AC308

Accounts and Finance Reporting

Self-Learning Course Manual

Version 1.0

Centre for Distance Learning
MAUTECH
Yola, Adamawa

EDUTECH PORTAL Solutions

COURSE MANUAL

Accounts and Financial Reporting

AC308

Modibbo Adama University of Technology
Open and Distance Learning Course Development Series

Instructional design & development by

EDUTECHPORTAL Solutions

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The Academic Collective wishes to thank those below for their contribution to the Special Edition of this Course Manual (Modibbo Adama University of Technology).

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Contents

About this Course Manual

Accounts and Financial Reporting AC308 is provided to you by MAUTECH-CDL, AS IS. Module is localised and adapted to ODL format under the Academic Collective.

How this Course Manual is structured

Course overview

The course overview gives you a general introduction to the course. Information contained in the course overview will help you determine:

- If the course is suitable for you.
- What you can expect from the course.
- How much time you will need to invest to complete the course.
- Where to get help.
- Course assessments.

We strongly recommend that you read the overview *carefully* before starting your study.

The course content

The course is broken down into Study Sessions. Each Study Session comprises:

- An introduction to the Study Session content.
- Learning outcomes.
- Study Session preview.
- New terminology.
- Structured content of the study session with a variety of focus articles, learning activities and learning devices.
- Study Session review.
- Self Assessments.
- Resources for further studying.

Your comments

After completing Accounts and Financial Reporting we would appreciate it if you would take a few moments to give us your feedback on any aspect of this course. Your feedback might include comments on:

- Course content and structure.
- Course reading materials and resources.
- Course assessments.
- Course duration.

Your constructive feedback will help us to improve and enhance this course. You can forward your comments to feedback.mautech@edutechportal.org

Course overview

Welcome to Accounts and Financial Reporting AC308

AC308 discusses how accountants act as processors and purveyors of information for decision making and the needs of those who use accounting information. It also looks at the role performed by accountants and notes the need to be aware of relevant regulatory and conceptual frameworks.

This course manual supplements and complements a blend of resources & platforms:

AC308 Audiobook – available via Audio Resources Library app on your official mobile device and accessible online at: www.arlibrary.cdl.mautech.edu.ng.

AC308 Courseware – available in your course pack as a disk, it is also downloadable from your course website: www.cdl.mautech.edu.ng/schoolboard.

Schoolboard –offers a multi-channel platform for you to discuss with content experts and other learners from across the nation and the globe at large. You may also use the platform to enrich your learning with engaging webinars, articulate presentations, smart puzzles, audiobooks, podcasts, interactive gloassaries, smart quizzes, case studies and discussions. Schoolboard comes with updates and is accessible on web and on app. It is also linkable from your course CD.

Accounts and Financial Reporting AC308 — is this course for you?

This course will help you to succeed and progress in career by learning how to prepare, interpret and analyse financial statements in a diverse range of financial accounting and reporting situations.

Course outcomes

Upon completion of Accounts and Financial Reporting AC308, you will be able to:

- prepare, interpret and analyse financial statements Apply your knowledge of accounting standards to practical situations

- describe the main elements of financial accounting information
- Apply your knowledge of accounting standards to practical situations

Study Skills

Being a self-learner has become increasingly feasible due to Open and Distance Learning (ODL) Systems. Studying a course or obtaining a certificate for career advancement can occur from the comfort of your home, on your own time, and at your own pace.

You can be a successful higher education student by self learning, it isn't magic! But it does require desire, dedication and a lot of work. Active listening to your audiobook, desktop publishing on your laptops, reading comprehension in your course manual, notetaking in the white margins, stress management, time management, assessment taking, and memorization are study skills required for a self learner.

If you really want to learn how to become a successful student, then you should explore the links that follow:

- http://www.oercommons.org/courses/communication-skills-study-skills-pdf/view
- http://www.edutechportal.org/resources/studyskills

Timeframe

This is a 15 week course. It requires a formal study time of 12 hours. We recommend you take an average of one to two hours for an extra personal study on each Study Session. You can also benefit from online discussions with your course tutor.

Need help?

You may contact via any of the following channels for information, learning resources and library services.

CDL Student Support Desk
Email: support@cdl.mautech.edu.ng

For technical issues (computer problems, web access, and etcetera), please visit: www.cdl.mautech.edu.ng/support; or send mail to support@cdl.mautech.edu.ng.

Academic Support

A course facilitator is commissioned for this course. You have also been assigned an academic tutor to provide learning support. See contacts of your course facilitator and academic advisor at the course website:
www.cdl.mautech.edu.ng/schoolboard

Assessments

Generally, there are two types of assessment: formative assessment and summative assessment. With regards to your formative assessment, there are three basic forms of assessment in the course: in-text questions (SELF-CHECKs), self assessment questions (SAQs), and tutor marked assessment (TMAs). This manual provides you with SELF-CHECKs and SAQs. Feedbacks to the SELF-CHECKs are placed immediately after the questions, while the feedbacks to SAQs are at the rear of manual.

