction is simplified;
- It is easy to add to:
- It is easily marked when a number of factual points have to be dealt with; and
- It facilitates logical thought and presentation.

The disadvantages of tabulation are:

- If you can write good English, tabulation will limit your ability to demonstrate this to the examiner; and
- It is not suitable when an open question is to be discussed.

A reasonable compromise is probably to use tabulation for presenting facts and not opinions. You should ensure that the form of each item in the tabulation makes sense with the introduction.

An example of how not to do it is:

This course of action is not recommended if:
(a) Labour unrest continues at the present level;
(b) When inflation rate increase; and
(c) Interest rate alterations.

Notice that (a) fits in satisfactorily with the introductory “if” but (b) and (c) do not. To correct, omit the “when” from “b” and rephrase (c) as “interest rates are expected to alter significantly”.

3. English Style
A report should be written in clear, fairly formal English. Avoid pompous business jargon, but on the other hand, avoid the over – colloquial approach. Use short and simple sentences.

It is probably better to report in third person: for example, “it is thought that ________ ” rather than “I think ________”.

Qualities of a good report
A good report should have six qualities:

(a) Fullness;
(b) Accuracy
(c) Literacy;
(d) Level/consciousness of users;
(e) Interest of the users; and
(f) Clarity of purpose

Remember the Acronym – FALLIC

(a) Fullness
All aspects of the subject must be covered. If for example, a report is drafted recommending that all employees should be disengage, it should contain:
1. Names of employees, positions in the firm, length of service and remuneration;
2. Reasons for dissatisfaction;
3. Suggested dates for disengagement, periods of notice required and terminal benefits arrangements;
4. Officers who will tell the employees of their dismissal;
5. Steps, if any, taken to help to find other jobs for the employees;
6. Steps taken to find replacements including details of any advertisement placed;
7. Dates of the reports; and
8. Signature(s) of the writer(s).

(b) Accuracy
Information should be checked if, for example, a reporting accountant is told by the vendors of a firm under investigation that “the premises are worth N50million, at least” he must corroborate this statement before using it in his report. At the very worst, he might say, “the vendor values the premises at N50million”, but “we are told the premises are worth N50million”, is a dishonest statement.

(c) Literacy
You are not expected or required to write in the style of a great writer. You must, however, form correct grammatical sentences which leave no room for ambiguity. Avoid split infinitives, incorrect positioning of a key word as “only”, repetition, unnecessary abbreviations and slangs. Be certain that your emphasis falls where you intend it.

(d) Level/Consciousness of users
A report is written for the readers, not for the writers. Writers of bad reports often seek to confuse their readers, by using terms they know will not be understood, in a mistaken attempt to create a favourable impression. This use of unnecessary jargon especially, appears in students’ scripts, but a more common fault is that of describing a familiar process in over-simplified terms in an attempt to conceal the writers’ inadequate knowledge by writing volumes.
The scope of a report is often determined by the level of the person or persons to whom it is directed, and great skill may be required if it is necessary to describe a technical process in lay terms.
An accountant may need to submit details of a new project to different groups of people. It is to be expected that his report to the Board of Directors will differ from reports to other managerial levels in the organization, both in style, scope and approach.

(e) Interest
Dull people tend to write dull reports. Good English itself commands interest.
Here is an attempt to communicate information in two different ways:
1. “The business has been trading for many years in the light engineering field, and has financed itself entirely out of internally generated profits. The management appears to be good, and the company has made fair progress in recent years. We do not consider that the price required is unreasonable, and it you intend to assume the duties of executive chairman of the company, you should find the purchase of the company a sound investment”
   Perhaps, this is a rather difficult extract to criticise, but is not the following a little more interesting?
2. “A remarkable aspect of the company is that throughout its 40 years history, it has never borrowed money, nor made demands upon its shareholders, beyond their original capital. This factor, which some would consider something of an achievement, may well be largely responsible for the company’s slow rate of real growth.
   If, as we believe, you intend to take over as chairman of the company, we consider that the purchase of the whole of the equity capital, even at the full asking price, should prove both absorbingly interesting and financially rewarding for you”

(f) Clarity
To be clear, a report should:
1. Contain no ambiguities;
2. Be divided logically into parts and arrive at a conclusion: and
3. Not necessarily be restricted to narrative matter.

Written information can be imparted in three different ways

- Narrative
- Tabulation
Diagrammatic

The diagrammatic may be further analysed into:

1. Graphs;
2. Histograms or distribution patterns;
3. Time series;
4. Bar charts
5. Pictograms; and
6. Pie charts

It is often far easier for the reader to absorb information in one of these forms than to wade through pages of description.

ILLUSTRATION 14

You have been consulted by your client, Chief Richard Balinga, who has independent means. He wishes to retire and sell his business to two trusted employees who have managed this business successfully in recent years. He is particularly anxious to retain some element of control until the purchase consideration is fully paid.

The capital structure of his family business, Balinga Limited is as follows:

- Authorized capital: ₦10 million
- Issued capital: 5 million ordinary shares of ₦1 each

You are required to write to your client setting out different means by which his objective could be achieved.

SUGGESTED SOLUTION 14

Dear Chief Balinga,

Arrangements for the sale of Balinga Limited

Thank you for your letter dated 29 July 2008, in which you sought our advice on how you could retain an element of control over your company during the period between the sale and your receipt of the full consideration due.

As you will certainly be aware, there are several methods of achieving your objective, two of which we list below:

(a) Release of your shares and when you receive such instalment.
(b) Placing the shares in a nominee’s name, for example, your stockbrokers who hold them in lien, until you are paid and then releases them to the buyers. Any dividend could meanwhile be placed in the nominee’s name until the completion of the contract of sale.

Our first suggestion suffers from the disadvantage that once control has passed, it may be difficult for you to collect your money on the remaining shares in the event of default:
We believe the second option of introducing a trustworthy nominee, would better serve your objective and gain the confidence of the buyers. An agreement would be drawn up between yourself, the buyers and the nominee company, leading to the release of the title by the nominee company, when the last instalment is paid. During the tenure of the agreement, the nominee company would distribute any dividends, according to the proportion of the purchase price paid at the time of receipt of the dividend.

In conclusion, we suggest that the prospective buyers insure their lives, for a sum, at least equal to the purchase price, so that their estates would be released from burden and your position would not become insecure if either of them were to die while the agreement is still in force.

Please, let us know if you require further information.

Thank you.

Yours faithfully

For XYZ & Co.

SELF ASSESSMENT EXERCISE
1. State the qualities of a good report.
2. What are the advantages and disadvantages of tabulation in report writing?

4.0 CONCLUSION
A good reporting style demands appropriate skills from a qualified accountant. Practice is essentially to acquire it. It is important to read and study the construction of reports that come your way in the course of your work.

5.0 SUMMARY
This unit demonstrates how accounting ratios are computed and interpreted. It is important to note that what is termed “ideal” ratio varies from industry to industry and sometimes on the size of the company.

Accounting ratios are of tremendous benefit in analysing and interpreting financial statements. However, they have their own limitations, which were discussed in this unit. Proper guide to writing a good report is also provided.

6.0 TUTOR MARKED ASSIGNMENT
1. State any party that is always interested in the interpretation of financial statements.
2. In computing returns on capital employed, (ROCE), the term capital employed could be defined as in various ways, depending on the profit figure used as the numerator. Mention one variant way of capital employed.

Using the following information to answer question 3 & 4
The following is the balance sheet of Gidado Ltd

<table>
<thead>
<tr>
<th></th>
<th>N,000</th>
<th>N’000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ordinary shares of capital @ N1 fully paid</td>
<td>10,000</td>
<td></td>
</tr>
<tr>
<td>Fixed assets</td>
<td></td>
<td>12,000</td>
</tr>
<tr>
<td>Reserves</td>
<td>5,000</td>
<td>9,000</td>
</tr>
<tr>
<td>Current assets</td>
<td>15,000</td>
<td></td>
</tr>
<tr>
<td>Current liabilities</td>
<td>6,000</td>
<td></td>
</tr>
</tbody>
</table>
The company estimates its future profits at ₦2,500 per annum and dividends on ordinary shares at ₦1,500 per annum.
Investigation reveals that similar shares should earn 7 percent and have a price earning ratio 10:1.

3. Compute future dividends per share.
4. Compute the value of ordinary shares on dividends yield basis.
5. Mention one limitation of ratio analysis.

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


Nigerian Accounting Standard Board, Statement of Accounting Standard
UNIT 1: ACCOUNTING FOR INSURANCE CLAIMS 1

CONTENT
1.0 Introduction
2.0 Objectives
3.0 Main Content
   3.1 Insurance Claim
   3.2 Steps and Procedures in Computing Insurance Claims
   3.3 Claims for Loss of Stock
4.0 Conclusion
5.0 Summary
6.0 Tutor Marked assignment
7.0 References/Further Reading

1.0 INTRODUCTION

An insurance contract is a "contract under which one party (the insurer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder." [IFRS 4.Appendix A]

An insurance claim is a formal request to an insurance company asking for a payment based on the terms of the insurance policy. Insurance claims are reviewed by the company for their validity and then paid out to the insured or requesting party (on behalf of the insured) once approved.

In this unit we shall be discussing insurance claim, steps and procedures in computing insurance claims and claim for loss of stock. Other issues shall follow in the subsequent unit.

2.0 OBJECTIVES

After studying this unit, you should be able to:

1. Define the terms stated by the policy on consequential loss.
2. Compute the consequential loss claim.
3. Outline the steps involved in ascertaining the value of stock destroyed if unknown.

3.0 MAIN CONTENT

3.1 INSURANCE CLAIMS

Insurance claims refer to the amounts payable under a contract of insurance on the occurrence of an insured event. Insurance claims may be broadly categorized into:
(a) Claims for loss of profit otherwise referred to as “consequential loss”;
(b) Loss of assets, e.g. stock or fixed assets.

Consequential loss

This type of insurance policy indemnifies the insured from losses arising from the suspension, wholly or partly, of the activities of the business, caused by fire or other man-made occurrences.

The terms of each policy vary according to the individual needs of the insured. However, normal policy provides for indemnity against the loss of profit due to:

(a) Reduction in turnover;
(b) Increased cost of working capital incurred, in order to avoid reduction in turnover.

In order to have better understanding of a policy on consequential loss, the following terms need to be defined:

(a) Period of indemnity: This refers to the period of dislocation, for which the policy was effected and is normally stated there-in, for example, “4 months”.
The basis of compensation is computed by reference to a percentage, which the turnover is supposed to earn. This percentage, multiplied by the amount of turnover reduced or loss as a result of fire, gives the amount of claim, subject to certain amendment and limitations, arising out of the “special circumstances clause and the average proviso”.
(b) 1. Rate of gross profit: This is calculated on the trading results of the last accounting period as follows:
\[
\frac{\text{net profit} + \text{insured standing charges}}{\text{turnover}} \times 100/1
\]
2. Rate of gross loss: Also calculated on the trading results of the last accounting period as follows:
\[
\frac{\text{insured standing charges} - \text{net loss}}{\text{turnover}} \times 100/1
\]
(c) Insured standing charges
These refer to fixed costs or expenditure specified by the business and stated in the policy, such as rent and salaries which the insured wishes to recover in the event of damage.
(d) Cost of workings
This is the expenditure which varies directly with production; that is, increase of insured standing charges due to fire for the sole purpose of avoiding or reducing the reduction in turnover.
(e) Period of damage or dislocation
This is the actual period during which the business of the insured is adversely affected.
(f) Annual turnover
This is the turnover of the period of 12 months immediately before the date of damage or fire.
(g) Standard turnover
This is the turnover of a period in the preceding year corresponding to the period of damage.
(h) Actual turnover
This is the turnover derived during the period of damage.

(i) Average clause

The average clause provides that, if the sum insured by the policy holder is less than the sum produced by applying the rate of gross profit to the annual turnover, then the amount payable shall be proportionately reduced, that is:

\[
\frac{\text{amount insured}}{\text{gross profit} \times \text{turnover}} \times \text{claim}
\]

The average clause is applicable when the sum insured is less than expected insurable sum (that is, gross profit% x annual turnover).

(j) Special circumstances clause

Consequential loss policy usually contains special circumstances clause, to provide for the trend of business or for special circumstances affecting the business either before or after the damage. It will affect the calculation of the following:

(a) Rate of gross profit;
(b) Reduction in turnover;
(c) Increases in cost of workings; and
(d) Savings in insured standing charges.

SELF ASSESSMENT EXERCISE

In order to have better understanding of a policy on consequential loss, what are the terms that need to be defined?

3.2 STEPS AND PROCEDURES IN COMPUTING INSURANCE CLAIMS

(a) Fixed the period of claim by taking the period of indemnity or the period of interpretation, whichever is smaller.
(b) Ascertain the ‘short’ or reduced turnover. That is, $N$

| Standing charges                        | $\times$   |
| Add any expected increase (if any)      | $\times$   |
| Less actual turnover                    | $\times$   |
| Reduction in turnover                   | $\times$   |

(c) Calculate the rate of gross profit based on the accounting year preceding the fire.
(d) Compute gross profit by applying (c) to (b).
(e) Add to (d) above, the increase in cost of working, bearing in mind the following restrictions:

(i) where all the insurable standing charges are not covered by the policy, then only a proportion of the increased cost of working will be allowed, that is:

\[
\frac{\text{net profit} + \text{insured standing charges}}{\text{net profit} + \text{total insurable standing charges}} \times \text{increase cost of working}
\]

(ii) loss of profit avoided due to increased cost of working that is, rate of gross profit x shortage of turnover avoided.

(f) Deduct any savings in insured standing charges to arrive at claims, which is subject to “average proviso”.

(g) Apply, if required, any amendment arising out of “special circumstances”.

(h) Determine whether the average clause is applicable or not and apply it to arrive at the actual claims.
ILLUSTRATION 15

From the following information, compute consequential loss claim:

Financial year ended 31 December 2006 with turnover of ₦200,000.

Fire takes place 1 June - 1 November.

Period of indemnity is 6 months

Net profit ₦12,000; plus insured charges ₦24,000

Sum insured ₦36,300

Uninsured standing charges ₦2,000

Standing turnover; that is, corresponding months (1 June – 1 November 2006 is ₦75,000).

Turnover in the period of interruption is ₦22,500.

Annual turnover for twelve months preceding the fire (1 June – 3 May 2007) is ₦220,000.

Increase in cost of working ₦4,000, during the period of interruption (with a saving of insured standing charges ₦1,500).

Reduced turnover avoided, through increase in cost of working ₦10,000 (that is) but for this expenditure, the turnover after the fire would have been only ₦12,500.

Owing to reserves acceptance to the insurer, the “special” circumstances clause stipulates for:

(i) Increase of turnover (standard & annual) by 10%

(ii) Increase of rate of gross profit by 2%.

You are required to compute the consequential loss claim

SUGGESTED SOLUTION 15

Computation of consequential loss

<table>
<thead>
<tr>
<th></th>
<th>₦</th>
<th>₦</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Loss of gross profit:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Turnover in standard period</td>
<td>75,000</td>
<td></td>
</tr>
<tr>
<td>Add agreed increase of 10%</td>
<td>7,500</td>
<td></td>
</tr>
<tr>
<td>Adjusted standard turnover</td>
<td>82,500</td>
<td></td>
</tr>
<tr>
<td>Actual turnover during (1 June – 1 Nov.)</td>
<td>(22,500)</td>
<td></td>
</tr>
<tr>
<td>Reduced turnover</td>
<td>60,000</td>
<td></td>
</tr>
<tr>
<td>Gross profit% on reduced turnover</td>
<td>12,000</td>
<td></td>
</tr>
<tr>
<td>(20% x 60,000)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(b) Claim for increase in cost of working:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Increase in cost of working</td>
<td>4,000</td>
<td></td>
</tr>
<tr>
<td>Subject to the lower of:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Apportionment, based on the insured</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Standing charges:
\[
\frac{12,000 + 24,000}{12,000 + (24,000 + 2,000)} \times 4,000 = 3,789
\]

2. GP\% of increase turnover

That is, \(₦10,000 \times \frac{2}{2,000} = 2,000\)

\(₦(22,500 - 12,500)\)

Lower of (i) & (ii) = 2,000

Savings in insured standing charges = 1,500

Claims = 12,500

Subject to the average proviso clause:

i. Amount insured \(₦36,300\)

ii. GP\% of annual turnover \(₦48,400\)

\((20\% \times 220,000 + 10\% \times ₦220,000)\)

Since the amount insured is lower, the average clause applies.

Workings:

i. Gross profit\% = \(\frac{NP + \text{Insured charges}}{\text{turnover}}\)

\((12,000 + 24,000)/200,000 = 18\%\)

Allowance increase = 20\% x 18\% = 3.6\%

ii. Standard period:

For period (1 June – 1 Nov) = 6 months

(Covered by the insurance period)

Application of the Average proviso clause:

\[
\frac{\text{amount insured}}{\text{GP\% x annual turnover}} \times \text{Claims}
\]

\(\frac{36,300}{48,400} \times 12,500 = 9,375\)

\(₦9,375\) (final claim for consequential loss)

**SELF ASSESSMENT EXERCISE**

Where all the insurable standing charges are not covered by the policy, what should be allowed and stating the formula?

### 3.3 CLAIMS FOR LOSS OF STOCK

When a trader loses stock as a result of fire, he should make a claim for loss of stock, provided he knows the value of stock loss. Where the exact value of stock in trade destroyed by fire is unknown, the usual method of ascertaining it, is arrived at as follows:

(a) Determining the basis of stock taking, particularly with regard to consistency of valuation and adjust for any inconsistency in price.

(b) Ascertaining the value of stock at the beginning of accounting period, that is, date of last balance sheet.
(c) Determining the value of goods purchased from the beginning of the period to the date of damage excluding goods purchased but not yet delivered to the company warehouse, where fire occurred.

(d) Determine total sales of goods from the beginning of the period to the date of damage excluding goods sold but not yet delivered to customers.

(e) Ascertain the value of stock salvaged/saved from the burnt premises.

(f) Calculate the average rate of gross profit made, in the previous accounting period, having regard to the factors likely to distort such average rate of gross profit such as:
   i. Year-end sales at required prices;
   ii. Perishable goods sold at reduced prices;
   iii. Abnormal goods taken into stock at a price other than at cost price;
   iv. Stock quantity shortage.

SELF ASSESSMENT EXERCISE
Where the exact value of stock in trade destroyed by fire is unknown, how is the usual method of ascertaining it arrived at?

4.0 CONCLUSION
A personal injury claim may require a different level of proof and persistence than a vehicle damage claim and insurance regulations vary from country to country. However, the basic steps to take information needed to file a claim are fairly similar.

Every insurance claim requires some kind of proof of damage or injury before an insurer will pay. On auto claims, someone said, there are five elements of proof that will come into play: what you tell the insurance companies, what the other party tells them, a police report, witnesses and physical damage at the scene.

5.0 SUMMARY
In this unit, we discussed accounting for insurance claim 1. This involved discussing insurance claim, steps and procedures in computing insurance claim and claim for loss of stock.

6.0 TUTOR MARKED ASSIGNMENT
1. What is refer to fixed costs or expenditure specified by the business and stated in the policy, such as rent and salaries which the insured wishes to recover in the event of damage?
2. The expenditure which varies directly with production; that is, increase of insured standing charges due to fire for the sole purpose of avoiding or reducing the reduction in turnover can be referred to as ________.
3. The turnover of a period in the preceding year corresponding to the period of damage is called what?
4. The turnover derived during the period of damage is referred to as ________?

7.0 REFERENCES/FURTHER READING
Aborode, R. (2004), A Practical Approach to Advanced Financial Accounting, Lagos, EL-TODA Venture Ltd
1.0 INTRODUCTION
In the previous unit, we discussed accounting for insurance claim one. In this unit we shall be discussing accounting for insurance claim two. This involves discussing steps or procedures in computing a claim for loss of stock, stock adjustments and accounting entries involved in accounting for insurance claim.

2.0 OBJECTIVES
After studying this unit, you should be able to:

1. Outline the steps or procedure for computing a claim for loss of stock.
2. State the adjustment required for stock.
3. Calculate the amount for claim due

3.0 MAIN CONTENT

3.1 STEPS OR PROCEDURE FOR COMPUTING A CLAIM FOR LOSS OF STOCK
(a) Prepare previous year’s trading account.
(b) Calculate the average rate of gross profit, using the gross profit derived in (1) above.
(c) Calculate the value of stock in warehouse at the date of damage.
(d) Calculate the value of stock destroyed in the fire.
(e) Determine whether the average clause is applicable or not, by comparing sum insured with the value of stock in the warehouse at the date of damage.
(f) Apply the average clause to derive the final claim.

SELF ASSESSMENT EXERCISE
State the steps for computing a claim for loss of stock.

3.2 STOCK ADJUSTMENTS
(a) Where opening stock includes goods whose value has been written down, the adjustment required is to deduct the written down value from the opening stock to get a normal value for the stock.
(b) Where the written down stock referred to in (a) above, was sold during the period, the amount for which it was sold must have been included in turnover, hence, the adjustment required is the deduction of the figure from sales figure.

(c) As in the case of opening stock, closing stock may include goods whose value has been written down. The value of stock that has been written down, must have been included in purchases figure. Where such goods remain unsold at the year end, it follows that they should be deducted from the goods available for sale, at the same full cost, in order that the figure or cost of goods sold, is not distorted. Adjustment required, is to add back to closing stock, in order to bring the closing stock back to its full cost.

3.3 ACCOUNTING ENTRIES
(a) Estimate the value of stock damaged and make the following accounting entries:
   Dr. Stock account} with the amount computed
   Cr. Trading account

(b) With the amount of agreed claim:
   Dr. Insurance claim} with the amount of claim
   Cr. Stock account

(c) With the value of stock loss- when claim is not payable by insurance company.
   Dr. Profit and loss account
   Cr. Stock account

ILLUSTRATION 16
On 30th September 2008, the premises of Highman Biscuits Ltd, was severely damaged by fire and the company’s business records were completely destroyed. However, the accountant of the company had been maintaining a back-up of the company’s accounting transactions in a USB Drive, from which the following data was obtained.

<table>
<thead>
<tr>
<th></th>
<th>₦'000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stock at 1st January, 2007</td>
<td>10,600</td>
</tr>
<tr>
<td>Stock at 1st January, 2008</td>
<td>8,200</td>
</tr>
<tr>
<td>Sales in 2007</td>
<td>34,920</td>
</tr>
<tr>
<td>Purchases in 2007</td>
<td>21,250</td>
</tr>
<tr>
<td>Sales for nine months to 30th Sept. 2008</td>
<td>13,120</td>
</tr>
<tr>
<td>Purchases for nine months to 30th Sept. 2008</td>
<td>11,800</td>
</tr>
<tr>
<td>Purchases in Sept. 2008 not yet delivered to the company</td>
<td>2,890</td>
</tr>
</tbody>
</table>

The accounting date of Highman Biscuits is 31 December.

During the stock valuation exercise conducted at 31 December 2006, ₦50,000 was written off a particular brand of biscuits. These goods which originally cost ₦150,000 were sold in February 2007 for ₦120,000.

Similarly, in valuing its closing stock at 31 December 2007, ₦60,000 was written off from another brand of biscuits. These goods originally cost ₦160,000. They were subsequently sold for ₦120,000 in May 2008.

Stock valued at ₦1.8million was salvaged on the day of the fire incident. You are required to calculate the amount of claim due, from the insurers in respect of the stock.

SUGGESTED SOLUTION 16
STATEMENT OF INSURANCE CLAIM

<table>
<thead>
<tr>
<th></th>
<th>Normal</th>
<th>Stock</th>
<th>Abnormal</th>
<th>Stock</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>₦’000</td>
<td>₦’000</td>
<td>₦’000</td>
<td>₦’000</td>
<td>₦’000</td>
</tr>
<tr>
<td>Stock at 1/1/2008</td>
<td>-</td>
<td>8,100</td>
<td>-</td>
<td>100</td>
<td>8,200</td>
</tr>
<tr>
<td>Purchases: Jan. – Sept. 2008</td>
<td>-</td>
<td>11,800</td>
<td>-</td>
<td>-</td>
<td>11,800</td>
</tr>
<tr>
<td>Cost of goods available for sale</td>
<td>-</td>
<td>19,900</td>
<td>-</td>
<td>100</td>
<td>20,000</td>
</tr>
<tr>
<td>Cost of goods sold:</td>
<td>N’000</td>
<td>N’000</td>
<td>N’000</td>
<td>N’000</td>
<td>N’000</td>
</tr>
<tr>
<td>Sales Jan. – Sept. 2008</td>
<td>13,000</td>
<td>-</td>
<td>120</td>
<td>-</td>
<td>13,120</td>
</tr>
<tr>
<td>Less: Gross profit @ 32.5%</td>
<td>4,225</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>4,225</td>
</tr>
<tr>
<td>Profit on abnormal stock</td>
<td>-</td>
<td>(20)</td>
<td>-</td>
<td>(20)</td>
<td>-</td>
</tr>
<tr>
<td>Cost of goods sold</td>
<td>(8,775)</td>
<td>(100)</td>
<td>(8,875)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Estimated value of stock</td>
<td>11,125</td>
<td></td>
<td>11,125</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Less: value of salvaged stock</td>
<td>-</td>
<td></td>
<td>1,800</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Stock lost (amount of claim)</td>
<td>-</td>
<td></td>
<td>9,325</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Workings
Calculation of gross profit % for the year ended

31st December 2007

<table>
<thead>
<tr>
<th></th>
<th>N’000</th>
<th>N’000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>34,920</td>
<td></td>
</tr>
<tr>
<td>Less: sale of devalued stock</td>
<td>120</td>
<td>34,800</td>
</tr>
<tr>
<td>Less cost of sales:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Opening stock</td>
<td>10,600</td>
<td></td>
</tr>
<tr>
<td>Less: amount written off stock (150 – 50)</td>
<td>100</td>
<td></td>
</tr>
<tr>
<td>Purchases</td>
<td>21,250</td>
<td>31,750</td>
</tr>
<tr>
<td>Closing stock</td>
<td>8,200</td>
<td></td>
</tr>
<tr>
<td>Add stock written off</td>
<td>60</td>
<td>8,260</td>
</tr>
<tr>
<td>Cost of goods sold (normal value)</td>
<td>(23,490)</td>
<td></td>
</tr>
<tr>
<td>Normal gross profit</td>
<td>11,310</td>
<td></td>
</tr>
<tr>
<td>Normal gross profit = (11,310 x 100)/34,800 = 32.5%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Tutorial notes

i. Observe that the purchases for September 2008 were not included in the computations above because the goods were yet to be delivered to the company before the date of the fire incident.

ii. Abnormal stock at 1st January 2008, is obtained by deducting ₦60,000 (the amount written off) from the original cost of ₦160,000.

iii. Profit on abnormal stock, is calculated by comparing the abnormal sale of ₦120,000 in 2008 with ₦100,000, the carrying value of stock written down.

iv. In the workings, the sales value of written down stock (₦120,000) was deducted from the overall sales value to obtain the value of normal sale.

v. Similarly, the opening value of written-down stock, was deducted from the overall opening stock, to exclude the abnormal stock from the figure of opening stock.
SELF ASSESSMENT EXERCISE
After studying this sub-unit, solve this same question without looking at the solution and compare your result to the solution in the illustration.

4.0 CONCLUSION
Accounting for insurance claim, involves the calculation of the claims payable by an insurance company, in the event of a stock loss and computing the loss of profit occasioned by interruptions in the business operations of an entity, by reason of a fire disaster. These losses are insurable and it is prudent for a business to take out an insurance policy on such eventualities.

5.0 SUMMARY
In this unit, we discussed accounting for insurance claims. It entails steps or procedure for computing a claim for loss of stock, stock adjustment and the accounting entries involved and the computation of claims due.

6.0 TUTOR MARKED ASSIGNMENT
1. State the double entries for value of stock loss when claim is not payable by the insurance company.
2. State the formula for calculating normal gross profit.
3. What do you understand by “special circumstances clause”?
4. Define “cost of working” as it relates to insurance claims.
5. Explain the phrase “period of indemnity” in the context of insurance claim accounting

7.0 REFERENCES/FURTHER READING
1.0 INTRODUCTION

The term ‘Dependent Branch’ means a branch which does not maintain its own set of books. All records have to be maintained by the head office. When the business policies and the administration of a branch are wholly controlled by the head office, its accounts also are maintained by it. On the other hand, a branch is said to be “independent” when a branch is authorized to prepare its own accounts on its books.

As the foreign branch is an independent branch, it keeps a complete set of books on the double entry system, prepares all the necessary accounts including the account of the Head Office, prepares its own trial balance, Trading and Profit and Loss Account and Balance Sheet. In short, the accounting procedure adopted at a foreign branch is exactly the same as that adopted at an independent domestic branch.

2.0 OBJECTIVES
After studying this unit, you should be able to:
1. Explain what an independent branch is.
2. Prepare a trading, profit and loss account, and a balance sheet for a branch, its head office and the business as a whole.
3. Explain the term “foreign branches”.
4. Explain the closing rate method
5. Explain the temporary method

3.0 MAIN CONTENT

3.1 INDEPENDENT BRANCHES

Where branches are semi-autonomous, they are usually responsible for the maintenance of their records. This arrangement is usually common in branches with large-scale operations.
At the end of each period, the branch sends its trial balance to the head office, which will generally contain assets, liabilities, income and expenditure of the branch and its dealing with other branches and head office. Transactions between the branch and head office as well as other branches are recorded in current accounts which serve as a link between the two units and any balance in the account, represents the amount of investment by the head office in the branch.

**UNREALIZED PROFITS**

If goods are transferred between branches and head office (or other branches) at price other than the cost, there will arise an unrealised profit for unsold stocks at the end of the period. This would be dealt with by making a provision for unrealized profit which is debited to the profit and loss account and deducted from stocks in the balance sheet.

**ILLUSTRATION 17**

Johnson Enterprises Ltd, based in Lagos has a branch in Kano. The trial as at 31 December 2008, for the branch and head office are as follows:

<table>
<thead>
<tr>
<th></th>
<th>Head Office</th>
<th>Branch Office</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Debits:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fixed assets (NBV)</td>
<td>76,000</td>
<td>30,800</td>
</tr>
<tr>
<td>Stocks at 1 January 2008:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Head office at cost</td>
<td>56,000</td>
<td></td>
</tr>
<tr>
<td>Branch at selling price</td>
<td>34,000</td>
<td></td>
</tr>
<tr>
<td>Debtors</td>
<td>34,896</td>
<td>7,808</td>
</tr>
<tr>
<td>Bank and cash</td>
<td>66,328</td>
<td>11,536</td>
</tr>
<tr>
<td>Purchases</td>
<td>391,800</td>
<td></td>
</tr>
<tr>
<td>Branch remittance to HO</td>
<td>225,720</td>
<td></td>
</tr>
<tr>
<td>Goods sent to branch</td>
<td></td>
<td>139,880</td>
</tr>
<tr>
<td>General expenses</td>
<td>68,000</td>
<td>40,000</td>
</tr>
<tr>
<td>Branch current account</td>
<td>253,064</td>
<td>-</td>
</tr>
<tr>
<td><strong>Credits:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Goods sent to branch</td>
<td>143,080</td>
<td></td>
</tr>
<tr>
<td>Bank remittance from branch</td>
<td>224,760</td>
<td></td>
</tr>
<tr>
<td>Sales</td>
<td>388,040</td>
<td>238,800</td>
</tr>
<tr>
<td>Creditors</td>
<td>32,468</td>
<td>1,080</td>
</tr>
<tr>
<td>Current account</td>
<td>253,064</td>
<td></td>
</tr>
<tr>
<td>Capital at 1 April</td>
<td>149,240</td>
<td></td>
</tr>
<tr>
<td>Provision for unrealized profit on stock 1 January</td>
<td>8,500</td>
<td>-</td>
</tr>
<tr>
<td><strong>Additional information:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>i. At 31 December 2008:</td>
<td>50,800</td>
<td></td>
</tr>
<tr>
<td>Stocks at HO (at cost)</td>
<td>50,800</td>
<td></td>
</tr>
<tr>
<td>Stocks at branch (transfer price)</td>
<td>19,200</td>
<td></td>
</tr>
<tr>
<td>Stocks in transit (transfer price)</td>
<td>3,200</td>
<td></td>
</tr>
<tr>
<td>Cash in transit to HO</td>
<td>960</td>
<td></td>
</tr>
<tr>
<td>ii. Goods are invoiced to branch at cost plus 331/3%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
| iii. Provide for depreciation on fixed assets at 20% per annum on reducing balance.
You are required to prepare a trading and profit and loss account for the year ended 31 December 2008 and a balance sheet as at that date for the branch, head office and the business as a whole.

**SUGGESTED SOLUTION 17**

**JOHNSON ENTERPRISES LTD**

**TRADING AND PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 31 DECEMBER 2008**

<table>
<thead>
<tr>
<th>Head Office</th>
<th>Branch</th>
<th>Adj. By HQ</th>
<th>Business</th>
</tr>
</thead>
<tbody>
<tr>
<td>₦</td>
<td>₦</td>
<td>₦</td>
<td>₦</td>
</tr>
<tr>
<td>Sales</td>
<td>388,040</td>
<td>-</td>
<td>238,800</td>
</tr>
<tr>
<td>Goods sent to branch</td>
<td>143,080</td>
<td>(143,080)</td>
<td>-</td>
</tr>
<tr>
<td>Less cost of sales:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Opening stock</td>
<td>56,000</td>
<td>-</td>
<td>34,000</td>
</tr>
<tr>
<td>Purchases</td>
<td>391,800</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Provision for u/p</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Goods from HQ</td>
<td>-</td>
<td>139,880</td>
<td>-</td>
</tr>
<tr>
<td>Less closing stock</td>
<td>50,800</td>
<td>-</td>
<td>19,200</td>
</tr>
<tr>
<td>Cost of sales</td>
<td>-</td>
<td>397,000</td>
<td>-</td>
</tr>
<tr>
<td>Stock in transit</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Gross profit</td>
<td>134,120</td>
<td>84,120</td>
<td>3,700</td>
</tr>
<tr>
<td>Less: General expenses</td>
<td>68,000</td>
<td>40,000</td>
<td>108,000</td>
</tr>
<tr>
<td>Depreciation</td>
<td>15,200</td>
<td>6,160</td>
<td>21,360</td>
</tr>
<tr>
<td>Net profit</td>
<td>50,920</td>
<td>37,960</td>
<td>3,700</td>
</tr>
</tbody>
</table>

*Stock in transit ₦3,200 is included in the closing stock valuation

**Workings**

i. Opening stock 1 January 2008
   - Head Office (at cost) 56,000
   - Branch 34,000
   - Less: unrealized profit 8,500
   
   Stock valuation 331/3% = ¼ of ₦34,000 = ₦8,500

ii. Closing stock 31 December 2008
   - Head office 50,800
   - Branch 19,200
   - In transit 3,200
   - 22,400
   
   Less unrealized profit 4,800

   Stock in transit ₦143,080 – ₦139,880 = ₦3,200

**BALANCE SHEET AS AT 31 DECEMBER 2008**

<table>
<thead>
<tr>
<th>Head-office</th>
<th>Branch</th>
<th>Adj.</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>₦</td>
<td>₦</td>
<td>₦</td>
<td>₦</td>
</tr>
</tbody>
</table>

130
Fixed assets                                      60,800                 24,640
Current assets:
Stocks                                          50,800                          19,200                     provision for       68,400
Debtors                                         34,896                            7,808                      u/p (4,800)          42,704
Bank and cash                                   66,328                            11,536                      stock in transit     78,824
                                               152,024                            38,544                      3200                189,928
Less:
Current liability:
Creditors                                       32,468                            1,080                      960                     119,556              37,464              33,548            156,380
                                               180,356                            62,104                      (640)                   241,820
Financed by:
Capital                                         149,240
Net profit                                       92,580
                                               241,820
Note: (i) Fixed assets                          H.Q               Branch
Cost 1/1/04                                      76,000                          30,800
Depreciation                                    15,200                            6,160
Net book value 31/12/04                         60,800                            24,640
(ii) Cash in transit                            960

SELF ASSESSMENT EXERCISE
What you understand by “independent branches”?

3.2 FOREIGN BRANCHES
Foreign branches are those situated outside the country where the head office is located. They are usually self-accounting and transactions are denominated in the currency of the host nation. This will necessitate the translation of the foreign currency into the head office currency (using exchange rates), before the combined trial balance and final accounts can be prepared.

In translating the trial balance of the foreign branch into the head office’s currency, we can apply the temporal method or the closing rate method. The exchange rates to use for each transaction under the two methods are tabulated below:

<table>
<thead>
<tr>
<th>Transactions</th>
<th>Temporary method</th>
<th>Closing rate method</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stocks</td>
<td>The actual rate ruling on the acquired date of purchase or transfer</td>
<td>The closing rate, if acquired by branch or at actual value, if acquired by head office</td>
</tr>
<tr>
<td>Fixed assets</td>
<td>At actual rate ruling on the date of purchase or transfer</td>
<td>Rate ruling on the balance sheet date</td>
</tr>
<tr>
<td>Current assets &amp; current liabilities</td>
<td>Rate ruling on the balance sheet date</td>
<td>Rate ruling on the balance sheet date</td>
</tr>
<tr>
<td>Profit and loss items</td>
<td>Average rate of exchange for the year</td>
<td>Rate ruling on the balance sheet date</td>
</tr>
<tr>
<td>Head office current account</td>
<td>At actual rate</td>
<td>Figure in the head office book</td>
</tr>
</tbody>
</table>

ILLUSTRATION 18
Muyiwa Plc, is a business that engages in trading of vegetable oil in Nigeria with a branch office in Tunisia. Trial balances, from the head office and branch books as 30 September 2008 are follows:

<table>
<thead>
<tr>
<th></th>
<th>Nigeria (₦’000)</th>
<th>Tunisia (₦’000)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Share capital – authorised</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Issued and fully paid</td>
<td></td>
<td>60,000</td>
</tr>
<tr>
<td><strong>Fixed assets</strong></td>
<td>104,960</td>
<td>52,960</td>
</tr>
<tr>
<td><strong>Stocks- 1 October 2007</strong></td>
<td>13,920</td>
<td>14,400</td>
</tr>
<tr>
<td><strong>Depreciation 1 October 2007</strong></td>
<td>26,400</td>
<td>12,000</td>
</tr>
<tr>
<td><strong>Purchases/sales</strong></td>
<td>23,600</td>
<td>108,800</td>
</tr>
<tr>
<td></td>
<td>49,296</td>
<td>21,600</td>
</tr>
<tr>
<td><strong>Operating expenses</strong></td>
<td>33,228</td>
<td>30,000</td>
</tr>
<tr>
<td><strong>Bank balance/overdraft</strong></td>
<td>8,832</td>
<td>45,840</td>
</tr>
<tr>
<td><strong>Branch/HQ current account</strong></td>
<td>16,300</td>
<td>34,400</td>
</tr>
<tr>
<td><strong>Provision for unrealised profit</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>On stock 1st October 2001</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Additional information:

(a) Fixed assets (except those costing ₦5,760,000) had been purchased in Nigeria some years ago and transferred to branch at a cost of ₦14,230,000. Other fixed assets were purchased locally on 1 October 2007.
(b) All purchases were made in Nigeria and invoiced in the branch at cost plus 10%; 6% of which relates to carriage expenses to Tunisia and 4% to profit.
(c) During the year ended 30th September 2008, the branch bought goods locally costing t12,500,000 out of which t3,600,000 worth of goods were still in stock at the end of the year.
(d) A remittance of t1,984,000 from the branch on 25 September 2008 was not received or credited by the head office until October 2008.
(e) On 30 September 2008, stocks were valued as follows:

<table>
<thead>
<tr>
<th>Country</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nigeria</td>
<td>₦26,240,000</td>
</tr>
<tr>
<td>Tunisia</td>
<td>t12,400,000</td>
</tr>
</tbody>
</table>

(f) The following exchanges rates were applicable

<table>
<thead>
<tr>
<th>Date</th>
<th>Rate to ₦1</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 October 2007</td>
<td>t4.5 to ₦1</td>
</tr>
<tr>
<td>30 September 2008</td>
<td>t4.0 to ₦1</td>
</tr>
<tr>
<td>Average during the year</td>
<td>t5.0 to ₦1</td>
</tr>
</tbody>
</table>

You are required to prepare the combined trading, profit and loss account balance sheet of Muyiwa Plc.