You will receive your TMAs as assignments at the MAUTECH schoolboard platform. Some of your TMAs will be graded and will constitute 30 percent of your course marks. Feedbacks to TMAs will be provided by your tutor in not more than 2 weeks after entries.

Your summative assessment is your final examination. AC308 exam is in multiple choice / essay format; and it carries 70 percent of your total earning in the course.

Schedule dates for submitting assignments and engaging in course activities is available on the course website.

Study Session 1

ACCOUNTS AND FINANCIAL REPORTING

INTRODUCTION

The overall objective of accounting is to produce information that can be used in making decisions, usually of an economic nature. It is primarily concerned with quantitative information that is evaluations in arriving at diverse conclusion.

Financial reporting deals with the presentation of financial and other relevant statements to show the extent to which the objective of the organisation has been achieved. It has been described as a way or manner of documenting the day-to-day financial or other transaction of an enterprise for a given accounting year. Simply put it entails the preparation of financial information. It is regarded as the basic source of information in economic and business environments. To use this information however, it must be well interpreted and its limitations understand.

Financial reports can be categorised into two;

1. External Financial Reports: - These are prepared for all users of financial statements irrespective of whether the user has or does not have direct access to the books and records of the business entity. Most users do not have access; however the company prepares an external financial report to satisfy the demands of all the parties involved. This is usually in form of a published animal financial report.
2. Internal Financial Reports: - These are prepared exclusively for insiders, mostly the management of the business entity. These provide the management with information that will help carryout its objectives and its responsibilities.

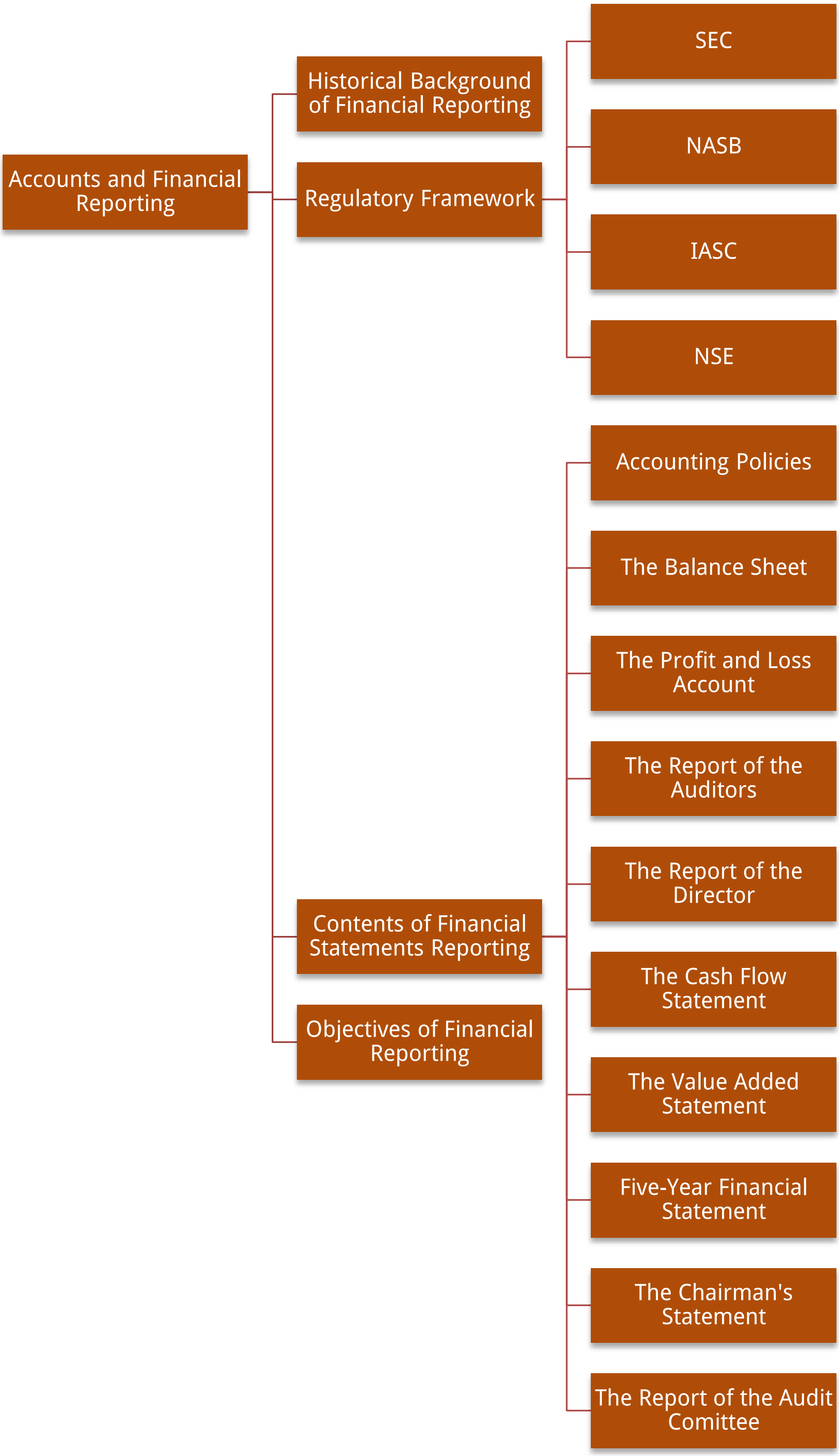
This session is concerned however, with external financial reporting and its interpretation.

Learning Outcomes

When you have studied this session, you should be able to:

1.1 define financial reporting.
1.2 outline the historical background of financial reporting.
1.3 state the objectives of financial accounting.
1.4 discuss the contents of financial statements.
1.5 explain the regulatory framework.

Session Preview



Study Session Duration

This Study Session requires a one hour of formal study time. You may spend an additional two hours for revision.

1.1 HISTORICAL BACKGROUND OF FINANCIAL REPORTING

Early definitions of accounting generally focused on the traditional record keeping functions of the accountant. It was defined as, “the art of recording, classifying and summarising in a significant manner and in monetary terms, transactions and events which are of a financial character”. In modern times however, it has been described as an information system that measures, processes and communicates financial information about an identified economic entity. It is therefore regarded as the language of business used in communicating financial and other information for decision making.

As a profession, accounting can be referred to as a youth and service activity, however it dates back to several thousand years as early as 3,600BC, where clay tablets were used to record facts usually of financial natures. Similar types of records were also discovered in ancient Greece, Egypt and Rome.

At the dawn of the 20th century, corporation had become a dominant force in financing, producing and distribution of goods and services. The demand for a feedback on operation was no longer limited to the owners of the business otherwise known as shareholders but to other parties, investors, creditors and security analysts came up and said that organisations should create and maintain accurate, reporting systems to meet their information needs. The governments and its agencies also give pronouncements and established laws and regulations, which have caused a lot of changes in business.

In the current dispensation, the advancement in knowledge and technology advancement in knowledge and technology has made man increasingly aware of his environment and how it affects him. There is therefore a growing demand on business enterprises to adequately report on their activities in any given period.

1.2 REGULATORY FRAMEWORK

Financial statements published by companies in Nigeria are products of several regulatory influences in addition to accounting concepts, assumption and conventions. These influences are; The Companies and Allied Matters Act 1990 (CAMA). The Act, which replaced the 1968 companies Act, stipulates rules relating to information which should be disclosed in published Accounts. The Act states expressly the firm and content of published Accounts and also additional requirement.

1.2.1 The Nigerian Securities and Exchange Commission (SEC)

This body requires full public disclosure of specified items of accounting information by companies offering their shares for sale for the first time in the securities market. Such information serve as part of the input required for the determination of the price of the share.

1.2.2 The Nigerian Accounting Standards Board (NASB)

Nigerian Accounting Standards Board (NASB) is a private company limited by guarantee. It has the responsibility of ensuring that Generally Accepted Accounting Practice and Internationally Accepted Standard of Accounting Practice are followed by all companies in Nigeria. This it has been done by issuing Statement of Accounting Standard (SAS) to guide companies in the preparation of their accounts. The ultimate objective of this company is to narrow divergences and harmonise accounting practice in the country. The company is currently working on issuing a statement on financial reporting.

1.2.3 The International Accounting Standards Committee (IASC)

This is the counterpart of Nigerian Accounting Standards Board (NASB) at the international level and it performs similar functions internationally.

The International Accounting Standards (IAS) is issued by this committee.

1.2.4 The Nigerian Stock Exchange (NSE)

The Nigerian Stock Exchange regulates items which companies must disclose in published accounts in addition to those statutorily required by CAMA. It enforces this requirement by ensuring that quoted companies obtain its approval before publishing their annual report and account.

Other laws and standards that influences the financial reports of companies are;

- Bank and other Financial Institutions Decree (1991)
- Insurance Decree (1997)
- Mortgage Institution Decree (1989)
- CBN guidelines issued from time to time

The following are applicable on taxation issues;

- Companies Income Tax Act (1979)
- Petroleum Profit Tax Act (1989)
- Income Tax Management Act (1967)
- Capital Gains Tax Act (1967)

1.3 CONTENTS OF FINANCIAL STATEMENTS REPORTS

The following include the contents of financial reports;

1.3.1 ACCOUNTING POLICIES

The policies are expected to be consistent from year to year, where there is an alteration however, the reasons for this is explained in the notes to the accounts.