**SUGGESTED SOLUTION 18**

**WORKINGS**

**TRANSLATION OF TUNISIA TRIAL BALANCE INTO NAIRA**

<table>
<thead>
<tr>
<th></th>
<th>t’000</th>
<th>t’000</th>
<th>Rate</th>
<th>₦’000</th>
<th>₦’000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fixed assets HQ</td>
<td>47,200</td>
<td>actual</td>
<td></td>
<td>14,230</td>
<td></td>
</tr>
<tr>
<td>Description</td>
<td>Nigeria</td>
<td>Tunisia</td>
<td>Total</td>
<td></td>
<td></td>
</tr>
<tr>
<td>-------------------------------------------------</td>
<td>---------</td>
<td>---------</td>
<td>-------</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Local</td>
<td>5,760</td>
<td>4.5</td>
<td>1,280</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Opening stock</td>
<td>14,400</td>
<td>5.0</td>
<td>2,880</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Depreciation 1 October</td>
<td>12,000</td>
<td>actual</td>
<td>3,618</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Purchases/sales</td>
<td>40,000</td>
<td>110,400</td>
<td>8,000</td>
<td>22,080</td>
<td></td>
</tr>
<tr>
<td>Debtors/creditors</td>
<td>27,200</td>
<td>30,720</td>
<td>6,800</td>
<td>7,680</td>
<td></td>
</tr>
<tr>
<td>Bank balance</td>
<td>34,400</td>
<td>4.0</td>
<td>8,600</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Working expenses</td>
<td>30,000</td>
<td>5.0</td>
<td>6,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Closing stock - balance sheet</td>
<td>12,400</td>
<td>5.0</td>
<td>2,480</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Closing stock - trading account</td>
<td>12,400</td>
<td>5.0</td>
<td>2,480</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Depreciation for the year - P&amp;L</td>
<td>5,296</td>
<td></td>
<td>2,480</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Depreciation – balance sheet</td>
<td>5,296</td>
<td></td>
<td>1,551</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Exchange gain</td>
<td></td>
<td></td>
<td>5,567</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>216,656</td>
<td>216,656</td>
<td>51,808</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**NOTES**

(a) Depreciation for P&L

Locally purchased assets (t576,000/5.0) 115
Assets from HQ 1,423
                   1,538

(b) Depreciation for balance sheet

Locally purchased assets (t576,000/4.5) 128
Asset from HO 1,423
                   1,551

MUYIWA PLC
Trading Profit and Loss Account for the Year Ended 30 September 2008

<table>
<thead>
<tr>
<th>Description</th>
<th>Nigeria</th>
<th>Tunisia</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nigeria</td>
<td>₦</td>
<td>₦</td>
<td>₦</td>
</tr>
<tr>
<td>Tunisia</td>
<td>₦</td>
<td>₦</td>
<td>₦</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>₦</td>
<td>₦</td>
<td>₦</td>
</tr>
<tr>
<td>Transfer to Branch</td>
<td>5,500</td>
<td>22,080</td>
<td>125,380</td>
</tr>
<tr>
<td>Sales</td>
<td>103,300</td>
<td>22,080</td>
<td>125,380</td>
</tr>
<tr>
<td>Opening stock</td>
<td>13,920</td>
<td>2,880</td>
<td>16,064</td>
</tr>
<tr>
<td>Transfer from HQ</td>
<td>5,500</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Purchases</td>
<td>23,600</td>
<td>2,500</td>
<td>26,100</td>
</tr>
<tr>
<td>Cost of sales</td>
<td>37,520</td>
<td>10,880</td>
<td>42,164</td>
</tr>
<tr>
<td>Less closing stock</td>
<td>26,240</td>
<td>2,480</td>
<td>28,656</td>
</tr>
<tr>
<td>Gross profit</td>
<td>97,520</td>
<td>13,680</td>
<td>111,872</td>
</tr>
<tr>
<td>Exchange gain</td>
<td>5,567</td>
<td>--</td>
<td>5,567</td>
</tr>
<tr>
<td>Unrealized profit (no longer required)</td>
<td>672</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>103,759</td>
<td>13,680</td>
<td>117,439</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Description</th>
<th>Nigeria</th>
<th>Tunisia</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Working expenses</td>
<td>33,228</td>
<td>6,000</td>
<td>39,228</td>
</tr>
<tr>
<td>Depreciation</td>
<td>10,496</td>
<td>1,538</td>
<td>12,034</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>43,724</td>
<td>7,538</td>
<td>51,262</td>
</tr>
</tbody>
</table>

**NET PROFIT**

<table>
<thead>
<tr>
<th>Description</th>
<th>Nigeria</th>
<th>Tunisia</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>60,035</td>
<td>6,142</td>
<td></td>
<td>66,177</td>
</tr>
</tbody>
</table>

**Balance Sheet as at 30 September 2008**

<table>
<thead>
<tr>
<th>Description</th>
<th>Nigeria</th>
<th>Tunisia</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fixed assets</td>
<td>104,960</td>
<td>15,510</td>
<td>120,470</td>
</tr>
</tbody>
</table>

133
Depreciation

\[
\begin{array}{ccc}
36,896 & 5,169 & 42,065 \\
68,064 & 10,341 & 78,405 \\
\end{array}
\]

Current assets

Stocks  
Debtors  
Branch current account  
Cash in transit  
Bank balance

\[
\begin{array}{ccc}
26,240 & 2,480 & 28,720 \\
49,296 & 6,880 & 56,176 \\
19,981 & & \\
496 & 496 & \\
8,104 & 8,104 & \\
164,077 & 27,805 & 191,882 \\
\end{array}
\]

Creditors

\[
\begin{array}{ccc}
(21,600) & (7,680) & (29,280) \\
(16,300) & (16,300) & \\
126,177 & 20,125 & 146,302 \\
\end{array}
\]

Bank overdraft

\[
\begin{array}{ccc}
(16,300) & (16,300) & \\
20,125 & 20,125 & \\
126,177 & 20,125 & 146,302 \\
\end{array}
\]

Workings

\[
\begin{array}{c}
i. \\
\text{Closing stock N'000} \\
\text{Head office} 26,240 \\
\text{Branch 2,480} \\
\text{Unrealised profit (64)} \\
\text{28,656} \\
\end{array}
\]

Using the closing rate method

**Translation of Tunisia trial balance into Naira**

<table>
<thead>
<tr>
<th></th>
<th>t'000</th>
<th>t'000</th>
<th>Rate</th>
<th>N'000</th>
<th>N'000</th>
</tr>
</thead>
<tbody>
<tr>
<td>fixed assets</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>HO</td>
<td>47,200</td>
<td></td>
<td>4.0</td>
<td>11,800</td>
<td></td>
</tr>
<tr>
<td>Local</td>
<td>5,760</td>
<td></td>
<td>4.0</td>
<td>1,440</td>
<td></td>
</tr>
<tr>
<td>Opening stock</td>
<td>14,400</td>
<td></td>
<td>5.0</td>
<td>2,880</td>
<td></td>
</tr>
<tr>
<td>Depreciation 1st October</td>
<td>12,000</td>
<td></td>
<td>5.0</td>
<td>2,400</td>
<td></td>
</tr>
<tr>
<td>Purchases/sales</td>
<td>40,000</td>
<td>110,400</td>
<td>5.0</td>
<td>8,000</td>
<td>22,080</td>
</tr>
<tr>
<td>Debtors/credits</td>
<td>27,200</td>
<td>30,720</td>
<td>4.0</td>
<td>6,800</td>
<td></td>
</tr>
<tr>
<td>Bank balance</td>
<td>34,400</td>
<td></td>
<td>4.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Working expenses</td>
<td>30,000</td>
<td></td>
<td>5.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Closing stock – balance sheet</td>
<td>12,400</td>
<td></td>
<td>4.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Closing stock- trading account</td>
<td>12,400</td>
<td></td>
<td>5.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Depreciation- balance sheet</td>
<td></td>
<td></td>
<td>5,296</td>
<td>4.0</td>
<td></td>
</tr>
<tr>
<td>Exchange gain</td>
<td>216,656</td>
<td>216,656</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**SELF ASSESSMENT EXERCISE**

What do you understand by the term foreign branches?
3.3 THE CLOSING RATE METHOD IN MORE DETAIL
Under this method, the amounts in the balance sheet of a foreign enterprise, should be translated into the reporting currency of the investing company, using the rate of exchange ruling at the balance sheet date. Exchange differences will, if this rate differs from that ruling at the previous balance sheet date or at the date of any subsequent capital injection (or reduction).

Amounts in the profit and loss account of a foreign enterprise, should be translated at a closing rate or at an average rate for the accounting period. The use of the closing rate is more likely to achieve the objective of reflecting the financial results and relationships as measured in the foreign branch’s financial statement prior to translation. However, it can be argued that an average rate reflects, more fairly, the profits and losses and cash flows as they arise to the group, throughout an accounting period. The use of either method is therefore permitted, provided that the one selected is applied consistently from period to period.

No definitive method of calculating the average rate has been prescribed, since the appropriate method may justifiable vary, between the individual companies. Factors that will need to be considered, include the company’s internal accounting procedures and the extent of seasonal trade variation; the use of a weighting procedures will, in most cases, be desirable. Where the average rate used, differs from the closing rate, a difference will arise, which should be dealt with, in reserves.

Note that:

(a) The profit and loss account may be translated either at the weighted average or the closing rate for the year.
(b) Any exchange difference arising is always a movement on reserves and never goes to the profit and loss account.

SELF ASSESSMENT EXERCISE
What do you understand by the closing rate method?

3.4 THE TEMPORAL METHOD IN MORE DETAIL
The mechanics of this method are identical with those used in preparing the accounts of an individual office. This means that;

(a) The profit and loss account is translated using actual rates where known (an average for the period tends to be used in practice), and historical rates for non-monetary items, such as opening and closing stock and depreciation; and
(b) Any exchange differences are reported as part of profit for the year.

SUMMARY OF TRANSLATION METHODS

<table>
<thead>
<tr>
<th>The main stages are:</th>
<th>Closing rate method</th>
<th>Temporary method</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stage 1</td>
<td>Under closing rate at the year end for all items (but see below)</td>
<td>Use the closing rate at the year end for monetary items and the appropriate historical rates for non-monetary items. Shareholders’ fund should be treated as balancing figure (see</td>
</tr>
</tbody>
</table>
Note: as mentioned above, the share capital may be translated at the historical rate (under both methods). The reserves will then be the balancing figure. The advantage of this method is that it simplifies the ‘cancellation’ of the share capital on consolidation.

<table>
<thead>
<tr>
<th>Stage 2</th>
<th>Translate the profit and loss account</th>
<th>Use the average rate or closing rate for the year, for all items (but see comment on dividends). The figures obtained can then be used in preparing the consolidated profit and loss account.</th>
<th>The profit and loss account should be translated, using the exchange rates ruling as at the time the amounts recorded in the financial statement were established. Note: In most examinations questions, it will be necessary to translate all items, apart from depreciation, at the average rate for the year, and to translate depreciation at the rates ruling when the relevant fixed assets were acquired (or re-valued). If, however, the information is available, you should use temporal rates specific to opening and closing stocks.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Translate the shareholders’ fund at the beginning of the year.</td>
<td>Use the closing rate at beginning of the year (that is opening rate).</td>
<td>Use the closing rate at the beginning of the year for monetary items and the appropriate historical rates for non-monetary items.</td>
<td></td>
</tr>
<tr>
<td>Stage 3</td>
<td>Translate the shareholders’ fund at the beginning of the year.</td>
<td>Use the closing rate at beginning of the year (that is opening rate)</td>
<td>Use the closing rate at the beginning of the year for monetary items and the appropriate historical rates for non-monetary items. Note: In many questions, it is necessary to reconstruct the opening balance sheet.</td>
</tr>
<tr>
<td>Stage 3</td>
<td>Calculate the total exchange difference for the year as follows: shareholders’ fund at the beginning of the year (as in stage 3 above).</td>
<td>This stage will be unnecessary unless you are asked to state the total exchange difference or are asked to prepare a statement of the movement in reserves.</td>
<td>After finding the exchange differences, it will be possible to prepare the consolidated profit and loss account. The exchange differences should be included before tax.</td>
</tr>
</tbody>
</table>

Add: retained profit before exchange differences (stage 2)  X
SELF ASSESSMENT EXERCISE
What do you understand by the temporary method?

4.0 CONCLUSION
Businesses sometimes carry on their operations through their branches in different places, while the operations of some branches are direct extensions of the Head Office activities. Some branches are largely independent and maintain separate records of their transactions with their head office. Unsold stocks relating to intra-company transfer of goods, give rise to the problem of unrealized profits, while foreign branches introduce the complication of foreign currency translation.

5.0 SUMMARY
In this unit we discussed accounting for independent and foreign branches. The two methods of accounting for foreign branches were dealt with in this unit.

6.0 TUTOR MARKED ASSIGNMENT
Short Answer Questions
1. State one possible reason why branch current account may not agree with head office current account.
2. State the formula for eliminating unrealised profits from goods sent to branch at cost plus 20%.
3. State how revenue and expenses are translated under the closing rate method.
4. When is the temporal method applicable for translation of the financial statements of foreign branches?
5. In the context of branch accounting, what is semi-autonomous branch?

7.0 REFERENCES/FURTHER READING
1.0 INTRODUCTION
A construction contract is a contractual agreement between two parties, whereby a party known as the contractee agrees to pay a specified consideration to the other party, known as the contractor, for the execution of a specific project based on specified terms and conditions.

A construction contract is carried out for the execution of a project, which may be civil, building, engineering and so on. The period of execution may be within one year (short-term projects), or spread over a period exceeding one year (long-term projects).

In accounting for construction contracts, SAS No 5: Accounting for Construction Contract method or the percentage of completion method.

2.0 OBJECTIVES
After studying this unit, you should be able to:
1. Explain what short-term contract is.
2. State the summary of the provision of SAS 5 in relation to short-term contract.
3. Prepare a contract account.
4. State the problems associated with accounting for long-term projects.
5. State the methods of approach for a construction business.
3.0 MAIN CONTENT
3.1 Accounting for Short-Term Projects
Short-term contracts are executed within a period of 12 months which may fall within one or two accounting year-ends. Where such a contract is commenced and completed within an accounting year-end, the resultant contract profit, is recognized immediately in that accounting year-end. Where the contract is commenced in one accounting year and concluded in the next, then, there is the need to determine in which accounting year to recognize such profit. There is also the need to determine the value of work-in-progress at the end of the first accounting year in which the contract was commenced but not completed.

The provision of SAS No 5: Construction Contracts on Short-Term Contracts is summarized as follows:

(a) The completed contract method should be used for short-term contracts.
(b) Foreseeable losses should be charged to the profit and loss account in the period in which they are identified.
(c) A contract should be regarded as completed, only when all activities relating to it are accomplished. In a situation where the additional costs require completing the contract are not significant, provision should be made for such costs and the contract treated as completed.

ILLUSTRATION 19
Bojuboju Construction Limited undertook to build a plant for Tolu Manufacturing Limited, at a contract price of ₦100,000. Expenditure relating to the contract is as follows:

<table>
<thead>
<tr>
<th></th>
<th>₦</th>
</tr>
</thead>
<tbody>
<tr>
<td>Materials</td>
<td>30,000</td>
</tr>
<tr>
<td>Direct wages</td>
<td>40,000</td>
</tr>
<tr>
<td>Direct expenses</td>
<td>5,000</td>
</tr>
<tr>
<td>Plant @ cost</td>
<td>35,000</td>
</tr>
<tr>
<td>Plant hire</td>
<td>2,000</td>
</tr>
<tr>
<td>Sundry tools</td>
<td>3,000</td>
</tr>
</tbody>
</table>

The contract was completed by the year ended 31 March, 2008. During which the company received ₦60,000 from Tolu Manufacturing Ltd. The written down values of the plant and tools were ₦25,000 and ₦500, respectively.

Required:
Prepare the contract account

SUGGESTED SOLUTION 19

<table>
<thead>
<tr>
<th></th>
<th>₦</th>
</tr>
</thead>
<tbody>
<tr>
<td>Materials</td>
<td>30,000</td>
</tr>
<tr>
<td>Contract price</td>
<td>100,000</td>
</tr>
<tr>
<td>Direct wages</td>
<td>40,000</td>
</tr>
<tr>
<td>Plant (WDV) c/d</td>
<td>25,000</td>
</tr>
<tr>
<td>Direct expenses</td>
<td>5,000</td>
</tr>
<tr>
<td>Sundry tools (WDV)</td>
<td>500</td>
</tr>
<tr>
<td>Plant @ cost</td>
<td>35,000</td>
</tr>
<tr>
<td>Plant hire</td>
<td>2,000</td>
</tr>
</tbody>
</table>

139
Sundry tools                      3,000
Contract profit taken            10,500
                                    125,500
                                    125,500

TOLU MANUFACTURING LIMITED
CONTRACTEE ACCOUNT

<table>
<thead>
<tr>
<th></th>
<th>₦</th>
<th>₦</th>
</tr>
</thead>
<tbody>
<tr>
<td>Value of work certified</td>
<td>100,000</td>
<td></td>
</tr>
<tr>
<td>Cash received</td>
<td></td>
<td>60,000</td>
</tr>
<tr>
<td>Contract debtor (bal. c/d)</td>
<td>40,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>100,000</td>
<td>100,000</td>
</tr>
</tbody>
</table>

SELF ASSESSMENT EXERCISE
State the provision of SAS No. 5 on short-term project.

3.2 ACCOUNTING FOR LONG-TERM PROJECTS
There are special problems associated with accounting for businesses which carry out long term construction contracts. These problems can be summarized as follows:

(a) These projects usually involved application of very substantial amounts of physical and financial resources.
(b) The production cycle can be very long in comparison with other businesses.
(c) Profit recognition for each year of operation during the period of execution of the contracts.

SELF ASSESSMENT EXERCISE
What are the problems associated with accounting for businesses which carry out long term construction contract?

3.3 MODE OF OPERATIONS
The following are the methods of approach for a construction business:

(a) Resources are controlled on contract basis.
(b) Each contract is given a separate identification code number and the costs of all resources supplied to that contract are charged to it.
(c) At intervals, throughout the period of the contract an approximation of the degree of completion of each contract (in terms of the contract price) and a certificate to this effect is issued by a qualified professional.
(d) The certificates enable estimates to be made of the profit earned or loss sustained on the contract up-to-date and also, of the value of the work-in-progress. Also the certificates are the bases for a claim for interim payments (known as progress payments).
(e) The contractor does not necessarily have to wait until the end of the contract period, or receive payments, before recognising profits.
(f) It is usual for the contractee to deduct withholding tax at source, from the progress payments.

SELF ASSESSMENT EXERCISE
Outline the method of approach for a construction business

4.0 CONCLUSION
Contractors choose from a variety of accounting procedures to account for the revenue they received from such contracts. However, the Standard has provision for such projects, especially long-term contract projects, so that contractors must account for revenue in limited ways.

5.0 SUMMARY
In this unit, we discussed contract account. This was treated considering accounting for short-term projects, accounting for long term-term projects and mode of operation. Specifically, accounting for short-term projects was treated with illustration to explain the accounting entries that should be made. More shall be done to substantiate the long-term projects in the following unit.

6.0 TUTOR MARKED ASSIGNMENT
1. Where a contract is commenced and completed within an accounting year-end, _______ is recognized immediately in that accounting year-end.
2. Where a contract is commenced in one accounting year and concluded in the next, then, there is the need to determine ________.
3. In a situation where the additional costs require to complete a contract are not significant, _______ should be made for such costs and the contract treated as completed.
4. _______ is a contractual agreement between two parties, whereby a party known as the contractee agrees to pay a specified consideration to the other party, known as the contractor, for the execution of a specific project based on specified terms and conditions.
5. The period of execution of a contract may be within _______ or ________.

7.0 REFERENCES/FURTHER READING
1.0 INTRODUCTION
Separate ledger accounts are maintained, for each contract in which relevant costs are posted and other relevant entries made for proper monitoring and management of each contract.

For each contract there is the need to determine the appropriate profit to be recognized. The following are the acceptable methods of recognizing profit on construction contracts:

(a) Architect’s or engineer’s certificate method;
(b) Percentage of completion method (SAS No 5).

2.0 OBJECTIVES
After studying this unit, you should be able to:
1. Prepare a contract and a contractee’s accounts.
2. Prepare a contract account where cost of completing the contract can be estimated with a degree of certainty.
3. Determine the value of work-in-progress.

3.0 MAIN CONTENT
3.1 ARCHITECT’S OR ENGINEER’S METHOD
Under this method, each contract is debited with the costs of materials supplied, payments to subcontractors, wages and contract overheads. At the end of the period, the account is credited with architectural valuation, the value of worked done but not yet certified and the value of unused resources, such as materials at site, and value of fixed assets at site. A credit balance on the account indicates a potential profit on the contract, while a debit balance indicates a potential loss.

In accordance with the concept of prudence, it is recommended that any foreseeable loss should be recognized systematically as below.

Profit recognized to date = estimated profit x \( \frac{\frac{2}{3} \times \text{cash received}}{\text{value of work certified}} \)

ILLUSTRATION 20
Vulture Nigeria Limited, undertakes to build another giant coal bunker for Eastern Coal Limited, at a contract price of ₦150,000,000, estimating that the work will take 18 months to complete. At the financial year ended 31 March 2008, the expenditure on the contract were as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Cost (₦'000)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Materials</td>
<td>30,000</td>
</tr>
<tr>
<td>Direct wages</td>
<td>40,000</td>
</tr>
<tr>
<td>Direct expenses</td>
<td>5,000</td>
</tr>
<tr>
<td>Plant @ cost</td>
<td>35,000</td>
</tr>
<tr>
<td>Plant hire</td>
<td>2,000</td>
</tr>
<tr>
<td>Sundry tools</td>
<td>3,000</td>
</tr>
</tbody>
</table>

The written down value of plant for the year ended 31 March 2008, was ₦25,000,000 while the value of work certified was ₦100,000,000, while cash received from the customer amounted to ₦60,000.

Required:
Prepare the contract and contractee's accounts, for the year ended 31 March 2008.

SUGGESTED SOLUTION 20

VULTURE NIGERIA LIMITED
CONTRACT ACCOUNT
For the year ended 31 March 2008

<table>
<thead>
<tr>
<th>Description</th>
<th>₦’000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Material</td>
<td>30,000</td>
</tr>
<tr>
<td>Direct wages</td>
<td>40,000</td>
</tr>
<tr>
<td>Direct expenses</td>
<td>5,000</td>
</tr>
<tr>
<td>Plant @ cost</td>
<td>35,000</td>
</tr>
<tr>
<td>Plant hire</td>
<td>2,000</td>
</tr>
<tr>
<td>Sundry tools</td>
<td>3,000</td>
</tr>
<tr>
<td>Profit recognised</td>
<td>4,200</td>
</tr>
</tbody>
</table>

WORKINGS:
1. Computation of profit recognised

EASTERN COAL LIMITED
CONTRACTEE’S ACCOUNT

<table>
<thead>
<tr>
<th>Description</th>
<th>₦’000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Value of work certified</td>
<td>100,000</td>
</tr>
<tr>
<td>Cash received</td>
<td>60,000</td>
</tr>
<tr>
<td>Contract debtor (bal. c/d)</td>
<td>40,000</td>
</tr>
</tbody>
</table>

100,000

100,000

143
Value of work certified 100,000

Cost of work to date:
- Material 30,000
- Direct wages 40,000
- Direct expenses 5,000
- Plant hire 2,000
- Plant at cost 35,000
- Tools at cost 3,000

115,000

Plant (wdv) c/d (25,000)
Tools (wdv) c/d (500)

89,500

Estimated profit 10,500

Profit to be recognized = 2/3 \times \frac{\text{cash received} \times \text{estimated profit}}{\text{value of work certified}}

= 2/3 \times \frac{(60,000,000 \times 10,500,000)}{100,000,000}

= N4,200,000

Note:

I. Cost of work certified, would have been used in calculating the estimated profit, if provided.

II. This is a prudent approach to calculating profit recognised.

Alternative approach to calculating profit taken

Another acceptable approach to recognised profit is as follows:

= \frac{\text{cash received}}{\text{value of work certified}} \times \text{estimated profit}

Therefore, profit taken = 60\% \times N10,500,000

= N6,300,000

SELF ASSESSMENT EXERCISE

Explain what you understand by architect or engineer’s method.

3.2 PERCENTAGE OF COMPLETION METHOD (SAS 5)

This method is in line with provision of SAS 5: Construction Contracts. It is applicable where cost of completing the contract can be estimated with a degree of certainty.

ILLUSTRATION 21

Given the details under illustration: Vulture Nigeria Limited, but with the following additional information:

(a) It is estimated that the plant will have a written down value of N15,000,000 at the end of the contract, while the sundry tools will be valued at N1,900,000.
(b) Estimated future cost to complete the contract are as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount (₦'000)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Materials</td>
<td>13,000</td>
</tr>
<tr>
<td>Wages</td>
<td>25,000</td>
</tr>
<tr>
<td>Direct expenses</td>
<td>2,900</td>
</tr>
<tr>
<td>Sundry tools at cost</td>
<td>2,000</td>
</tr>
</tbody>
</table>

Required:

Prepare the contract account, showing the profit taken.

**SUGGESTED SOLUTION 21**

**VULTURE NIGERIA LIMITED**

**CONTRACT ACCOUNT**

For the year 31 March, 2008

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount (₦'000)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Material</td>
<td>30,000</td>
</tr>
<tr>
<td>Plant (wdv) c/d</td>
<td>25,000</td>
</tr>
<tr>
<td>Direct wages</td>
<td>40,000</td>
</tr>
<tr>
<td>Plant hire</td>
<td>2,000</td>
</tr>
<tr>
<td>Plant at cost</td>
<td>35,000</td>
</tr>
<tr>
<td>Tools at cost</td>
<td>3,000</td>
</tr>
<tr>
<td>Profit recognized</td>
<td>6,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>121,000</strong></td>
</tr>
</tbody>
</table>

Workings:

Computation of profit recognised

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount (₦'000)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Contract price</td>
<td>150,000</td>
</tr>
<tr>
<td>Cost of work to date:</td>
<td></td>
</tr>
<tr>
<td>Materials</td>
<td>30,000</td>
</tr>
<tr>
<td>Direct wages</td>
<td>40,000</td>
</tr>
<tr>
<td>Direct expenses</td>
<td>5,000</td>
</tr>
<tr>
<td>Plant hire</td>
<td>2,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>77,000</strong></td>
</tr>
<tr>
<td>Estimated future cost:</td>
<td></td>
</tr>
<tr>
<td>Materials</td>
<td>13,000</td>
</tr>
<tr>
<td>Wages</td>
<td>25,000</td>
</tr>
<tr>
<td>Direct expenses</td>
<td>2,900</td>
</tr>
<tr>
<td>Depreciation:</td>
<td></td>
</tr>
<tr>
<td>Plant N(35,000 − 15,000)</td>
<td>20,000</td>
</tr>
<tr>
<td>Tools N(3,000 + 2,000 − 1,900)</td>
<td>3,100</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>23,100</strong></td>
</tr>
<tr>
<td>Estimated contract cost to completed</td>
<td><strong>141,000</strong></td>
</tr>
</tbody>
</table>

Estimated Profit = \[\text{Estimated Profit} = \frac{\text{value of work certified} \times \text{estimated profit}}{\text{contract price}}\]

Attributable profit = \[\text{Attributable profit} = \frac{(100,000,000 \times 9,000,000)}{150,000,000}\]

145
146

= N6,000,000

Note: Future cost must be capable of being estimated with a degree of certainty.

Alternative approach to calculating profit taken

There are other conservative approaches, to calculating the profit to be taken, which are acceptable:

(a) \( \frac{\text{cash received}}{\text{value of work certified}} \times \frac{\text{value of work certified}}{\text{contract price}} \times \text{estimated profit} \)

(b) \( \frac{\text{cost of work completed}}{\text{estimated contract cost on completion}} \times \text{estimated profit} \)

The profit taken under each of the above alternative methods are as follows:

(a) \( \frac{60,000,000}{100,000,000} \times \frac{100,000,000}{150,000,000} \times 9,000,000 = \text{N3},600,000 \)

(b) \( \frac{89,500,000}{141,000,000} \times 9,000,000 = \text{N5},713,000 \)

SELF ASSESSMENT EXERCISE
After studying this unit, solve the question without looking at the solution and compare your answer to the solution given in the illustration.

3.3 VALUATION OF WORK IN PROGRESS (WIP) ON LONG-TERM CONTRACT

Under the provisions of SAS No 5: Accounting for Construction Contracts, the value of work in progress for balance sheet purposes, is calculated as follows:

\[
\text{Value of WIP for balance sheet} = \frac{\text{Cost incurred to date}}{\text{x}} + \frac{\text{Plus attributable profit (if any)}}{\text{x}} - \frac{\text{Less foreseeable losses}}{\text{x}} - \frac{\text{Less progress payments received or receivable}}{\text{x}}
\]

ILLUSTRATION 22
The following details are provided in respect of four contracts:

<table>
<thead>
<tr>
<th></th>
<th>Sango</th>
<th>Abule</th>
<th>Pero</th>
<th>Igbesa</th>
</tr>
</thead>
<tbody>
<tr>
<td>Contract price</td>
<td>800,000</td>
<td>85,000</td>
<td>60,000</td>
<td>100,000</td>
</tr>
<tr>
<td>Cash received</td>
<td>450,000</td>
<td>76,000</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Value of work invoiced</td>
<td>500,000</td>
<td>80,000</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Cost of work certified</td>
<td>400,000</td>
<td>60,000</td>
<td>50,000</td>
<td>12,000</td>
</tr>
<tr>
<td>Estimated future costs</td>
<td>120,000</td>
<td>2,000</td>
<td>20,000</td>
<td>70,000</td>
</tr>
<tr>
<td>Costs to date</td>
<td>400,000</td>
<td>60,000</td>
<td>55,000</td>
<td>13,000</td>
</tr>
</tbody>
</table>

You are required to:
(a) Calculate profit or loss to be taken on each contract.
(b) Show how the work in progress would be disclosed in the balance sheet.

**SUGGESTED SOLUTION 22**

(a)

<table>
<thead>
<tr>
<th>Contracts</th>
<th>Sango</th>
<th>Abule</th>
<th>Pero</th>
<th>Igbesa</th>
</tr>
</thead>
<tbody>
<tr>
<td>Contract price</td>
<td>₦800,000</td>
<td>₦85,000</td>
<td>₦60,000</td>
<td>₦100,000</td>
</tr>
<tr>
<td>Costs to date</td>
<td>₦400,000</td>
<td>₦60,000</td>
<td>₦55,000</td>
<td>₦13,000</td>
</tr>
<tr>
<td>Estimated future costs</td>
<td>₦120,000</td>
<td>₦20,000</td>
<td>₦20,000</td>
<td>₦70,000</td>
</tr>
<tr>
<td>Estimated contract costs</td>
<td>₦520,000</td>
<td>₦62,000</td>
<td>₦75,000</td>
<td>₦83,000</td>
</tr>
<tr>
<td>Estimated profit/(loss)</td>
<td>₦280,000</td>
<td>₦23,000</td>
<td>₦(15,000)</td>
<td>₦(17,000)</td>
</tr>
<tr>
<td>Profit/(loss) taken</td>
<td>₦157,500</td>
<td>₦20,565</td>
<td>₦(15,000)</td>
<td>-</td>
</tr>
</tbody>
</table>

(b)

Work in progress (for balance sheet)

<table>
<thead>
<tr>
<th></th>
<th>₦</th>
<th>₦</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost to date:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sango</td>
<td>₦400,000</td>
<td></td>
</tr>
<tr>
<td>Abule</td>
<td>₦60,000</td>
<td></td>
</tr>
<tr>
<td>Pero</td>
<td>₦55,000</td>
<td></td>
</tr>
<tr>
<td>Igbesa</td>
<td>₦13,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>₦528,000</td>
<td></td>
</tr>
<tr>
<td>Add profit taken:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sango</td>
<td>₦157,500</td>
<td></td>
</tr>
<tr>
<td>Abule</td>
<td>₦20,565</td>
<td></td>
</tr>
<tr>
<td></td>
<td>₦178,065</td>
<td></td>
</tr>
<tr>
<td>Less foreseeable losses:</td>
<td></td>
<td>₦15,000</td>
</tr>
<tr>
<td>Pero</td>
<td>₦15,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>₦691,065</td>
<td></td>
</tr>
<tr>
<td>Less progress payments:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Received:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sango</td>
<td>₦450,000</td>
<td></td>
</tr>
<tr>
<td>Abule</td>
<td>₦76,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>₦526,000</td>
<td></td>
</tr>
<tr>
<td>Receivable:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sango N(500,000 – 450,000)</td>
<td>₦50,000</td>
<td></td>
</tr>
<tr>
<td>Pero N(80,000 – 76,000)</td>
<td>₦4,000</td>
<td></td>
</tr>
<tr>
<td>Igbesa</td>
<td>₦15,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>₦69,000</td>
<td></td>
</tr>
<tr>
<td>Construction work in progress</td>
<td>₦96,065</td>
<td></td>
</tr>
</tbody>
</table>

Workings:

1. **Profit or loss taken on projects:**
   - Sango = ₦280,000 x \( \frac{500,000}{800,000} \) x \( \frac{450,000}{500,000} \) = ₦157,500
   - Abule = 23,000 x \( \frac{80,000}{85,000} \) x \( \frac{76,000}{80,000} \) = ₦20,565
   - Pero = All the foreseeable losses should be recognised immediately
   - Igbesa = \( \frac{17,000 \times 15,000}{100,000} \) x \( \frac{0}{80,000} \) = Nil
SELF ASSESSMENT EXERCISE
After studying this unit, solve the question without looking at the solution and compare your answer to the solution given in the illustration.

4.0 CONCLUSIONS
There are two acceptable methods for accounting for construction contracts. Also, there are acceptable methods for profit determination.

5.0 SUMMARY
In this unit, the use of architect’s or engineer’s certificate method and percentage of completion method were used. The determination of the value of work-in-progress for the balance sheet disclosure was examined. The criteria stated in the statement of Accounting Standard No 5: Accounting for Construction Contracts was also examined.

6.0 TUTOR MARKED ASSIGNMENT
1. Which of the methods on accounting for contracts recognises profits as actual?
2. Briefly define long-term construction contracts.
3. Itemise one feature of a construction contract.
4. Differentiate between long-term and short-term construction contracts.
5. State one basis for recognizing losses on long-term construction contracts.

7.0 REFERENCE/FURTHER READING
1.0 INTRODUCTION

In this unit, we shall be discussing the concept of sinking fund. A sinking fund is a fund established by a government agency or business for the purpose of reducing debt by repaying or purchasing outstanding loans and securities held against the entity. It helps keep the borrower liquid so it can repay the bondholder.

2.0 OBJECTIVES

After studying this unit, you should be able to:

1. Prepare the sinking fund accounts.
2. Show the difference between sinking fund for asset replacement and debenture replacement.
3. Show the accounting entries for debenture and equities investment.

3.0 MAIN CONTENT

3.1 ASSET REPLACEMENT

When an asset needs to be replaced, the funds needed could be provided by setting aside an agreed amount each year, invested with the component of compound interest. This will be sufficient to provide a sum equal to the cost of the asset, less residual value at the end of its estimated life. The advantage of this method is that cash will be available to provide for the asset replacement.
The book value of the asset remains unchanged during the period of building the sinking fund, the depreciation being reflected in the credit balance on the sinking fund account. At the end of the period, the balance in the sinking fund will be transferred to the credit of the asset, leaving the balance in the latter, as the residual balance.

At the occurrence of each of the following situations (a – e), the sinking fund account, entries for the write off of asset, will be as stated against, each (a – e).

<table>
<thead>
<tr>
<th></th>
<th>Dr</th>
<th>Cr</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a)</td>
<td>On setting aside the instalment annuity</td>
<td>P &amp; L</td>
</tr>
<tr>
<td>(b)</td>
<td>On investing the instalment</td>
<td>Cash</td>
</tr>
<tr>
<td>(c)</td>
<td>On receipt and reinvestment</td>
<td>Cash</td>
</tr>
<tr>
<td></td>
<td>of interest on investment</td>
<td>Sinking fund Inv.</td>
</tr>
<tr>
<td>(d)</td>
<td>On the expiry of the life of the asset</td>
<td>Sinking fund</td>
</tr>
<tr>
<td>(e)</td>
<td>On purchase of new asset</td>
<td>Asset</td>
</tr>
</tbody>
</table>

**ILLUSTRATION 23**

Plant which cost ₦250,000 with life span of 3 years and the residual value of ₦31,250 was invested at 5%. You are to show relevant accounts, assuming that the amounts to be set aside are ₦69,250 for the first year and ₦69,500 for each of the remaining two years. Assume that the replacement cost is equal to the original cost.

You are required to prepare the sinking fund account.

**SUGGESTED SOLUTION 23**

**SINKING FUND ACCOUNT**

<table>
<thead>
<tr>
<th>Year</th>
<th>₦</th>
<th>Year P &amp; L</th>
<th>₦</th>
</tr>
</thead>
<tbody>
<tr>
<td>Year 1 P &amp; L</td>
<td>69,250</td>
<td>69,250</td>
<td></td>
</tr>
<tr>
<td>Year 2 balance b/d</td>
<td>142,250</td>
<td>69,250</td>
<td></td>
</tr>
<tr>
<td>Interest</td>
<td>3,500</td>
<td>69,500</td>
<td></td>
</tr>
<tr>
<td>P/L</td>
<td>142,250</td>
<td>142,250</td>
<td></td>
</tr>
<tr>
<td>Year 3 balance c/f</td>
<td>218,750</td>
<td>142,250</td>
<td></td>
</tr>
<tr>
<td>Interest</td>
<td>7,000</td>
<td>69,500</td>
<td></td>
</tr>
<tr>
<td>P&amp;L</td>
<td>218,750</td>
<td>218,750</td>
<td></td>
</tr>
</tbody>
</table>

**Plant account**

<table>
<thead>
<tr>
<th>Balance c/d</th>
<th>₦</th>
</tr>
</thead>
<tbody>
<tr>
<td>218,750</td>
<td>218,750</td>
</tr>
</tbody>
</table>

**Plant Account**

<table>
<thead>
<tr>
<th>Year 1 Cash</th>
<th>₦</th>
<th>Sinking fund account</th>
<th>₦</th>
</tr>
</thead>
<tbody>
<tr>
<td>250,000</td>
<td>218,750</td>
<td>Cash</td>
<td>31,250</td>
</tr>
</tbody>
</table>

Sinking investment 5% Stock Account

<table>
<thead>
<tr>
<th>Year</th>
<th>₦</th>
<th>Year</th>
<th>₦</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>69,250</td>
<td>1</td>
<td>balanced c/d</td>
</tr>
<tr>
<td>2.</td>
<td>69,250</td>
<td>2</td>
<td>Bal. c/d</td>
</tr>
</tbody>
</table>
Cash                   69,500
Cash (out)            3,500
                   142,250
3. Bal. b/d 142,250 3 Bal. c/d 218,750
Cash                  69,500
Cash (interest)      7,000
                   218,750
4. Bal. b/d 218,750

Note:

The investment will be sold for ₦218,750 which, added to the cash of ₦31,250 received for scrap value of the old plant, will provide ₦250,000 towards the cost of a new plant.

Debenture Repayment

Sinking fund can be provided to write off a loan debenture or an asset in case of amortisation. Where debenture is redeemable at a fixed date, a sinking fund can be accumulated by transferring equal amounts out of profits to create a sinking fund account. Simultaneously, a sum equivalent to the amount of each transfer will be invested in securities to create a sinking fund investment which, with compound interest at a specified rate, will sum up to the amount required to pay the debt.

Sinking fund to redeem a loan liability, etc.

<table>
<thead>
<tr>
<th>Dr</th>
<th>Cr</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) On setting aside the instalment annuity</td>
<td>P&amp;L account  Sinking fund account</td>
</tr>
<tr>
<td>(b) On investing the instalment</td>
<td>Sinking fund cash account</td>
</tr>
<tr>
<td>(c) On receipt and re-investment</td>
<td>Cash account  Sinking fund account</td>
</tr>
<tr>
<td>Of interest on investment</td>
<td>Sinking fund Cash account</td>
</tr>
<tr>
<td>(d) On redemption of debentures</td>
<td>Cash account  Sinking fund Investment account</td>
</tr>
<tr>
<td></td>
<td>Debenture Cash account  General reserve account</td>
</tr>
</tbody>
</table>

ILLUSTRATION 24

Sphere Company Limited borrowed ₦5,000,000 through debentures and agreed to redeem the amount at the end of 5 years by means of a sinking fund.

Prepare the necessary accounts.

SUGGESTED SOLUTION 24

Debenture Account

<table>
<thead>
<tr>
<th></th>
<th>₦</th>
<th></th>
<th>₦</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>5,000,000</td>
<td>Bal. c/d</td>
<td>5,000,000</td>
</tr>
</tbody>
</table>

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ILLUSTRATION 25

Agbon-magbe Ltd has issued ₦2.5m 7 percent debenture at par, on 1 January 2007. The terms include that the company should provide a sinking fund for redemption on 31 December, a year later. It is ascertained that the annual sum to be set aside for the three years at 5% compound interest, to accumulate to ₦1.00 is ₦0.317209.

Required:

(a) Compute the first investment to be made on 31 December, following the issue:
(b) Show journal entries for the first two years; and
(c) Ledger accounts for the three years.

SUGGESTED SOLUTION 25

(a) Amount to be set aside ₦2.5m x 0.317209 = ₦793,022.5

(b) Journal entries

\[
\begin{array}{ccc}
\text{Dr} & \text{Cr} \\
793,022.5 & 793,022.5 \\
\text{Sinking fund account} & \text{Cash account} \\
\text{Being annual sum invested at 5\% per annum in December 2008} & \\
39,500 & 39,500 \\
\text{Cash account} & \text{Sinking fund account} \\
\text{Being interest received on ₦793,022.5 at 5\% per annum} & \\
39,500 & 39,500 \\
\text{Sinking fund investment account} & \text{Cash account} \\
\text{Being investment of interest received} & \\
39,500 & 39,500
\end{array}
\]

(c) Ledger accounts for the three years

\[
\begin{array}{ccc}
\text{31 Dec. 2009 cash} & 2.5 & \text{Debenture redeemed} & 2.5 \\
\text{31 Dec. 2006 cash} & 793,022.5 & 31 Dec. 2006 bal c/f & 793,022.5 \\
\text{1 Jan. 2007 bal b/d} & 793,022.5 & 31 Dec. 2007 bal c/f & 1,625,696 \\
\text{Cash} & 793,022.5 & \\
\text{Interest at 5\% on (793,022.5)} & 39,651 & 39,651 \\
\text{1,625,696} & & 1,625,696
\end{array}
\]

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The difference between the use of sinking fund for assets replacement and debenture or loan repayment, are:

(a) Amount set aside for the sinking fund for writing off the asset is debited to profit and loss account, whereas for the redemption of debentures, it is debited to the appropriation account.