The accounting policies disclosed by most organisations include

- Accounting convention
- Turnover or Income Recognition
- Fixed Assets
- Depreciation
- Debtors
- Taxation
- Foreign Currencies or Exchange Rates
- Retirement Benefits Scheme etc.

1.3.2 THE BALANCE SHEET

This statement reveals the financial position of the organisation as at the accounting year end. It is sometimes referred to as the statement of a company's affairs. The balance sheet contains a lot of vital information which can be used in assessing the overall viability and stability of any company. The statute requires that the following should be stated expressly;

- Fixed Assets
- Current Assets
- Creditors
- Amount falling due within one year
- Amount falling due after more than one year
- Capital and Reserves
- Minority interest (if any)

1.3.3 The Profit and Loss Account

This is also called an income or revenue statement. Its purpose is to derive the profit or loss for each accounting year. Like the balance sheet, it reveals a lot of vital information, one of which is the major source(s) of income of the organisation.

Notes to the Accounts: - These notes form an integral part of the profit and loss account and the balance sheet. The notes usually provide explanatory information in respect of the items already disclosed in these statements. Put differently it serves as a tool to enhance the understanding of the other accounting statements.

1.3.4 The Reports of the Auditors

This report is an expression of opinion by the auditors on the truth and fairness of the information contained in the published financial statements. The auditors are required to check the accuracy of the financial statement presented and the extent to which the statement comply with statutory requirements, generally accepted accounting principles and accounting standards formulated by the various accounting bodies. The external or independent auditor is there after expected to report on the examination carried out.

1.3.5 The Report of the Direction

Direction are required to prepare in respect of each financial year a report which is included in the annual report of the company.

1.3.6 The Cash Flow Statement

The statement of cash flow provides information about cash receipts and cash payments of an enterprise over a period of time. It is a replacement of the previously required statement of source and application of funds.

1.3.7 The Value Added Statement

Value added may be defined as the excess turnover of a business over brought in goods and services. The statement basically reports what wealth has been created by the company during the period and how this has been shared among the stakeholders.

1.3.8 Five-Year Financial Summary

This is a financial summary which provides the major information on a company and facilitates inter-period comparison over the 5 years involved. In recent times, pictures graphs, and charts are increasingly being used by companies in their financial reports and accounts to aid and enhance the understanding of some of the salient items in the company.

1.3.9 The Chairman's Statement

This is usually the fact statement in the financial report. It is written by the chairman of the company's board of directors to the shareholders of the company. Its purpose is basically to intimate the shareholders with certain issues and information that cannot fit into other statements.

1.3.10 The Report of the Audit Committee

CAMA 1990 provides that every public company shall establish an audit committee. The committee which comprises of an equal number of directors and representatives of the shareholders (subject to a maximum of six members) shall at every AGM report on its duties. This report is included in the financial report as the report of the audit committee.

1.4 OBJECTIVES OF FINANCIAL REPORTING

According to the statement of Financial Accounting No.1, "Objectives of Financial Reporting", the overall objectives of financial reporting is to provide information that is useful for rational investment, credit and similar decisions. This assertion has been echoed and re-echoed overtime. In otherwords, the main reason for the existence of financial reports is to be able to make meaningful decisions from the information so provided. Nonetheless, there are other objectives which financial reports are set to achieve.

- To show compliance with statutory regulations and standards.
- To determine the extent of stewardship of the management to the shareholders.
- To determine whether financial statements show a true and fair view of an enterprise financial position.
- To determine whether proper books of accounts and records have been maintained for the financial year under consideration.
- To determine areas where the enterprise had made errors or where misleading effects have been involved.
- To determine the extent to which the resources of the enterprises have been fully utilised.
- To determine the extent to which the organisation meets its social responsibilities.

Session Review

The early objectives of financial Reporting were concerned with the prevention of fraud by the promoters and managers of joint stock companies and giving some protection to creditors and shareholders against the possibility of malpractices by company managers.
Basic understanding of the financial reporting will make the student appreciate the objectives, historical background and the regulatory framework of the Financial Reports. This will facilitate the effective understanding and interpretation of Financial Statements.

Assessment

1. What do you understand by Financial Reports?
2. State the main objective of Financial Reporting.
3. State precisely the contents of Financial Reports and list the matters to be expressly disclosed in each.
4. In the context of the law, enumerate the various laws and Acts that provides for the preparation of financial statements and its disclosure requirements.

Resources

Articulate Presentation

This is a complimentary resource to facilitate the quick delivery of this session. It is available in your course pack (Schoolboard disc / online page), and also linked here.