The difference in the treatment is due to the fact that one is a definite charge for depreciation whilst the other is merely an appropriation to prevent the amount set aside from being used as dividend, until the debt is repaid.

(b) When the asset is written off, the fund and the assets are cleared until a new asset is purchased whilst the investment account remains. Whereas, in debenture redemption, the investment and debenture are cleared but the fund remains and is available for distribution.

### SELF ASSESSMENT EXERCISE

After studying this unit, solve the question without looking at the solution and compare your answer to the solution given in the illustration.

#### 3.2 NATURE OF INVESTMENT

(a) An investment could be either fixed interest securities (debentures/loan stocks) or equities.

(b) The investment in fixed interest securities, attracts fixed interest, on the nominal value of the investment, which may be payable annually, semi-annually or quarterly.

(c) The value of the investment is the (quoted price x nominal value) plus other cost (if purchased) or less other cost (if sold).

(d) For the fixed interest securities, the investment can be purchased/sold cum-div/interest (including dividend) or ex-div/interest (excluding dividend).

Cum-div is a situation when the price includes the right of a buyer to receive the next instalment of interest, including subsequent instalments of interest.

Ex-div is a situation when price does not include the right of a buyer to receive the next instalment of interest. He is then entitled to subsequent instalments of interest. All prices are “cum-div” unless when specifically stated to be ex-div.

### SELF ASSESSMENT EXERCISE

What do you understand by the term “Cum-div” and “Ex-div”?

#### 3.3 ACCOUNTING ENTRIES FOR FIXED INTEREST SECURITIES

(a) Purchases Cum-Div

i. Compute net purchase price as: (quoted price x nominal value) + stamp duty, brokerage etc. – accrued interest.

ii. Dr investment a/c (capital column) with the purchase price

Dr accrued interest account (income column) with accrued interest
Cr bank a/c with purchase price

iii. Dr bank a/c
Cr investment a/c (income column) with interest including the immediate one.

(b) Purchases Ex-Div

i. Compute purchase price as: (quoted price x nominal value) + stamp duty brokerage etc.

ii. Dr investment a/c (capital column) with purchase price
Cr bank account

iii. Dr investment a/c (capital column) with interest
Credit investment account (income column)

iv. Dr bank account with the instalments of interest excluding the immediate next one
Cr investment account (income column)

(c) Sales Cum-Div

i. Calculate net proceeds as: (quoted price x nominal value) – (brokerage, stamp duty etc. + accrued interest)

ii. Dr bank a/c- with net proceeds
Cr investment account (income column) with accrued interest
Cr investment account (capital column) with balance net proceeds

iii. Calculate profit/loss on sales = net proceeds – cost

\[
\text{Where cost} = \frac{\text{nominal value of investment sold} \times \text{average cost}}{\text{nominal value of total investment}}
\]

And average cost = purchase cum div – net purchase price
Purchase ex-div = purchase price plus interest

iv. Dr P&L account with loss on sale
Cr investment account (capital column)
Dr Investment account (capital column) with profit on sale
Cr P&L account

v. Dr bank account
Cr investment account (income column) with interest on net investment, that is, purchase- sales as from immediate next instalment.

(d) Sales Ex-Div

i. Calculate the net proceeds (as in sales cum-div)

ii. Calculate the interest on the securities sold from the date of sales to the date of next instalment.

iii. Dr Bank a/c
Cr investment a/c (capital column) with net proceeds.

iv. Dr investment a/c (income column)
Cr investment a/c (capital column) with interest in step 2

v. Calculate profit/loss on disposal = net proceeds + interest – cost

\[
\text{Where cost} = \frac{\text{nominal value of investment sold} \times \text{average cost}}{\text{nominal value of total investment}}
\]

SELF ASSESSMENT EXERCISE
How do you treat sales cum-div in the books?

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3.4 ACCOUNTING ENTRIES FOR EQUITIES INVESTMENT

The current practice is not to make an apportionment of dividend on purchase or sales of equities, either “cum” or “ex” dividend. The full cost of investment including expenses is debited to the capital column.

(a) Dr Investment account (normal column) with cost of investment including expenses.
   Cr Bank account

(b) Dr Investment account (nominal column) with bonus shares (scrip issue)
   Cr Bank account

(c) Dr Investment account (capital column) with amount paid to purchase the right taken-up.
   Cr Bank account

(d) Dr Bank account with sales proceeds on the right sold
   Cr Investment account (capital column)

(no record will be made as regard the nominal value)

(e) Dr Bank account with dividend received
   Cr Investment account (income column)

Note:

When two prices are quoted in a question e.g. 60k to 75k, the lower is the purchase price whilst the higher is the sales price. For balance sheet purposes, the mid-market price is taken.

ILLUSTRATION 26

The following transactions of Ayo Investment Ltd took place during the year ended June 30, 2008.

1/7/2007 – Purchased ₦120,000 4% Rivers State Development Stock (interest payable February &
   August) at 60 1/2% (sixty and half percent).
   - Purchased 300,000 9% Treasury bill at 68 (interest payable Oct. & April).
   Brokerage and other expenses amounted to ₦1,000.

12/7/2007- Purchased 200,000 ordinary shares each in NDC PLC for ₦400,000.

1/8/2007- Received half-year’s interest on 4% River State Development Stock.

15/8/2007 – NDC PLC made a bonus issue of 3 ordinary shares for every 2 held. 25,000 units of the
   bonus issue was sold for ₦10 each.

30/8/2007- Purchased ₦150,000 9% Treasury bill at 70 ex-div

1/10/2007- Received interest on 9% Treasury bill
   - Purchased 50,000 ordinary shares of ₦1 each in OPC plc at ₦7.75 each.

2/01/2008- Sold ₦30,000 4% River State Development Stock at 61 ex-div.
1/02/2008- Received half-year’s interest on 4% River State Development Stock.

1/03/2008- Received dividend of 18% on shares in NDC PLC.

1/04/2008- Received interest on 9% treasury bill.

- OPC PLC made a right issue on the basis of ‘1 for 2’ at N5/share. Half of the right was
sold on the market for N2.50 per share.

01/06/2008- Received dividend of 12 ½ % on shares in OPC PLC.

You are required to write up the relevant investment accounts as they would appear in the books of Ayo investments limited for the year ended 30 June, 2008.

**SUGGESTED SOLUTION 26**

**INVESTMENT- 4% RIVER STATE DEVELOPMENT STOCK**

<table>
<thead>
<tr>
<th>Nom</th>
<th>Income</th>
<th>Capital</th>
<th>Nom</th>
<th>Income</th>
<th>Capital</th>
</tr>
</thead>
<tbody>
<tr>
<td>₦</td>
<td>₦</td>
<td>₦</td>
<td>₦</td>
<td>₦</td>
<td>₦</td>
</tr>
<tr>
<td>1/7/07 Bank purchase 120,000</td>
<td>2,000</td>
<td>70,600</td>
<td>1/8/07 Bank interest</td>
<td>2,400</td>
<td></td>
</tr>
<tr>
<td>2/1/08 Adj. For Ex-div</td>
<td>100</td>
<td>2/1/08 Bank sales</td>
<td>30,000</td>
<td>18,300</td>
<td></td>
</tr>
<tr>
<td>30/1/08 Inv. Income</td>
<td>4,200</td>
<td>2/1/08 Adj. For Ex-div</td>
<td>100</td>
<td></td>
<td></td>
</tr>
<tr>
<td>30/1/08 P &amp; L a/c</td>
<td>750</td>
<td>2/1/08 Bank interest</td>
<td>2,400</td>
<td></td>
<td></td>
</tr>
<tr>
<td>30/6/08 Bal. c/d</td>
<td>90,000</td>
<td>1,500</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

| 120,000 | 6,300 | 71,350 |

Bal. b/d | 90,000 | 1,500 | 52,950 |

**NDC PLC- Ordinary Shares Account**

<table>
<thead>
<tr>
<th>Nom</th>
<th>Income</th>
<th>Capital</th>
<th>Nom</th>
<th>Income</th>
<th>Capital</th>
</tr>
</thead>
<tbody>
<tr>
<td>₦</td>
<td>₦</td>
<td>₦</td>
<td>₦</td>
<td>₦</td>
<td>₦</td>
</tr>
<tr>
<td>12/8/07 Bank purchase 200,000</td>
<td>400,000</td>
<td>15/8/07 Bank sales</td>
<td>250,000</td>
<td>250,000</td>
<td></td>
</tr>
<tr>
<td>15/8/07 Bonus issue</td>
<td>300,000</td>
<td>1/3/08 Bank dividend</td>
<td>22,500</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1/3/08 Inv. Income</td>
<td>22,500</td>
<td>30/6/08 bal. c/d</td>
<td>250,000</td>
<td>200,000</td>
<td></td>
</tr>
<tr>
<td>31/6/08 profit on disposal</td>
<td>50,000</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

| 500,000 | 22,500 | 450,000 |

| 500,000 | 22,500 | 450,000 |

1/7/08 balance b/d | 250,000 |

**OPC PLC- Ordinary Shares**

<table>
<thead>
<tr>
<th>Nom</th>
<th>Income</th>
<th>Capital</th>
<th>Nom</th>
<th>Income</th>
<th>Capital</th>
</tr>
</thead>
<tbody>
<tr>
<td>₦</td>
<td>₦</td>
<td>₦</td>
<td>₦</td>
<td>₦</td>
<td>₦</td>
</tr>
<tr>
<td>1/10/07 Bank Purchase 50,000</td>
<td>387,500</td>
<td>1/4/08 Bank sales of right</td>
<td>31,256</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1/4/08 Bank right</td>
<td>12,500</td>
<td>62,500</td>
<td>1/6/08 Bank Div</td>
<td>7,812.50</td>
<td></td>
</tr>
<tr>
<td>30/6/08 Inv. Income</td>
<td>7,812.50</td>
<td>30/6/08 Bal. c/d</td>
<td>62,500</td>
<td>418,750</td>
<td></td>
</tr>
<tr>
<td>62,500</td>
<td>7,812.50</td>
<td>450,000</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

| 62,500 | 7,812.50 | 450,000 |

| 62,500 | 7,812.50 | 450,000 |

Bal. b/d | 62,500 | 418,750 |

**INVESTMENT – 9% Treasury Bill**

<table>
<thead>
<tr>
<th>Nom</th>
<th>Income</th>
<th>Capital</th>
<th>Nom</th>
<th>Income</th>
<th>Capital</th>
</tr>
</thead>
<tbody>
<tr>
<td>₦</td>
<td>₦</td>
<td>₦</td>
<td>₦</td>
<td>₦</td>
<td>₦</td>
</tr>
</tbody>
</table>

| 156 |
1/7/04 Bal. b/d   450,000 6,750 304,375

Note:
Securities in fixed interest (loan stock), are normally quoted in units of N100, unless otherwise specified.

Purchase price of 4% Rivers State Dev. Stock will be:
N120,000 x 0.605 = N72,600
Accrued interest = 5/12 x 4% x 120,000 = (2,000) 70,600

SELF ASSESSMENT EXERCISE
After studying this unit, solve the question without looking at the solution and compare your answer to the solution given in the illustration.

4.0 CONCLUSION
Corporate stocks, bonds, and debentures can be a risky investment. However, the introduction of sinking fund is a way for companies to minimize this risk for investors.

A sinking fund is basically a pile of money a corporation sets aside to repay its dividends on stocks or other debt instruments. Since corporations must repay the principal amount and its interest at maturity to holders, there is a chance that the final amount could be too high for a company in financial trouble. Companies that can’t pay the maturity debt will default. The setting aside of assets minimizes the final bill that the company must pay when an instrument’s term is up. Because the amount of debt the company has is reduced, the risk of the company defaulting is lessened.

5.0 SUMMARY
In this unit, we discussed sinking fund and annuity. This was discussed considering asset replacement, the nature of investment and accounting entries for fixed interest and equities investment.

6.0 TUTOR MARKED ASSIGNMENT
1. On purchase of new asset, debit ________ account and credit _______ account.
2. Sinking fund can be provided to write off a loan debenture or an asset in case of _________.
3. Where debenture is redeemable at a fixed date, a sinking fund can be accumulated by transferring ________ to create a sinking fund account.
4. ________ is a situation when the price includes the right of a buyer to receive the next instalment of interest, including subsequent instalments of interest.
5. ________ is a situation when price does not include the right of a buyer to receive the next instalment of interest.

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


Nigerian Accounting Standard Board, Statement of Accounting Standard
1.0 INTRODUCTION
In this unit, we shall be discussing underwriter’s account and stock brokerage accounts.

An underwriter is one who undertakes to take over shares not purchased when they are being offered for sale to the public or by private placement, in return for an agreed commission.

A stockbroker buys or sells stocks and shares based on his client’s instruction at a price determined daily on the floor of the exchange by market forces. After buying or selling, the stockbroker will send to his client a contract note detailing the unit price, quotation of shares bought or sold, commissions and charges payable or receivable on the transaction.

2.0 OBJECTIVES
After studying this unit, you should be able to:

1. State and explain the terms in underwriting.
2. Prepare underwriting account.
3. Prepare contract journal of the stockbroker.
4. Calculate unit valuation.
3.0 MAIN CONTENT
3.1 NATURE AND TERMS IN UNDERWRITING
Like stated above in the introduction, an underwriter is one who undertakes to take over shares not purchased when they are being offered for sale to the public or by private placement, in return for an agreed commission. The following terminologies are relevant:

(a) Underwriting commission: This is the commission an underwriter receives on the value of shares he underwrites. This is based on the original contract. Not on the portion actually taken up.
(b) Sub-underwriting commission: this is the commission the principal underwriter will pay to a sub-underwriter in case he enters into a sub-underwriting agreement in order to spread the risk. This is based on the original value of the contract and not on the portion taken up.
(c) Over-riding commission: This is the additional commission paid to the principal underwriter in case of sub-underwriting agreement.
(d) Firm application: This is the number of shares, which will be allotted to the principal underwriter in addition to the proportion to be underwritten, on the residue, not fully subscribed by the public.

Book-Keeping Procedure

- Open a separate account for each underwriting contract
- Provide separate columns for shares and cash

SELF ASSESSMENT EXERCISE
Define the following terms:
- a. Underwriting commission
- b. Sub-underwriting commission
- c. Over-riding commission

3.2 ACCOUNTING ENTRIES FOR UNDERWRITER’S ACCOUNT
(a) Dr: Underwriting account} with application and allotment proceeds
   Cr: Cash/Bank account } in respect of shares taken over
   Note: If there is any excess payment on application due to the advance payment, the excess will be set-off against allotment monies.
(b) Dr: Bank/Cash account } with commission received
   Cr: underwriting accounting
(c) Dr: Underwriting account
   Cr: Bank/Cash } with commission paid to sub-underwriter
   Note: If shares are received for remuneration, debit the shares column only
(d) Dr: Underwriting account
   Cr: Bank/Cash account } with the option paid for
(e) Dr: Bank/Cash account }
   Cr: Underwriting account} with option money received
(f) Dr: Underwriting account} with incidental expenses on underwriting contract
   Cr: Bank/Cash account }
(g) Dr: Underwriting account
   Cr: P & L account } with profit on underwriting contract
(h) Dr: P & L account
       Cr: Understanding account) with loss on underwriting contract

(i) Dr: Closing stock of unsold shares
       Cr: Underwriting account } with value of closing stock of unsold shares

**ILLUSTRATION 27**

Frontline Ltd decided to issue 1,000,000 shares of N1.00 each at par, 10 kobo payable on application, 40 kobo on allotment and 50 kobo on first and final call. Yinkus Ltd, a finance company, agrees to underwrite the whole issue, at a commission of 2.5% and to apply firm for 200,000 shares. Yinkus Ltd arranged with Funky Ltd that they sub-underwrite 25% of the shares for a commission of 2%.

The public applies for and was allotted 400,000 shares and Yinkus Ltd was allotted the firm’s application for 200,000 shares.

Yinkus Ltd had deposited cheque designed for the application money on shares underwritten and Funky Ltd in turn, had deposited the relevant cheques and which cleared when the result of the issue became known and commission due was paid.

After allotment and before final payment, Yinkus Ltd sold 100,000 shares at 45k each, having made the final payment. Yinkus Ltd then sold 250,000 shares at 110k each.

At the end of the financial year of Yinkus Ltd, shares of frontline ltd, were valued at 120k each.

You are required to prepare the underwriting account of Yinkus Ltd reflecting the above transactions.

**SUGGESTED SOLUTION 27**

<table>
<thead>
<tr>
<th>Shares</th>
<th>₦</th>
<th>Shares</th>
<th>₦</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank firm application</td>
<td>500,000</td>
<td>50,000</td>
<td>Bank-commission received</td>
</tr>
<tr>
<td>Bank-shares taken on allot</td>
<td>200,000</td>
<td>Bank-sales</td>
<td>100,000</td>
</tr>
<tr>
<td>Bank- Final call</td>
<td>200,000</td>
<td>Bank-sales</td>
<td>250,000</td>
</tr>
<tr>
<td>Bank-commission paid</td>
<td>5,000</td>
<td>Bal. c/d</td>
<td>150,000</td>
</tr>
<tr>
<td>P &amp; L account</td>
<td>40,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>500,000</td>
<td>495,000</td>
<td>500,000</td>
<td>495,000</td>
</tr>
<tr>
<td>150,000</td>
<td>150,000</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**WORKINGS**

Share taken over: ₦ ₦

Firm application
Total issue 1,000,000
Firm application (200,000) 200,000
Public application (400,000) 400,000
Sub-underwriting (100,000) 300,000 500,000
### 3.3 STOCK BROKERAGE ACCOUNT

**INTRODUCTION**

Accounting Entries

A summary of the basic double entries in the books of the stockbroker is set out below:

**On purchase of shares by a client**

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
<th>With</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Client</td>
<td>Jobber commission receivable stamp</td>
<td>Price paid for shares stockbrokers</td>
</tr>
<tr>
<td></td>
<td>account contract stamp account</td>
<td>commissions stamp duty on purchase</td>
</tr>
<tr>
<td></td>
<td></td>
<td>contract stamp.</td>
</tr>
<tr>
<td>(b) Jobber bought</td>
<td>Bought ticket accounts</td>
<td>“Make-up” price of shares plus stamp</td>
</tr>
<tr>
<td>Stamp account</td>
<td></td>
<td>duty.</td>
</tr>
<tr>
<td>(c) Jobber or cash</td>
<td>Cash or Jobber</td>
<td>Difference between price paid for shares</td>
</tr>
<tr>
<td></td>
<td></td>
<td>and “make-up” price (plus stamp duty).</td>
</tr>
<tr>
<td>(d) Cash</td>
<td>Client</td>
<td>Cash received from client.</td>
</tr>
<tr>
<td>(e) Ticket account</td>
<td>Cash</td>
<td>Cash paid to stock exchange for</td>
</tr>
<tr>
<td></td>
<td></td>
<td>purchases during the account</td>
</tr>
<tr>
<td>(f) Contract sold account</td>
<td>Cash</td>
<td>Monthly payment to the Inland Revenue</td>
</tr>
<tr>
<td>(g) Commission receivable</td>
<td>Profit and loss account</td>
<td>Commission earned</td>
</tr>
</tbody>
</table>

**On sale of shares by a client**

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
<th>With</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Jobber account</td>
<td>Client commission receivable contract</td>
<td>Net proceeds selling commission</td>
</tr>
<tr>
<td></td>
<td>stamp contract stamp account</td>
<td></td>
</tr>
<tr>
<td>(b) Ticket account</td>
<td>Jobber in inland revenue buyer’s stamp</td>
<td>“make-up” price of shares sold plus</td>
</tr>
<tr>
<td></td>
<td>duty</td>
<td></td>
</tr>
<tr>
<td>(c) Cash or jobber</td>
<td>Jobber or cash</td>
<td>Difference between gross proceed proceeds and “make-</td>
</tr>
</tbody>
</table>
In practice, a contract journal will be used for the entries of purchases and sales.

**ILLUSTRATION 28**

Mr. Johnson, a stockbroker, carried out the following instructions for his clients:

From Mr. Ayodele- Purchased 2,000 shares of Cadbury Plc at ₦ 72

From Mr. Ayodele- Purchased 1,000 shares of Unilever Plc at ₦ 80

From Mr. Adamu- Sold 2,000 shares of BOC Gases Plc at ₦ 5

From Mr. Okoro- Purchased 10,000 shares of Texaco Plc at ₦ 100

From Mr. Okoro- Sold 5000 shares of Nigeria Breweries Plc at ₦ 60

Stockbrokers commission is 1% and stamp duty of 1% is payable on every transaction.

Prepare contract journal of the stockbroker.

**SUGGESTED SOLUTION 28**

**MR. JOHNSON**

**CONTRACT JOURNAL**

<table>
<thead>
<tr>
<th>Date</th>
<th>Name of Party</th>
<th>Description of Securities</th>
<th>Price</th>
<th>Total value</th>
<th>Name of Party</th>
<th>Description of Securities and Commission</th>
<th>Stamp Duties</th>
<th>₦</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Ayodele</td>
<td>2000 Cadbury Plc</td>
<td>72</td>
<td>146,880</td>
<td>Dealer</td>
<td></td>
<td>2,880</td>
<td>144,000</td>
</tr>
<tr>
<td></td>
<td>Ayodele</td>
<td>1000 Unilever Plc</td>
<td>80</td>
<td>81,600</td>
<td>Dealer</td>
<td></td>
<td>1,600</td>
<td>80,000</td>
</tr>
<tr>
<td></td>
<td>Dealer</td>
<td></td>
<td>5</td>
<td>10,000</td>
<td>Adamu</td>
<td>2000 BOC Gases Plc</td>
<td>200</td>
<td>9,800</td>
</tr>
<tr>
<td>Okoro</td>
<td>Dealer</td>
<td>10,000</td>
<td>100</td>
<td>1,020,000</td>
<td>Dealer</td>
<td>20,000</td>
<td>1,000,000</td>
<td></td>
</tr>
<tr>
<td>--------</td>
<td>---------</td>
<td>--------</td>
<td>-----</td>
<td>---------</td>
<td>---------</td>
<td>--------</td>
<td>----------</td>
<td></td>
</tr>
<tr>
<td>Texaco Plc</td>
<td>60</td>
<td>300,000</td>
<td>Okoro 5000 Nig Breweries</td>
<td>6,000</td>
<td>294,000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>1,558,480</td>
<td></td>
<td>30,680</td>
<td>1,527,800</td>
<td></td>
</tr>
</tbody>
</table>

(a) Each item is debited to dealer or client account
(b) Half credited to stamp duties account and half credited to commission account.
(c) Each item credited to dealer or client account.

SELF ASSESSMENT EXERCISE
After studying this unit, solve the question without looking at the solution and compare your answer to the solution given in the illustration.

3.4 INVESTMENT AND UNIT TRUST ACCOUNTS
Investment trusts, together with unit trusts, from a group of financial intermediaries, whose main function is to enable investors to spread their risks and obtain the advantages of professional management of their investments. They generally hold the shares of a wide range of companies, and thus the purchaser of shares in a trust, spreads his funds in small accounts over a large number of expertly selected managed investments.

There are important distinctions between investment trusts and unit trusts. The main difference being that an investment trust is not really a trust at all, but a limited liability company operating under CAMA (2004), whereas a unit trust operates under a trust deed.

An investment trust raises its capital by issuing shares to the public, in the normal way and utilizes the funds obtained to invest in other securities.

Investment trusts distribute dividends annually, out of the income they receive from their investment assets, after allowing for expenses of administration and allocation to reserves

Disclosures in Investment Trust Account
As a limited liability company, investment trust companies must comply with the provisions of CAMA (2004).

However, the treatment and details of income from investments in the Revenue account (as the profit and loss account of an investment trust company is conveniently termed), should normally be shown by way of note.

Any of the following two formats could be adopted:

Extract from revenue accounts

<table>
<thead>
<tr>
<th>Note</th>
<th>₦</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>

(a) Gross income:
Dividends and interest 1 x

Relative explanatory note to revenue account:

Note 3 Dividends and interest:
Quoted investment xx
Unquoted investment xx
X

(b) Income:
Interest and dividends 2 x

Note 4 Interest and dividends, have been
Received from investments as follows:
Quoted on Nigeria Stock Exchange xx
Quoted on other stock exchange xx
Unquoted xx
Investment funds on deposit xx
X

Unit Trust Accounts

Unit trust is an organization whose objective is the collective investment of money subscribed by its members.

There are three parties to the Trust: the Managers, the Trustees and the Holders. Units are usually value-based; that is, the current value of the portfolio plus cash-in-hand and at Bank (that is, un-invested funds).

Accounts required – (In the books of the Trustee)

(a) Bank account
(b) Unit capital account
(c) Investment account
(d) Statement of Valuation
(e) Statement of Financial Position

Accounting Entries

(a) Dr: Bank account } with money lodged on the subscription of units by unit holder
    Cr: Unit Capital account)
(b) Dr: Investment account} with purchase of securities
    Cr: Bank account }
(c) Dr: Bank account } with dividends/income received on investment
    Cr: Investment account}
(d) Dr: Unit Capital account} with the payment to a resigning member
    Cr: Bank account }

Resigning member will be paid based on prevailing value per unit at his/her resignation.

ILLUSTRATION 30
Forty (40) people came together to form Yommy Unit Trust and they have appointed you as the trustee. The rule of the trust provides that each member will subscribe one unit per month, the value of a unit being defined as:

“The unit value shall be₦ 5,000 ay the first monthly meeting. Thereafter, at each monthly meeting, the trust portfolio shall be valued at the monthly market price (as shown in the Stock Exchange listing), to which shall be added any un-invested cash balance, and the total sum divided by the number of units subscribed for to date, to give the current unit value.”

Any member, who wishes to resign, is paid in cash, the value of the units he/she has subscribed for, up-to-date. The value for this purpose is the current unit value, fixed at the meeting at which he gives his intention to withdraw.

At the first monthly meeting, the members agreed to purchase 8000 unique products Plc ordinary shares at N22.50 each and the balance of cash-in-hand, carried forward.

At the next meeting, these shares were quoted at ₦ 24.50 and with monthly subscription they decided to buy 16,000 Excel Plc ordinary shares at ₦ 14 each. By the time members met for the third meeting, Unique Products PLC ordinary shares were quoted at ₦ 24 and Excel PLC ordinary shares at N12.50 and it was agreed to buy 60,000 ordinary shares of Bakers PLC at ₦ 3 each. Two members resigned at this meeting and they were given refund of their units in cash, at the agreed valuation.

On the day of the fourth meeting, the shares in the trust’s portfolio were valued as follows:

Unique Products PLC ₦ 24
Excel PLC ₦ 13
Bakers PLC ₦ 3

On that day ₦5,000 and ₦ 7,000 were received as dividends on Unique and Excel respectively.

You are required to:

(a) Calculate the unit valuation on the day of the fourth meeting.
(b) Prepare a draft statement that will clearly convey to the members the trust’s financial position, on that date.
(c) Show all the entries in the books of the trustee and the balances up to the end of month 3.

SUGGESTED SOLUTION 30

(a) Statement of Financial Position

<table>
<thead>
<tr>
<th>Units</th>
<th>₦</th>
</tr>
</thead>
<tbody>
<tr>
<td>40 Month 1 – Subscriptions: 40 units at ₦ 5,000</td>
<td>200,000</td>
</tr>
<tr>
<td>Purchases: 8,000 Unique Ord. @ ₦ 22.50</td>
<td>(180,000)</td>
</tr>
<tr>
<td></td>
<td>20,000</td>
</tr>
<tr>
<td>40 Month 2- Subscriptions: 40 units @ ₦ 5,400 each</td>
<td>216,000</td>
</tr>
<tr>
<td>Purchases: 60,000 Excel Ord. @ ₦ 14 each</td>
<td>(224,000)</td>
</tr>
<tr>
<td></td>
<td>12,000</td>
</tr>
<tr>
<td>38 Month 3- Repayments: 4 units at ₦ 5,050 each</td>
<td>(20,200)</td>
</tr>
</tbody>
</table>
Subscriptions: 38 units at ₦5,050 each

\[191,900\]

Purchases: 60,000 Bakers Ord. @ ₦3 each

\[-180,000\]

Investment income

\[12,000\]

\[15,700\]

(b) STATEMENT OF VALUATION

<table>
<thead>
<tr>
<th>Month</th>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Month 2</td>
<td>8000 Unique Ord. @ ₦24.50 per unit</td>
<td>₦196,000</td>
</tr>
<tr>
<td></td>
<td>Bank Balance for month 1</td>
<td>₦20,000</td>
</tr>
<tr>
<td></td>
<td>No. Of units</td>
<td>40</td>
</tr>
<tr>
<td></td>
<td>Value/unit</td>
<td>₦5,400</td>
</tr>
<tr>
<td>Month 3</td>
<td>8,000 Unique Ord. @ ₦24</td>
<td>₦192,000</td>
</tr>
<tr>
<td></td>
<td>16,000 Excel Ord. @ ₦12.50</td>
<td>₦200,000</td>
</tr>
<tr>
<td></td>
<td>Bank balance for month 2</td>
<td>₦12,000</td>
</tr>
<tr>
<td></td>
<td>No. Of units (40 + 40)</td>
<td>80</td>
</tr>
<tr>
<td></td>
<td>Value/unit</td>
<td>₦5,050</td>
</tr>
<tr>
<td>Month 4</td>
<td>8,000 Unique Ord. @ ₦24 per unit</td>
<td>₦192,000</td>
</tr>
<tr>
<td></td>
<td>16,000 Excel Ord. @ ₦13 per unit</td>
<td>₦208,000</td>
</tr>
<tr>
<td></td>
<td>60,000 Baker Ord. @ ₦3 per unit</td>
<td>₦180,000</td>
</tr>
<tr>
<td></td>
<td>Bank balance for month 3</td>
<td>₦3,700</td>
</tr>
<tr>
<td></td>
<td>No. Of units (80 + 38 – 4)</td>
<td>114</td>
</tr>
<tr>
<td></td>
<td>Value/unit</td>
<td>₦5,120</td>
</tr>
</tbody>
</table>

(c) Bank A/C

<table>
<thead>
<tr>
<th></th>
<th>₦</th>
<th>₦</th>
</tr>
</thead>
<tbody>
<tr>
<td>Month 1 Unit Cap.</td>
<td>200,000</td>
<td>Month 1 Invest</td>
</tr>
<tr>
<td>2 Unit Cap</td>
<td>216,000</td>
<td>2 Invest.</td>
</tr>
<tr>
<td>3 Unit Cap.</td>
<td>191,900</td>
<td>3 Unit Cap.</td>
</tr>
<tr>
<td>3 Investment income</td>
<td>12,000</td>
<td>3 Investment 180,000</td>
</tr>
</tbody>
</table>

Bal. c/d | ₦619,900 | 15,700 |

INVESTMENT A/C

<table>
<thead>
<tr>
<th></th>
<th>₦</th>
<th>₦</th>
</tr>
</thead>
<tbody>
<tr>
<td>Month 1 Bank</td>
<td>180,000</td>
<td>Bal. c/d</td>
</tr>
<tr>
<td>2 Bank</td>
<td>224,000</td>
<td></td>
</tr>
<tr>
<td>3 Bank</td>
<td>180,000</td>
<td></td>
</tr>
<tr>
<td>bal. b/d</td>
<td>584,000</td>
<td></td>
</tr>
</tbody>
</table>

UNIT CAPITAL A/C

<table>
<thead>
<tr>
<th></th>
<th>₦</th>
<th>₦</th>
</tr>
</thead>
<tbody>
<tr>
<td>Month 3 Bank</td>
<td>20,200</td>
<td>Month 1 Bank</td>
</tr>
<tr>
<td>Bal c/d</td>
<td>587,700</td>
<td>2 Bank</td>
</tr>
<tr>
<td>--------</td>
<td>---------</td>
<td>--------</td>
</tr>
<tr>
<td></td>
<td></td>
<td>3 Bank</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>607,900</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

INVESTMENT INCOME A/C

| Bal. c/d | ₦12,000 | Month 4 Bank | ₦12,000 |

SELF ASSESSMENT EXERCISE
What are the parties to a unit trust?

4.0 CONCLUSION

Only a stockbroker who is a member of the Nigerian Stock Exchange is allowed to deal in quoted stocks and shares on behalf of his clients, on the capital market’s trading floor.

5.0 SUMMARY

This unit details the double entry principles and related books of accounts maintained by the operators of investment and unit trust companies, sinking funds and annuities, underwriting and stock-broking firms.

6.0 TUTOR MARKED ASSIGNMENT

1. State one function of a stockbroker
2. What is the main distinction between an investment trust and a unit trust?
3. Distinguish between investment purchase or sold cum-div and ex-div.
4. Who is an underwriter?
5. What is an underwriting commission?

7.0 REFERENCES/FURTHER READING

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


Nigerian Accounting Standard Board, Statement of Accounting Standard
1.0 INTRODUCTION
In this unit, we shall be discussing accounting for contract, investment, lease and hire purchase. Statement of Accounting Standards (SAS) NO.11 stipulates detailed appropriate treatment and disclosure of lease transactions in the books of both the lessor and lessee.

2.0 OBJECTIVES
After studying this unit, you should be able to:
1. Explain a lease and the various types.
2. Show the steps involved in accounting for lease.
3. Compute the finance charge to be recognised.
4. Record detail accounting entries.

3.0 MAIN CONTENT
3.1 WHAT IS A LEASE?
This is a contractual agreement between an owner, the lessor, and another party, the lessee, which conveys to the latter, the right to use the leased asset for an agreed period of time in return for a consideration, usually periodic payments called ‘rents’.

Leasing arrangements are usually contracted as operating lease or finance/capital lease.

Operating lease
This 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).
Finance or Capital lease

This is one which ownership, risks and reward are transferred to the lessee, who is under obligation 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 forms of finance or capital leases are:

(a) Leveraged lease is three-party lease involving a lender (often a financial institution) in addition to the usual lessor and lessee. The lender supplies, in most cases, the greater part of the purchase price of the leased asset.

(b) Sales-typed lease is one where the offeror or dealer (the lessor) transfers substantially all the ownership risks and benefits of the property to the lessee and at the inception of the lease, the fair property of the leased property is greater or less than its carrying amount in the books of the lessor, resulting in a profit or loss to the lessor, who is often a manufacturer or dealer.

(c) 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 the leased asset is the same as its carrying amount to the lessor (often not the manufacturer or dealer).

(d) ‘Sales and lease back’ is one in which the seller of the property, leases it back from the buyer.

SELF ASSESSMENT EXERCISE
What are the other forms of finance lease?

3.2 ACCOUNTING FOR LEASES IN THE BOOKS OF LESSEE

The following steps are necessary:

Step 1 Calculate the total lease payments, that is, instalment payment x no. of instalments.

Step 2 Compute cash/fair value of the leased property. It may be given, but if not, calculate it as follows:

(a) Instalments in arrears (that is, at year end) = \( \frac{\text{instalment} \ (1-[1+r]^n)}{r} \)

   Where \( r \) = lease rental rate
   \( n \) = duration of the lease.

(b) Instalments in advance (that is, at the beginning of the year) = \( \frac{\text{instalment \ 1- (1+r)^t +1}}{r \ N} \)

   Where \( t \) = n-1
   \( N \) = duration of the lease.

Step 3 Compute the depreciation on the Cash price/fair value of the leased asset.

Step 4 Calculate the total interest on the lease/finance charges:

   Total lease payment \( xx \)
Cash/fair value \( (x) \)

Total lease interest/finance charges \( x \)

Treatment of finance charges- Finance charges may be spread over the period of the lease, using:

(a) Straight line method;
(b) Sum of the years digit method; and
(c) Actuarial method.

Straight-line Method:

Finance charges are distributed evenly over the period of the lease and are written off to profit and loss account accordingly, that is: 
\[ \text{finance charge/duration of lease} \]

Sum of the year’s digit method:

The financial charges will be written off to profit and loss account on the basis of the sum of the year’s digits. For a leased asset with 3 years life span, the finance charges will be distributed into each year’s profit and loss account as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>digit</th>
<th>Proportion</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>3</td>
<td>3/6</td>
</tr>
<tr>
<td>2</td>
<td>2</td>
<td>2/6</td>
</tr>
<tr>
<td>3</td>
<td>1</td>
<td>1/6</td>
</tr>
</tbody>
</table>

Actuarial method

Interest in each period will be computed on the balance after deducting the instalment payments and adding the interest due on the cash price.

<table>
<thead>
<tr>
<th></th>
<th>Interest</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash price</td>
<td>xx</td>
</tr>
<tr>
<td>Less year 1 instalment</td>
<td>x</td>
</tr>
<tr>
<td>Balance year 1</td>
<td>x</td>
</tr>
<tr>
<td>Interest: X% of balance year 1</td>
<td>x xx</td>
</tr>
<tr>
<td></td>
<td>x</td>
</tr>
<tr>
<td>Less year 2 instalment</td>
<td>x</td>
</tr>
<tr>
<td>Balance year 2</td>
<td>x</td>
</tr>
<tr>
<td>Interest: X% of balance year 2</td>
<td>xx xx</td>
</tr>
<tr>
<td></td>
<td>XXX</td>
</tr>
<tr>
<td>Less year 3 instalment</td>
<td>x</td>
</tr>
<tr>
<td>Balance year 3</td>
<td>x</td>
</tr>
<tr>
<td>Interest: X% of balance year 3</td>
<td>x xx</td>
</tr>
<tr>
<td></td>
<td>Xx xx</td>
</tr>
</tbody>
</table>
Note: The interest will be charged before the instalment payments are deducted, if it is payable in arrears.

### Accounting Records:

<table>
<thead>
<tr>
<th>Interest Payable Method</th>
<th>Interest Suspense Method</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Leased assets a/c</td>
<td>(a) Lease assets a/c</td>
</tr>
<tr>
<td>(b) Prov. For depreciation a/c</td>
<td>(b) Prov. For depreciation a/c</td>
</tr>
<tr>
<td>(c) Lessors a/c</td>
<td>(c) Lessors a/c</td>
</tr>
<tr>
<td>(d) Finance charges a/c</td>
<td>(d) Finance charges a/c</td>
</tr>
<tr>
<td>(e) Profit and loss a/c</td>
<td>(e) Profit and loss a/c</td>
</tr>
<tr>
<td>(f) Finance charges suspense a/c</td>
<td></td>
</tr>
</tbody>
</table>

### Accounting Entries

<table>
<thead>
<tr>
<th>Interest payable method</th>
<th>Interest suspense method</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Dr: Leased assets account</td>
<td>(a) Dr: Leased assets account</td>
</tr>
<tr>
<td>Cr: Lessor’s account</td>
<td>Cr: Lessor’s account</td>
</tr>
<tr>
<td>(with cash price/fair value of leased assets)</td>
<td>(with cash price/fair value of leased assets)</td>
</tr>
<tr>
<td>(b) Dr: Finance charge account</td>
<td>(b) Dr: Interest suspense a/c</td>
</tr>
<tr>
<td>Cr: Lessor’s a/c</td>
<td>Cr: Lessor’s a/c</td>
</tr>
<tr>
<td>(with interest for each of the period)</td>
<td>(with total lease interest)</td>
</tr>
<tr>
<td>(c) Dr: Lessors a/c</td>
<td>(c) Dr: Finance charge a/c</td>
</tr>
<tr>
<td>Cr: Bank a/c</td>
<td>Cr: Interest suspense a/c</td>
</tr>
<tr>
<td>(with the instalment payment)</td>
<td>(with the interest due for each of the period)</td>
</tr>
<tr>
<td>(d) Dr: Profit and loss a/c</td>
<td>(d) Dr: Profit and loss a/c</td>
</tr>
<tr>
<td>Cr: Finance charge a/c</td>
<td>Cr: Finance charge a/c</td>
</tr>
<tr>
<td>(with the interest due for each period)</td>
<td>(with interest due for each of the period)</td>
</tr>
<tr>
<td>(e) Dr: Profit and loss a/c</td>
<td>(e) Dr: lessor’s a/c</td>
</tr>
<tr>
<td>Cr: Prov. For Depreciation a/c</td>
<td>Cr: Bank a/c</td>
</tr>
<tr>
<td>(with the depreciation for each period)</td>
<td>(with instalment payment)</td>
</tr>
<tr>
<td>(f) Dr: Profit and loss a/c</td>
<td></td>
</tr>
<tr>
<td>Cr: Prov. For depreciation a/c</td>
<td>(f) Dr: Profit and loss a/c</td>
</tr>
<tr>
<td>(with depreciation for each period).</td>
<td>(with depreciation for each period).</td>
</tr>
</tbody>
</table>

### ILLUSTRATION 31

Bakasi Haulage Contractors Limited has two alternatives. It could either buy or lease a new truck at a cost of N18million.

The term of the lease is as follows:

(a) The primary period of the lease is for 4 years from January 1, 2008, with a rental repayment of N 6million per annum, payable on December 31 of each year.
(b) The lessee has the right to continue to lease the truck after the end of primary period for an indefinite period, subject to only a nominal rent.