Schoolboard

Access your schoolboard app, or visit www.schoolboard.edutechportal.org/introductiontomicroeconomics to access updated online activities and resources related to the units of this Study Session.

Study Session 2

THE CONCEPT OF COST AND COST ELEMENTS

INTRODUCTION

All private and public sector organisations need information relating to the cost of goods or services they produce or render, buy or enjoy etc. Small, medium and large-scale businesses, federal, state and local governments, various government agencies and parastatals, non-profit making organisations etc. all need cost accounting information before taking decision. They would like to know the estimated or actual costs of products, inventories, services, projects, contracts, functions, etc. for comparison against their benefits before taking any objective decisions. That would greatly aid effective managerial decision making at all levels.

Learning Outcomes

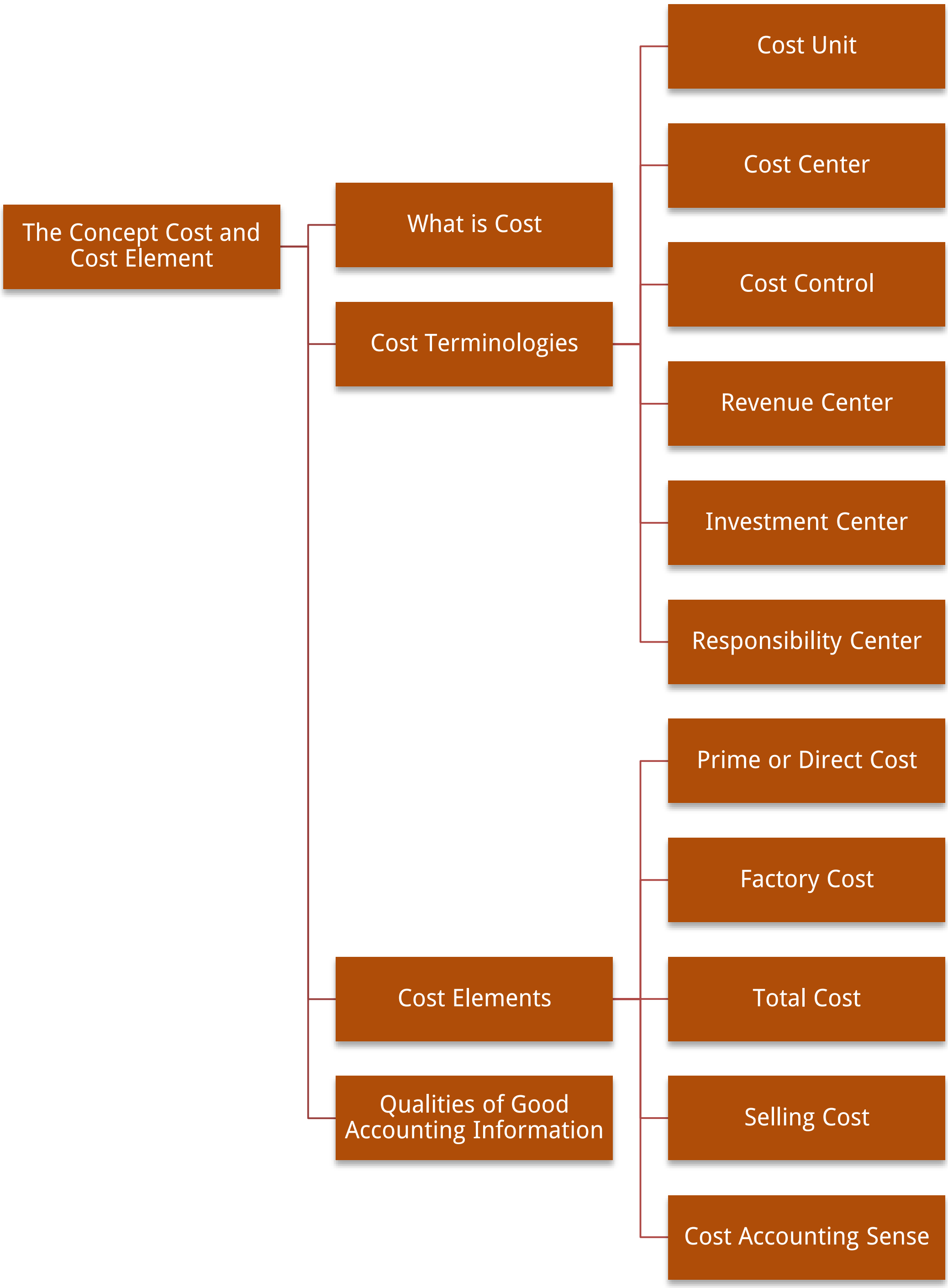
When you have studied this session, you should be able to:

2.1 discuss cost, cost centres and responsibility.
2.2 outline ways of classifying costs.
2.3 explain cost control.
2.4 state the uses of accounting information.