(c) The lessee is required to pay for repairs, maintenance and insurance cost as they arise.

(d) The interest rate implicit in the lease is 15% per annum.

(e) The lessee estimated that the useful economic life of the truck is 6 year and that depreciation could be calculated on straight line basis.

Required:

(a) Compute the finance charge to be recognised on the leased truck under the different methods of spreading finance charges.

(b) Record detailed accounting entries in respect of one of the methods identified in (a) above.

SUUGESTED SOLUTION 31
BAKASI HAULAGE CONTRACTORS LIMITED

(a) Calculation of finance charge:

i. Total lease payment = ₦ 6million x 4 = ₦ 24million

ii. The fair value of the leased truck:

\[
\text{Fair value of leased truck} = \frac{\text{Installment} \times [1-(1+r)^{-n}]}{r} = \frac{6m \times [1-(1.15)^{-4}]}{0.15}
\]

(Instalment payment in arrears) = ₦ 6m x 2.8550

= ₦ 17,130,000

iii. Depreciation = ₦ 17,130,000/6 years = ₦ 2,855,000

iv. Calculation of interest:

Total installments – ₦ 24,000,000
Cash price/fair value (17,130,000)
Total interest/finance charge 6,870,000

Straight line method = total interest/lease period = ₦ 6,870,000/4 = ₦ 1,717,500

Sum of the years digit method:

<table>
<thead>
<tr>
<th>Year</th>
<th>Digit</th>
<th>Interest Allocation</th>
<th>Finance Charge</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>4</td>
<td>4/10 x ₦ 6,870,000</td>
<td>2,748</td>
</tr>
<tr>
<td>2</td>
<td>3</td>
<td>3/10 x ₦ 6,870,000</td>
<td>2,061</td>
</tr>
<tr>
<td>3</td>
<td>2</td>
<td>2/10 x ₦ 6,870,000</td>
<td>1,374</td>
</tr>
<tr>
<td>4</td>
<td>1</td>
<td>1/10 x ₦ 6,870,000</td>
<td>687</td>
</tr>
<tr>
<td></td>
<td>10</td>
<td></td>
<td>6,870</td>
</tr>
</tbody>
</table>

Actuarial method:

<table>
<thead>
<tr>
<th>Interest</th>
<th>Finance Charge</th>
</tr>
</thead>
<tbody>
<tr>
<td>₦ 0'000</td>
<td>₦ 0'000</td>
</tr>
</tbody>
</table>

Fair value/cash price 17,130
Add: Interest- 15% x ₦ 17,130,000 2,570 2,570
19,700

Less 1st instalment 6,000
13,700
Add: Interest- 15% x ₦ 13,700,000 2,055 2,055
15,755
Less 2\textsuperscript{nd} instalment & 6,000 \\
& 9,755 \\
Add: Interest- 15\% x ₦9,755,000 & ₦1,463 \\
& 1,463 \\
Less 3\textsuperscript{rd} instalment & 6,000 \\
& 5,218 \\
Add: Interest-15\% x N5,218,000 & ₦782 \\
& 782 \\
Less 4\textsuperscript{th} instalment & 6,000 \\
& - \\
& ₦6,870 \\

(b) Accounting Entries:
Under Interest payable Method

<table>
<thead>
<tr>
<th>Leased Truck Account</th>
<th>₦'000</th>
<th>₦'000</th>
</tr>
</thead>
<tbody>
<tr>
<td>1/1/05 Lessor A/c</td>
<td>17,130</td>
<td>31/12/05 Bal. c/d</td>
</tr>
<tr>
<td>1/1/06 Bal b/d</td>
<td>17,130</td>
<td>31/12/05 Bal. c/d</td>
</tr>
<tr>
<td>1/1/07 Bal. b/d</td>
<td>17,130</td>
<td>31/12/07 Bal. c/d</td>
</tr>
<tr>
<td>1/1/08 Bal. b/d</td>
<td>17,130</td>
<td>31/12/08 Bal. c/d</td>
</tr>
</tbody>
</table>

Provision for depreciation account

<table>
<thead>
<tr>
<th>₦,000</th>
<th>₦'000</th>
</tr>
</thead>
<tbody>
<tr>
<td>31/12/06 Bal c/d</td>
<td>2,855</td>
</tr>
<tr>
<td>31/12/07 Bal. c/d</td>
<td>5,710</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>31/12/08 Bal c/d</td>
<td>8,565</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>1/1/09 Bal b/d</td>
<td>8,565</td>
</tr>
</tbody>
</table>

Lessor’s Account

<table>
<thead>
<tr>
<th>₦'000</th>
<th>₦'000</th>
</tr>
</thead>
<tbody>
<tr>
<td>31/12/05 Instalment</td>
<td>6,000</td>
</tr>
<tr>
<td>31/12/05 Bal. c/d</td>
<td>13,700</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>31/12/06 Instalment</td>
<td>6,000</td>
</tr>
<tr>
<td>31/12/06 Bal c/d</td>
<td>9,755</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>31/12/07 Instalment</td>
<td>6,000</td>
</tr>
<tr>
<td>31/12/07 Bal c/d</td>
<td>5,218</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>31/12/08 Instalment</td>
<td>6,000</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Finance charges account
Under interest suspense account method:

Finance charges/leased truck & depreciation provision accounts are the same as under interest payable a/c method.

<table>
<thead>
<tr>
<th>Date</th>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>31/12/05</td>
<td>Finance charges</td>
<td>2,570</td>
</tr>
<tr>
<td>31/12/05</td>
<td>Lessor a/c</td>
<td>2,570</td>
</tr>
<tr>
<td></td>
<td>bal. c/d</td>
<td></td>
</tr>
<tr>
<td>31/12/06</td>
<td>Finance charges</td>
<td>2,055</td>
</tr>
<tr>
<td>31/12/06</td>
<td>Lessor a/c</td>
<td>2,055</td>
</tr>
<tr>
<td></td>
<td>bal. c/d</td>
<td></td>
</tr>
<tr>
<td>31/12/07</td>
<td>Finance charges</td>
<td>1,463</td>
</tr>
<tr>
<td>31/12/07</td>
<td>Lessor a/c</td>
<td>1,463</td>
</tr>
<tr>
<td></td>
<td>bal. c/d</td>
<td></td>
</tr>
<tr>
<td>31/12/08</td>
<td>Finance charges</td>
<td>782</td>
</tr>
<tr>
<td>31/12/08</td>
<td>Lessor a/c</td>
<td>782</td>
</tr>
</tbody>
</table>

Lessor’s account

<table>
<thead>
<tr>
<th>Date</th>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>31/12/05</td>
<td>Bank</td>
<td>6,000</td>
</tr>
<tr>
<td></td>
<td>1/1/05 Leased Truck</td>
<td>17,130</td>
</tr>
<tr>
<td>31/12/05</td>
<td>Bal c/d</td>
<td>24,000</td>
</tr>
<tr>
<td></td>
<td>31/12/05 Finance charges</td>
<td>6,870</td>
</tr>
<tr>
<td>31/12/06</td>
<td>Bank</td>
<td>6,000</td>
</tr>
<tr>
<td></td>
<td>1/1/06 Bal. b/d</td>
<td>18,000</td>
</tr>
<tr>
<td>31/12/06</td>
<td>Bal c/d</td>
<td>18,000</td>
</tr>
<tr>
<td></td>
<td>31/12/06 Finance charges</td>
<td></td>
</tr>
<tr>
<td>31/12/07</td>
<td>Bank</td>
<td>6,000</td>
</tr>
<tr>
<td></td>
<td>1/1/07 Bal b/d</td>
<td>12,000</td>
</tr>
<tr>
<td>31/12/07</td>
<td>Bal c/d</td>
<td>12,000</td>
</tr>
<tr>
<td></td>
<td>31/12/07 Finance charges</td>
<td></td>
</tr>
<tr>
<td>31/12/08</td>
<td>1/1/08 Bal b/d</td>
<td>6,000</td>
</tr>
</tbody>
</table>

SELF ASSESSMENT EXERCISE

In treatment of finance charges, explain the sum of years digit method.

4.0 CONCLUSION

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. A gross lease is when the tenant pays a flat rental amount and the landlord pays for all property charges regularly incurred by the ownership.
5.0 SUMMARY

In this unit we discussed accounting for lease. The problem of computing and charging to respective periods, of finance charges for leasing, is the focal points that were extensively discussed and illustrated in this unit. Various methods of determining finance charges in the books of lessor and lessee were demonstrated. SAS 11 which stipulates detailed appropriate treatment and disclosures of lease transactions in the books of lessor and lessee was reviewed.

6.0 TUTOR MARKED ASSIGNMENT

1. In accordance with Statement of Accounting Standards (SAS 11), define finance lease.

2. Which of the two main differences between accounting entries required under interest payable and interest suspense methods of accounting for finance charge?

3. What is the main difference accounting entries required under interest payable and interest suspense methods of accounting for finance charge?

4. ___________ 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 the leased asset is the same as its carrying amount to the lessor (often not the manufacturer or dealer).

5. ___________ is one in which the seller of the property, leases it back from the buyer.

7.0 REFERENCES/FURTHER READING


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

It should be noted that what the hire purchaser has, while the hire period lasts, is just possession. He does not acquire the title until he has paid the last instalment and exercised his option to acquire title by paying a further token sum, which shall be stipulated in the hire purchase agreement.

The hire purchaser, however, has the first option and the item cannot be sold to another person unless he has the first option and the item cannot be sold to another person unless he has indicated his unwillingness to exercise the option.

2.0 OBJECTIVES
After studying this unit, you should be able to:

1. Define some terminologies used in hire purchase transactions.
2. Calculate the hire purchase interest attributable to each year.
3. Compute interest payable using the actuarial method.
4. Show relevant ledger entries in the books of the seller and buyer.
5. Prepare balance sheet extract reflecting the balances as at the end of the period.
3.0 MAIN CONTENT
3.1 DEFINITION OF HIRE PURCHASE TERMINOLOGIES
Hire Purchase Price: This is the total sum (deposit plus instalments) payable by the hire purchaser.

Cash Price: This is the normal selling price of the goods to be sold.

Hire Purchase Interest: or finance charge, is the excess of the hire purchase price over the cash price. The hire purchaser interest is the compensation to the seller for having his funds tied down with the buyer over the hire period.

Deposit: This is the initial sum payable by the hire purchaser at the inception of the hire purchase transaction.

Instalment: This is the sum payable by the hire purchaser buyer at specified intervals to liquidate the balance of hire purchase price at the end of the hire period.

SELF ASSESSMENT EXERCISE
What is hire purchase price?

3.2 ACCOUNTING FOR HIRE PURCHASE TRANSACTIONS IN BUYER’S BOOKS
It is in the nature of hire purchase transactions that what the buyer buys under this arrangement is invariably a fixed asset. To acquire trading stocks under a hire purchase arrangement is virtually not feasible for the following reasons:

(a) The hire purchase option is normally chosen where the value of the item is relatively high and payment under cash purchase transactions will involve a much cash outflow. It is unlikely that trading stocks will fall under this category.

(b) Goods purchased under hire purchase terms cannot be sold during the hire period.

(c) To acquire trading stocks under hire purchase terms will require so short a hire period as to nullify the benefits of the hire purchase arrangement.

The hire purchaser shall bring the asset on hire purchase into his books as a fixed asset and depreciate it normally, even though, he has not yet acquired title. This is an instance where the financial reality or substance of a transaction takes precedence over the legal form in compliance with the convention of “substance over form”.

The Hire Purchase Interest/Finance Charge

The hire purchase spreads the hire purchase interest on a rotational basis over the hire period. This may be achieved by using any of the following methods:

(a) Equal instalments (or straight line) method;

(b) Sum of the years digits method; and

(c) Actuarial method.

Equal Instalments (or Straight Line) Method

Under this method, the hire purchase interest is spread equally over the hire period. It is the simplest method.
ILLUSTRATION 32
ABC sold a machine to XYZ on hire purchase basis. You are given the following information.

**Cash price**  ₦ 28,000

**Initial deposit**  ₦ 10,000

A yearly instalment of ₦ 7,500 each payable on 31 December for 4 years, was agreed. The company makes up accounts to 31 December.

**Required:** Calculate the hire purchase interest attributable to each year.

**SUGGESTED SOLUTION 32**

<table>
<thead>
<tr>
<th>Initial deposit</th>
<th>Add: Instalments (₦ 7,500 x 4)</th>
<th>Hire purchase price</th>
<th>Less: Cash price</th>
<th>Hire purchase interest</th>
</tr>
</thead>
<tbody>
<tr>
<td>10,000</td>
<td>30,000</td>
<td>40,000</td>
<td>(28,000)</td>
<td>12,000</td>
</tr>
</tbody>
</table>

Therefore, hire purchase interest written off each year is ₦ 12,000/4 = ₦ 3,000

**Sum of the Year Digits Method**

Under this method, hire purchase interest is written off over the hire period in a reducing manner, based on digits as illustrated below:

Assuming the facts are the same as in illustration (a) above, calculate the hire purchase interest attributable to each year.

<table>
<thead>
<tr>
<th>Year</th>
<th>Digit Allowed</th>
<th>Workings</th>
<th>Hire Purchase Interest</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>4</td>
<td>4/10 x ₦ 12,000</td>
<td>4,800</td>
</tr>
<tr>
<td>2</td>
<td>3</td>
<td>3/10 x ₦ 12,000</td>
<td>3,600</td>
</tr>
<tr>
<td>3</td>
<td>2</td>
<td>2/10 x ₦ 12,000</td>
<td>2,400</td>
</tr>
<tr>
<td>4</td>
<td>1</td>
<td>1/10 x ₦ 12,000</td>
<td>1,200</td>
</tr>
</tbody>
</table>

1/10 x ₦ 12,000

In a situation where the number of instalments is higher, the determination of the sum of the digits becomes a problem. To solve the problem, you can use the formula below:

\[ S = \frac{n}{2} (n - 1) \]

Where:

\[ S = \text{Sum of the digits} \]
\[ n = \text{no. Of instalments} \]

In the above example, sum of the digits = 4/12 (4-1) = 10

**Actuarial Method**
Under this method, hire purchase interest is written off by changing a fixed rate of interest on the outstanding balance at the date of instalments. This method produces a constant periodic rate of return on the outstanding cash price for each period. The rate of interest may be obtained from actuarial table. Alternatively, the rate may be calculated using the annuity formula and solving for \( r \), the interest rate. The annuity formula is given as follows:

\[
P = a(1 - (1 + r)^{-n})
\]

Where \( P \) = Cash price less deposit  
\( a \) = instalment payable at specified intervals  
\( n \) = number of instalments  
\( r \) = rate of interest per period covered by each instalment

**ILLUSTRATION 33**

John sold equipment to Janet on hire purchase, you are given the following information:

<table>
<thead>
<tr>
<th></th>
<th>₦</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash price</td>
<td>20,945</td>
</tr>
<tr>
<td>Initial deposit</td>
<td>8,000</td>
</tr>
</tbody>
</table>

The HP contract agreed annual instalments of ₦5,000 each, payable on 31 December, over 4 years period.

HP interest is charged at 20% per annum.

Required: Compute interest payable using the actuarial method.

**SUGGESTED SOLUTION 33**

**HIRE PURCHASE INTEREST**

<table>
<thead>
<tr>
<th></th>
<th>₦</th>
<th>₦</th>
</tr>
</thead>
<tbody>
<tr>
<td>Year 0 cash price</td>
<td>20,945</td>
<td></td>
</tr>
<tr>
<td>Less deposit</td>
<td>8,000</td>
<td>12,945</td>
</tr>
<tr>
<td>Year 1 HP interest @ 20%</td>
<td>2,589</td>
<td>2,589</td>
</tr>
<tr>
<td>1st instalment</td>
<td>(5,000)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>10,534</td>
<td></td>
</tr>
<tr>
<td>Year 2 HP interest @ 20%</td>
<td>2,106</td>
<td>2,106</td>
</tr>
<tr>
<td>2nd instalment</td>
<td>(5,000)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>7,640</td>
<td></td>
</tr>
<tr>
<td>Year 3 HP interest @ 20%</td>
<td>1,528</td>
<td>1,528</td>
</tr>
<tr>
<td>3rd Instalment</td>
<td>(5,000)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>9,168</td>
<td></td>
</tr>
<tr>
<td>Year 4 HP interest @ 20%</td>
<td>832</td>
<td>832</td>
</tr>
<tr>
<td>4th Instalment</td>
<td>(5,000)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>5,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(5,000)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>7,055</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>₦</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nil</td>
<td>7,055</td>
</tr>
</tbody>
</table>
Accounting Entries:

(a) Asset acquired on HP terms:
   Dr: HP fixed asset a/c } with the cash price
   Cr: HP creditors a/c

(b) Deposit/Instalment paid
   Dr: HP creditors a/c } with amount paid
   Cr: bank a/c

(c) Recognition of HP interest included in
    Instalments paid:
   Dr: HP interest a/c } with HP interest attributable to the
   Cr: HP creditors a/c } instalment period

(d) At the accounting year-end:
   Dr: profit and loss a/c } with HP interest written off
   Cr: HP interest a/c } during the year
   Dr: profit and loss a/c } with depreciation on HP asset
   Cr: provision for depreciation a/c

Note: The closing balance on the HP creditors account is the outstanding portion of the cash price.
When HP interest suspense method is operated, the hire purchase creditors account balance is,
therefore, disclosed in the balance sheet.

ILLUSTRATION 34

Jackson Ltd purchased a new car on 1 January 2005, from Sulyman Ltd, on hire purchase terms
under which Jackson Ltd paid a deposit of ₦ 615,000, to be followed by four annual instalments of ₦ 500,000 each, payable on 31 December. Interest is charged on outstanding balance at 10% per annum. Cash price of the car is ₦ 2,200,000.

The accounting year of both companies ends on 31 December. Depreciation on the car is at 20% per annum on straight-line basis. All the sums due were paid on due dates.

Required:

(a) Show the relevant ledger entries in the books of Jackson Ltd.
(b) Prepare a balance sheet extract reflecting balances as at 31 December 2003.

SUGGESTED SOLUTION 34

Using HP Interest Account Method

(a) HP Creditor (Sulyman Ltd) A/c

<table>
<thead>
<tr>
<th>Date</th>
<th>Description</th>
<th>Amount</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>1/1/05</td>
<td>Bank (deposit)</td>
<td>₦ 615,000</td>
<td>₦ 2,200,000</td>
</tr>
<tr>
<td>31/12/05</td>
<td>Bank 1st Instalment</td>
<td>₦ 500,000</td>
<td>₦ 158,500</td>
</tr>
<tr>
<td>31/12/05</td>
<td>Bal. c/d</td>
<td>1,243,500 (2,200,000 – 615,000) x 10%</td>
<td>₦ 2,358,500</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>2,358,500</td>
</tr>
<tr>
<td>31/12/06</td>
<td>Bank (2nd inst.)</td>
<td>₦ 500,000</td>
<td>₦ 1,243,500</td>
</tr>
<tr>
<td>31/12/06</td>
<td>Bal. c/d</td>
<td>₦ 867,850</td>
<td>₦ 124,350</td>
</tr>
</tbody>
</table>

181
**Jackson Limited**

**(b) Balance Sheet Extract as at 31 December, 2007**

<table>
<thead>
<tr>
<th></th>
<th>Cost</th>
<th>Depr.</th>
<th>NBV</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Fixed Assets</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Motor Vehicle</strong></td>
<td>2,220,000</td>
<td>1,320,000</td>
<td>900,000</td>
</tr>
</tbody>
</table>

**Current Liabilities**

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Hire purchase creditor</td>
<td>454,635</td>
</tr>
</tbody>
</table>

**Using Hire Purchase Suspense Account Method**

**(a)**

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1/1/05 Bank (deposit)</td>
<td>615,000</td>
</tr>
<tr>
<td>31/12/05 Bank (1&lt;sup&gt;st&lt;/sup&gt; Inst.)</td>
<td>500,000</td>
</tr>
<tr>
<td>31/12/05 Bal. c/d</td>
<td>1,500,000</td>
</tr>
</tbody>
</table>
2,615,000  2,615,000
31/12/06 Bank (2\textsuperscript{nd} Inst.)  500,000  1/1/06 Bal. b/d  1,500,000
31/12/06 Bal. c/d  1,000,000  
1,500,000  1,500,000
31/12/07 (3\textsuperscript{rd} Inst.)  500,000  1/1/07 Bal b/d  1,000,000
31/12/07 Bal. c/d  500,000  
1,000,000  1,000,000
31/12/08 Bank (4\textsuperscript{th} Inst.)  500,000  1/1/08 bal. b/d  500,000

\textbf{HP Interest Suspense Account}

\begin{tabular}{c|c|c}
\hline
Year & Amount & Description \\
\hline
1/1/05 & 415,000 & HP Creditors A/c \\
(500,000 x 4) + 615,000) & & N(2,200,000 – 615,000) x 10% \\
- 2,200,000 & 415,000 & 31/12/05 Bal. c/d \\
& & 256,500 \\
1/1/05 Bal. c/d & 256,500 & 31/12/06 HP Interest A/c \\
& & 124,350 \\
& & 256,500 \\
1/1/07 Bal. c/d & 132,150 & 31/12/07 HP Interest Account \\
& & 86,785 \\
& & 45,365 \\
1/1/08 Bal. c/d & 45,365 & 31/12/08 HP Interest A/c \\
& & 45,365 \\
\hline
\end{tabular}

Workings:
(Initial deposit + 4 Instalments) – cash price.
N(615,000 + 2,000,000) – N2,200,000
= N415,000

\textbf{HP Interest Account}

\begin{tabular}{c|c|c}
\hline
Year & Amount & Description \\
\hline
31/12/05 HP Int. Suspense a/c & 158,500 & 31/12/05 P&L a/c \\
31/12/06 HP Int. Suspense a/c & 124,350 & 31/12/06 P&L a/c \\
31/12/07 HP Int. Suspense a/c & 86,785 & 31/12/07 P&L a/c \\
31/12/08 HP Int. Suspense a/c & 45,365 & 31/12/08 P&L a/c \\
\hline
\end{tabular}

Note: Provision for depreciation account is the same as in solution (a) above.