Study Session Duration

This Study Session requires a one hour of formal study time. You may spend an additional two hours for revision.

Session Preview



2.1 WHAT IS COST?

To economist, cost is what must be given up in order to obtain something. Accountants however, view cost as the value of economic resources used in the production of goods, services, income or profit. This shows that the accountant is always linking the concept of cost to production, as cost is being incurred for the production of goods and services the generation of revenue (income) or the making of profit. Cost elements (materials, labour and overhead) are therefore, to be considered and aggregated before arriving at the cost of production.

2.2 COST TERMINOLOGIES

2.2.1 Cost Unit

This is about a unit of quantity of product or service in relation to which costs may be ascertained or expressed.

2.2.2 Cost Centre

This refers to a location, a person or an item of equipment in relation to which costs may be ascertained and used for the purpose of cost control.

A location may mean a department, storeyard sales area or a factory. A person may be sales manager, production manager, personnel manager, finance manager, or work manager. An item of equipment may be machine, delivery vehicles, car, truck etc. As the purpose of cost centre is to aid effective cost control within an organisation, all the costs incurred will have to be charged to the relevant cost centre. It is then that cost control could be exercised.

2.2.3 Cost Control

This refers to the ability of management to make sure that expenditures (re-current and capital) are well monitored and supervised to ensure that things are according to plan and that actual results (cost incurred) are obtained for comparison against planned results (cost to be incurred) so that appropriate corrective action(s) can be taken on the variance that is bound to arise before it is too late.

Before any cost control can be effected, standards or targets of performance must be set against which actual costs can be measured and compared. This would reveal inefficiencies so that appropriate actions could be taken to guard against the future.

2.2.4 Revenue Centre

This is called profit centre assist has control over both cost and revenue and so, on comparison, profit or loss could be ascertained in the centre at the end of an accounting period.

2.2.5 Investment Centre

This is any responsibilities centre within an organisation that has control over cost and revenue and also over investments of funds.

2.2.6 Responsibility Centre

A responsibility centre is any point within an organisation where control over the incurrence of cost or the generating of revenue is found. Such a point could be an individual (manager, supervisory officer or just an employee), an operation, a department, a division, a subsidiary or the entire organisation itself.

2.3 COST ELEMENTS

These are the items of cost making up the total cost of a product or service. These items to be identified and aggregated, are as follows.

2.3.1 Prime or Direct Cost

This is made up of direct material cost, direct labour costs and direct expenses. Direct materials are those that actually become part of the product, or service while direct labour costs (wages), are wages paid to employees.

2.3.2 Factory Cost

This is made up of prime cost plus the share of fixed production overhead costs chargeable to the product or service. Fixed production costs are incurred in production that is overheads incurred within the four walls of the factory proper. Factory cost is about total manufacturing costs of a cost unit (product or service).

2.3.3 Total Cost

This would be given by the sum of factory cost plus the share of shelling, administrative and distributive overhead expenses attributable to the product or service. Selling expenses are those incurred in inducing customers to place orders. Distributive expenses are those incurred in getting finished products reach the customers. They include warehousing, packaging and transportation expenses. Administrative expenses are those incurred in managing the enterprises. They include top management costs, accounts, legal and personnel department costs, audit fees, and other general administrative costs.

2.3.5 Selling Price

This is about the total cost as identified above, plus targets profit. Although selling price is not part of the cost elements of the seller; it is about cost of purchase to the buyer. The target profit is to be projected by the management based on its pricing policy.

2.3.6 Cost Accounting Sense

This is a new scientific method of pricing products or services based on accurate identification, apportionment and computation of actual total cost of a product or service that would help management in assessing the performance of an organisation, profitability-wise, liquidity-wise or productivity-wise.

2.4 QUALITIES OF GOOD ACCORDING INFORMATION

To give room for good planning, effective control and visionary decision-making information must be obtained.

The required qualities of good accounting information are;

i. Relevance: The information should be relevant to the user(s) and the purpose for which it is needed.
ii. Timeless: The information is not to be supplied late for the purpose for which it is required. It should be made available within the time it is called for.
iii. Reliable Accurate: The information should be produced in compliance with relevant statutory regulations, professional requirements or managerial guidelines.
iv. Understandable: The information should not be too complex or ambiguous or just too difficult to understand. It should however not to be too simple and bulky.
v. Completeness: The information should show full disclosure of what is required. It is not to be released in a piece-meal, manner.
vi. Objectivity: The information is not to be subjective or personal to the providers. It should be the type that would assist management towards achieving organisational objectives and goals.
vii. Comparable: The information should give room for comparative analysis with information provided in the previous periods.

Session Review

You have been taken through various aspects of cost accounting: the meaning, nature and importance of cost. Important cost terminologies like cost units, cost centre, cost control and cost elements have been explained. Finally, the qualities expected of a good cost accounting information were explained.

Assessment

1. Discuss the following concepts.
   a. Cost
   b. Accounting
   c. Information

  d. Production

2. Differentiate between the following pairs of terms.
   a. Cost unit and cost centre
   b. Prime cost and factory cost
   c. Fixed production expenses and fixed administrative expenses

3. Discuss the behavioural pattern of;
   a. Variable cost
   b. Fixed cost
   c. Total cost
   d. Step cost

4. You have just been appointed to a position requiring to present to your management a paper highlighting the advantages of cost accounting system. Summarise the points you would cover in your presentation.

Resources

Articulate Presentation

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Study Session 3

REGULATORY FRAMEWORK OF ACCOUNTING

INTRODUCTION

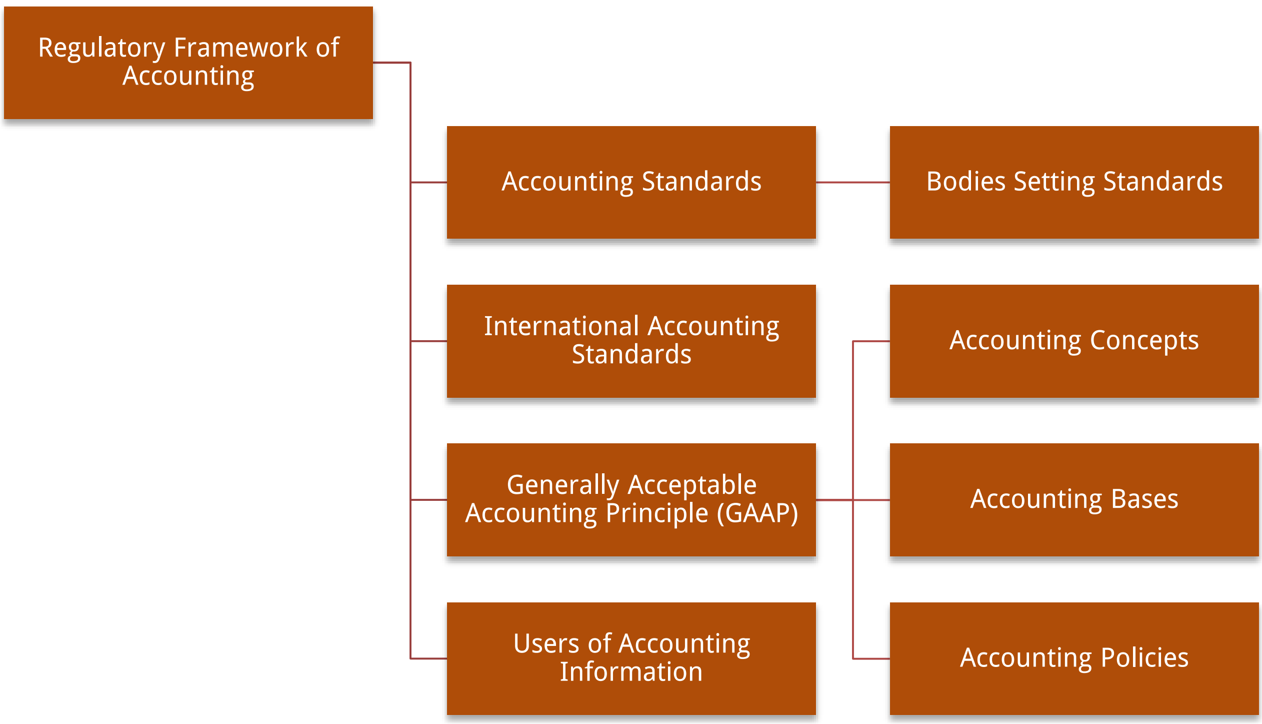
In this Study Session you will examine the regulatory bodies of the accounting as a profession. In doing so, you will review the meaning of accounting. You will also discuss and apply accounting concepts and convention.

Learning Outcomes

When you have studied this session, you should be able to:

3.1 discuss the various regulatory bodies of the accounting profession.
3.2 explain accounting
3.3 describe accounting concepts and convention and their applications.

Session Preview



Study Session Duration

This Study Session requires a one hour of formal study time. You may spend an additional two hours for revision.

3.1 ACCOUNTING STANDARDS

Accounting standards are authoritative statements of how particular types of transactions and other events should be reflected in financial statements.

3.1.1 Bodies Setting Standards

There are three widely recognised accounting standards, namely,

i. International Accounting Standards (IAS)
ii. Nigerian Statements on Accounting Standards (SAS)
iii. Financial Reporting Standards (FRS) of the United Kingdom, formerly known as Statement of Standing Accounting Practice (SSAP).