\textbf{Jackson Ltd}

\textit{Balance Sheet (Extract) as at 31 December, 2007}

\begin{tabular}{l|c|c|c}
\hline
\textbf{Cost} & \textbf{Depr.} & \textbf{NBV} \\
\hline
\textbf{Fixed Assets:} & & \\
Motor Vehicle & 2,200,000 & 1,760,000 & 440,000 \\
\hline
\textbf{Current Liabilities:} & & \\
HP Creditor & 500,000 & & \\
Less: HP Interest Suspense & 45,365 & 454,635 & \\
\hline
\end{tabular}

Note:
The basic difference between approaches (a) and (b) above are:
(a) With method (a), HP interest attributes to the instalment periods are credited to HP creditors account periodically and debited to HP interest account, when instalments are paid.

With method (b), the whole of the expected HP interest is credited to HP creditors, interest at the inception of the transaction is held in suspense in the HP interest suspense account. From this account, the interest is written off to the expense account periodically. Every time an instalment is paid, the HP interest attributable to the period is expensed by debiting the HP interest account and crediting the HP interest suspense account.

(b) With method (a), the balance on the HP creditors account is the cash price still outstanding at that date.

With method (b), the balance on the HP creditors account is the cash price outstanding plus the unamortized balance of the total expected HP interest, which is the debit balance on the HP interest suspense account. In the balance sheet, the balance on the latter account will be deducted from the balance on the former account to obtain cash price outstanding.

(c) Method (a), is recommended for solving examination question unless you are specifically required to adopt method (b).

SELF ASSESSMENT EXERCISE
To acquire trading stocks under a hire purchase arrangement, what are the reasons that make it virtually not feasible?

3.3 ACCOUNTING FOR HIRE PURCHASE TRANSACTIONS IN SELLER’S BOOKS

From the seller’s point of view, goods sold on HP basis, fall into two categories:

(a) Large items: and

(b) Small items: It is impossible for HP seller to separate gross profit from HP interest because of large volume of transactions. We shall, therefore, concentrate on large items.

For large items, the amounts involved are relatively substantial and the transactions, relatively few and infrequent. It is, therefore, possible and practicable for the HP seller to separate gross profit and HP interest and account for each separately. It should be noted that sales gives rise to two kinds of profit: namely

(a) Gross profit, that is, cash price less cost of goods.
(b) HP interest, that is, hire price less cash price.

In accounting for large items, there are two possible methods:

(a) Hire purchase interest received method; and
(b) Hire purchase interest suspense account method.

(a) Accounting Entries where HP Interest Received Account Method is Used

(i) Sales of goods on HP terms:

Dr: HP Debtors account } with cash price of goods sold
(ii) Deposits/Instalments received:

Dr: Bank/Cash account } with amount received.
Cr: HP debtors account 

(iii) Recognition of HP interest included

In instalments received:

Dr: HP Debtors account } with interest attributable to the period
Cr: HP Interest received account } covered by the instalment.

(iv) At accounting year-end:

Dr: HP trading account } with cost of goods sold on HP terms
Cr: General Trading or Purchase a/c

Dr: HP Sales a/c } with total credits on the HP sales a/c for the period
Cr: HP Trading account

Dr: HP Interest received account } with total credits on the HP interest received
Cr: HP Trading account } account for the period

Dr: HP Trading account } with the unrealized gross profit (see note (ii) below)
Cr: Provision for unrealized profit a/c

Dr: HP Trading Account } with the credit balance on the account after
Cr: Profit & loss account } entries (a) – (d) above

(b) Accounting Entries where HP Interest Suspense Account Method is Used

i. Sales of goods on HP terms:

Dr: HP Debtors account } with HP price
Cr: HP Sales account } with cash price
Cr: HP Interest Suspense account } total HP interest

   ii. Deposits/instalments received } same treatment as in (a) above

   iii. Recognition of HP interest included in instalments received:
       Dr: HP interest Suspense account } with interest attributable to the period
       Cr: HP Interest received account } covered by the instalment.
iv. At accounting year-end } same as in method (a) above

Notes:

1. The HP seller may spread the HP interest using any of the methods already considered.
2. Unrealized profit is calculated using the formula:
   Unrealized profit = balance of cash price outstanding/cash price x (cash price – cost)
3. Subsequent movement in the provision for unrealized profit is reflected in the HP trading account and provision account.

ILLUSTRATION 35
The facts are the same as in illustration 111 (above), except for the additional information that Sulyman Ltd recognizes as profit, every year, the proportion of the expected gross profit, which the sum received every year from Jackson Ltd, bears to the cash price. The cost of the car to Sulyman Ltd, was N1,900,000.

You are required to show the ledger entries in the books of Sulyman Ltd and the balance sheet extract as at 31 December, 2007.

SUGGESTED SOLUTION 35
   (a) Using HP Interest Received Account Method

   HP Debtor’s Account (Jackson Ltd)

<table>
<thead>
<tr>
<th></th>
<th>₦</th>
<th></th>
<th>₦</th>
</tr>
</thead>
<tbody>
<tr>
<td>1/1/05 HP sales</td>
<td>2,200,000</td>
<td>1/1/05 Bank (deposit)</td>
<td>615,000</td>
</tr>
<tr>
<td>31/12/05 HP Int. Rec.</td>
<td>158,500</td>
<td>1/12/05 Bank (1st Inst.)</td>
<td>500,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td>31/12/05 Bal. c/d</td>
<td>1,243,500</td>
</tr>
<tr>
<td></td>
<td>2,358,500</td>
<td></td>
<td>2,358,500</td>
</tr>
<tr>
<td>1/1/06 Bal. b/d</td>
<td>1,243,500</td>
<td>31/12/06 Bank (2nd Inst.)</td>
<td>500,000</td>
</tr>
<tr>
<td>31/12/06 HP Int. Rec.</td>
<td>124,350</td>
<td>31/12/06 Bal. c/d</td>
<td>867,850</td>
</tr>
<tr>
<td></td>
<td>1,367,850</td>
<td></td>
<td>1,367,850</td>
</tr>
<tr>
<td>1/1/07 Bal. b/d</td>
<td>867,850</td>
<td>31/12/07 Bank (3rd Inst.)</td>
<td>500,000</td>
</tr>
<tr>
<td>31/12/07 HP Int. Rec.</td>
<td>86,785</td>
<td>31/12/07 Bal. c/d</td>
<td>454,635</td>
</tr>
<tr>
<td></td>
<td></td>
<td>954,635</td>
<td>954,635</td>
</tr>
<tr>
<td>1/1/08 Bal. b/d</td>
<td>454,635</td>
<td>31/12/08 Bank (4th Inst.)</td>
<td>500,000</td>
</tr>
<tr>
<td>31/12/08 HP Int. Rec.</td>
<td>45,365</td>
<td></td>
<td>-</td>
</tr>
<tr>
<td></td>
<td>500,000</td>
<td></td>
<td>500,000</td>
</tr>
</tbody>
</table>

   HP Sales Account

<table>
<thead>
<tr>
<th></th>
<th>₦</th>
</tr>
</thead>
<tbody>
<tr>
<td>31/12/05 Trading a/c</td>
<td>2,200,000</td>
</tr>
<tr>
<td>1/1/05 HP Debtors a/c</td>
<td>2,200,000</td>
</tr>
</tbody>
</table>

   HP Interest Received Account

<table>
<thead>
<tr>
<th></th>
<th>₦</th>
<th></th>
<th>₦</th>
</tr>
</thead>
<tbody>
<tr>
<td>31/12/05 HP Trading a/c</td>
<td>158,500</td>
<td>31/12/05 HP Debtors a/c</td>
<td>158,500</td>
</tr>
<tr>
<td>31/12/06 HP Trading a/c</td>
<td>124,350</td>
<td>31/12/06 HP Debtors a/c</td>
<td>124,350</td>
</tr>
<tr>
<td>31/12/07 HP Trading a/c</td>
<td>86,785</td>
<td>31/12/07 HP Debtors a/c</td>
<td>86,785</td>
</tr>
<tr>
<td>31/12/08 HP Trading a/c</td>
<td>45,365</td>
<td>31/12/08 HP Debtors a/c</td>
<td>45,365</td>
</tr>
</tbody>
</table>
HP Trading Account

<table>
<thead>
<tr>
<th></th>
<th>₦</th>
<th>₦</th>
</tr>
</thead>
<tbody>
<tr>
<td>31/12/05 Purchases</td>
<td>1,900,000</td>
<td>31/12/05 HP Sales</td>
</tr>
<tr>
<td>31/12/05 Prov. For unreal. profit (w1)</td>
<td>169,560</td>
<td>31/12/05 HP Interest Rec.</td>
</tr>
<tr>
<td>31/12/05 P&amp;L a/c</td>
<td>288,940</td>
<td>31/12/05 HP Sales</td>
</tr>
<tr>
<td></td>
<td>2,358,500</td>
<td></td>
</tr>
<tr>
<td>31/12/06 P&amp;L a/c</td>
<td>175,570</td>
<td>31/12/06 HP Int. Rec.</td>
</tr>
<tr>
<td></td>
<td>31/12/06 Prov. for unreal. profit</td>
<td>51,220</td>
</tr>
<tr>
<td></td>
<td>175,570</td>
<td>31/12/06 HP Int. Rec.</td>
</tr>
<tr>
<td>31/12/07 P&amp;L a/c</td>
<td>143,135</td>
<td>31/12/07 HP Int. Rec.</td>
</tr>
<tr>
<td></td>
<td>31/12/07 Prov. for Unreal. Profit</td>
<td>56,350</td>
</tr>
<tr>
<td></td>
<td>143,135</td>
<td>31/12/07 HP Int. Rec.</td>
</tr>
<tr>
<td>31/12/08 P&amp;L a/c</td>
<td>107,355</td>
<td>31/12/08 HP Int. Rec.</td>
</tr>
<tr>
<td></td>
<td>31/12/08 Prov. for Unreal. Profit</td>
<td>61,990</td>
</tr>
<tr>
<td></td>
<td>107,355</td>
<td>31/12/08 HP Int. Rec.</td>
</tr>
</tbody>
</table>

Note: ₦ 288,940 recognised as HP profit for year ended 31/12/05, is made up of:

- ₦ 169,560 attributable to the year
- ₦ 118,340 gross profit realised in the year = (₦ 2.2m – ₦ 1.9m) – ₦ 169,560

Provision for Unrealised Profit Account

<table>
<thead>
<tr>
<th></th>
<th>₦</th>
<th>₦</th>
</tr>
</thead>
<tbody>
<tr>
<td>31/12/05 Bal. c/d (w1)</td>
<td>169,560</td>
<td>31/12/05 HP Trading a/c</td>
</tr>
<tr>
<td>31/12/06 HP Trading a/c</td>
<td>51,220</td>
<td>1/1/06 Bal. b/d</td>
</tr>
<tr>
<td>31/12/06 Bal. c/d (w2)</td>
<td>118,340</td>
<td>1/1/06 Bal. b/d</td>
</tr>
<tr>
<td></td>
<td>169,560</td>
<td>31/12/07 HP Trading a/c</td>
</tr>
<tr>
<td>1/1/07 Bal b/d</td>
<td>118,340</td>
<td>31/12/07 HP Trading a/c</td>
</tr>
<tr>
<td>31/12/07 Bal. b/d (w3)</td>
<td>61,990</td>
<td>1/1/07 Bal. b/d</td>
</tr>
<tr>
<td></td>
<td>118,340</td>
<td>31/12/07 HP Trading a/c</td>
</tr>
<tr>
<td>31/12/08 HP Trading a/c</td>
<td>61,990</td>
<td>1/1/08 Bal. b/d</td>
</tr>
</tbody>
</table>

After year 2005, only the movement, that is, increase or decrease in the provision for unrealised profit that will be transferred to the hire purchase trading account, for example, the provision for unrealised profit at 1 January 2006, was ₦ 169,360, while at 31/12/06, was ₦ 118,340. This represents a decrease of ₦ 51,220, which was transferred to HP Trading a/c by debiting the provision for unrealised profit a/c and crediting the HP trading account.

₦ 51,220 is the portion of gross profit considered to have been realised in the year ended 31 December 2006. It is the proportion of gross profit, which the cash price received from Jackson Ltd in 2006, bears to the cash price as shown below:

\[
\frac{500,000 - 124,350}{2,200,000} \times 2,200,000 - 1,900,000
\]
\[
= \frac{375,560 \times 300,000}{2,200,000} = \₦51,220
\]

Note: cash received in year 2006, is the 2nd instalment of ₦500,000 less HP interest attributable to 2006, that is, ₦500,000 - ₦124,350 = ₦375,650. The point raised above, is equally applicable to years 2007 and 2008.

Sulyman Ltd

Balance Sheet (extract) as at 31 December, 2007

Current Assets: ₦

HP Debtor 454,635

Less: Provision for Unrealised profit 61,990

392,645

Works

Unrealised gross profit (UGP) = \( \frac{\text{Unrealised gross profit (UGP)}}{\text{Unrealised gross profit (UGP)}} \times \text{Unrealised gross profit (UGP)} \)

1. UGP at 31/12/05 = \( \frac{1,243,450}{2,200,000} \times (₦2,200,000 - 1,900,000) \)

   = \( \frac{1,243,450}{2,200,000} \times 300,000 \)

   = ₦169,560

2. (w2) UGP @ 31/12/06 = \( \frac{867,850}{2,200,000} \times 300,000 \)

   = ₦118,340

3. (w3) UGP @ 31/12/07 = \( \frac{454,635}{2,200,000} \times 300,000 \)

   = ₦61,990

(b) Using HP Interest Suspense Account Method

HP Debtor’s Account (Jackson Ltd)

\begin{align*}
\text{₦} & & \text{₦} \\
1/1/05 HP Sales & 2,200,000 & 1/1/05 Bank (deposit) & 615,000 \\
1/1/05 HP Interest Suspense & 415,000 & 31/12/05 Bank (1st Inst.) & 500,000 \\
& & 31/12/05 Bal. c/d & 1,500,000 \\
& & 2,615,000 & 2,615,000 \\
1/1/06 Bal. b/d & 1,500,000 & 31/12/06 Bank (2nd Inst.) & 500,000 \\
& & 31/12/06 Bal. c/d & 1,000,000 \\
& & 1,500,000 & 1,500,000 \\
1/1/07 Bal. b/d & 1,000,000 & 31/12/07 Bank (3rd Inst.) & 500,000 \\
& & 31/12/07 Bal. c/d & 500,000 \\
& & 1,000,000 & 1,000,000 \\
1/1/08 bal. b/d & 500,000 & 31/12/08 bank (4th Inst.) & 500,000
\end{align*}

Hire Purchase Interest Suspense Account

\begin{align*}
\text{₦} & & \text{₦} \\
\end{align*}

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<table>
<thead>
<tr>
<th>Date</th>
<th>Description</th>
<th>Amount 1</th>
<th>Amount 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>31/12/05</td>
<td>HP Interest Rec.</td>
<td>158,500</td>
<td>1/1/05 HP Debtor 415,000</td>
</tr>
<tr>
<td>31/12/05</td>
<td>Bal. c/d</td>
<td>256,500</td>
<td>415,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td>415,000</td>
<td>415,000</td>
</tr>
<tr>
<td>31/12/06</td>
<td>HP Interest a/c</td>
<td>124,350</td>
<td>1/1/06 Bal. b/d 256,500</td>
</tr>
<tr>
<td>31/12/06</td>
<td>Bal. c/d</td>
<td>132,150</td>
<td>256,500</td>
</tr>
<tr>
<td></td>
<td></td>
<td>256,500</td>
<td>256,500</td>
</tr>
<tr>
<td>31/12/07</td>
<td>HP Interest a/c</td>
<td>86,785</td>
<td>1/1/07 Bal. b/d 132,150</td>
</tr>
<tr>
<td>31/12/07</td>
<td>Bal c/d</td>
<td>45,365</td>
<td>132,150</td>
</tr>
<tr>
<td></td>
<td></td>
<td>132,150</td>
<td>132,150</td>
</tr>
<tr>
<td>31/12/08</td>
<td>HP Interest a/c</td>
<td>45,365</td>
<td>1/1/08 Bal. b/d 45,365</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Date</th>
<th>Description</th>
<th>Amount 1</th>
<th>Amount 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>31/12/05</td>
<td>HP Trading a/c</td>
<td>158,500</td>
<td>31/12/05 HP Int. Suspense a/c 158,500</td>
</tr>
<tr>
<td>31/12/06</td>
<td>HP Trading a/c</td>
<td>124,350</td>
<td>31/12/06 HP Int. Suspense a/c 124,350</td>
</tr>
<tr>
<td>31/12/07</td>
<td>HP Trading a/c</td>
<td>86,785</td>
<td>31/12/07 HP Int. Suspense a/c 86,785</td>
</tr>
<tr>
<td>31/12/08</td>
<td>HP Trading a/c</td>
<td>45,365</td>
<td>31/12/08 HP Int. Suspense a/c 45,365</td>
</tr>
</tbody>
</table>

Note: The HP sales account, HP Trading account and provision for unrealised profit account are the same as in method (a) solution above.

**Sulyman Ltd**

**Balance Sheet (Extract) as at 31 December 2007**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount 1</th>
<th>Amount 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current assets:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Hire purchase debtor</td>
<td>500,000</td>
<td></td>
</tr>
<tr>
<td>Less: HP Interest Suspense</td>
<td>45,365</td>
<td></td>
</tr>
<tr>
<td>Provision for unrealised profit</td>
<td>61,990</td>
<td></td>
</tr>
<tr>
<td></td>
<td>107,355</td>
<td></td>
</tr>
<tr>
<td></td>
<td>392,645</td>
<td></td>
</tr>
</tbody>
</table>

**SELF ASSESSMENT EXERCISE**

What are the two methods for accounting for large items?

**4.0 CONCLUSION**

The basic differences between the two methods illustrated are:

(a) With method (a), the HP purchase interest attributable to the instalment periods are debited to the HP debtors account periodically when the instalments are received and credited to the HP interest received account.

With method (b), the whole of the expected HP interest is debited to the HP debtor account, at inception and credited to HP interest suspense account from where the interest will be periodically released to the HP interest received account when instalments are received.

(b) With method (a), the balance on the HP debtor account is the cash price outstanding from the customer.

With method (b), the balance on the HP debtor account is the cash price outstanding plus the HP interest yet to be recognised as income. This is why on the balance sheet,
the debtor’s balance will be shown less the credit balance on the HP interest suspense account.

(c) Method (a), is recommended for solving examination questions unless you are specifically required to adopt method (b).

5.0 SUMMARY
Leasing and hire purchase are like twin brothers. The identical problem of computing and charging to respective periods, of finance charges and hire purchase interest for leasing and hire purchase respectively, are the focal points that were extensively discussed and illustrated in the previous unit and this unit. Various methods of determining finance charges and hire purchase interest in the books of lessor and lessee and HP seller and buyer were demonstrated.

6.0 TUTOR MARKED ASSIGNMENT
1. How should a hire purchase seller account for unrealised profit on goods sold on hire purchase in its books?
2. What does hire purchase interest represent in a hire purchase transaction?
3. __________ is the total sum (deposit plus instalments) payable by the hire purchaser.
4. __________ is the normal selling price of the goods to be sold.
5. __________ is the excess of the hire purchase price over the cash price.
6. __________ is the initial sum payable by the hire purchaser at the inception of the hire purchase transaction.
7. __________ is the sum payable by the hire purchaser buyer at specified intervals to liquidate the balance of hire purchase price at the end of the hire period.

7.0 REFERENCES/FURTHER READING