IAS Set by IASC

The International Accounting Standards Committee (IASC) was established on 29th June, 1973 as a result of agreement by accountancy bodies in Australia, Canada, France, Germany, Japan, Mexico, The Netherlands, the UK and Ireland and the United States of America. The business of IASC is conducted by a board comprising representatives of up to thirteen countries and up to four organisations having an interest in financing reporting.

Objectives of IASC

The objectives of IASC as set out in its constitution are;

i. To formulate and publish, in the public interest, accounting standards to be observed in the presentation of financial statements and to promote their worldwide acceptance and observance and,
ii. To work generally for the improvement and harmonisation of financial statements.

IASC and IFAC

IASC has a mutual agreement with the International Federation of Accountants (IFAC) which has the same membership as IASC. Members of IFAC agree to support the objectives of IASC by undertaking the following;

a. To ensure that published financial statements comply with IAS in all material respects and disclose the fact of such compliance.
b. To persuade government and standard setting bodies that published financial statements should comply with IAS in all materials respects.
c. To persuade authorities controlling securities markets and the industrial and business community that published financial statements should

comply with IAS in all materials respects and disclose the fact of such compliance.

d. To ensure that the auditors satisfy themselves that the financial statements comply with IAS in all material respects.

e. To foster acceptance and observance of IAS internationally.

IAS's promulgated by IASC do not override the local regulations of each country where local regulations require deviation from International Accounting Standards, the local members of IASC are expected to persuade the relevant authorities of the benefits of harmonisation with International Accounting Standards.

Nigerian Accounting Standards Board (NASB)

Membership

The NASB was established in 1982 with the following membership;

i. Institute of Chartered Accountants of Nigeria
ii. Central Bank of Nigeria (CBN)
iii. Nigerian Accounting Teachers Association
iv. Nigerian Association of Chambers of Commerce, Industry, Mines and Agriculture (NACCIMA)
v. Nigerian Bankers Association
vi. Nigerian Stock Exchange
vii. Securities and Exchange Commission (SEC)
viii. Federal Ministry of Finance

The council is headed by a non-executive chairman.

Objectives of NASB

The objectives of the NASB as set out in its constitution are;

i. To formulate and publish in the public interest, accounting standards to be observed in the preparation of financial statements and to promote the general acceptance and adoption of such standards by preparers and users of financial statements.
ii. To promote and sponsor legislation, when necessary, in order to ensure that standards developed and publicised by the Board receive nationwide acceptance, adoption and compliance.
iii. To review from time to time, the standards developed by the Board in the light of charges in the social, economic and political environment.

The council of NASB is responsible for issuing Statements of Accounting Standards (SAS).

Application of SAS

SAS's apply to

a. Annual reports and accounts or financial statements published by companies and corporations incorporated under the laws of Nigeria and circulated to external users e.g. shareholders, debenture holders.

b. All other significant industrial, commercial and service enterprises operating in Nigeria.
c. SASs do not apply for financial statements for internal use by management.

NASB as Government Parastatal

After the promulgation of the companies and Allied Matters Decree 1990, the NASB became a parastatal of the Federal Ministry of Commerce and Tourism in order to give legal backing to standards issued by the Board CAMA 1990 required Nigerian Companies to comply with Accounting Standards issued by Accounting Standards Board to be formed under the decree.

List of Standards Issued from its Inception

SAS 1 Disclosure of Accounting policies

SAS 2 Information to be disclosed in financial statements

SAS 3 Accounting for property, plant and equipment

SAS 4 On stocks

SAS 5 Construction contracts

SAS 6 Extraordinary items and prior year adjustments

SAS 7 Foreign Exchange conversion and translations

SAS 8 Employees Retirement Benefit

SAS 9 Accounting for Depreciation

SAS 10 Accounting by banks, and non-banks financial institutions

(Part I)

SAS 11 On leases

SAS 12 Accounting for Deferred Taxes

SAS 13 On investments

SAS 14 Accounting in the petroleum-industry upstream activities

3.2 INTERNATIONAL ACCOUNTING STANDARDS

1. Disclosure of Accounting policies (-IAS-1)
2. Inventory valuation and presentation (IAS-2)
3. Consolidated Financial Statements (IAS-27)
4. Depreciating Accounting (IAS-4)
5. Information to be disclosed in financial statements (IAS-5)
6. Accounting Responses to charging prices (IAS-15)
7. Statements of changes in financial position (IAS-7)

8. Unusual and prior period items and change in accounting policies (IAS-)
9. Accounting for Research and Development Activities (IAS-9)
10. Contingencies and Events occurring after Balance Sheet Date (IAS-10)
11. Accounting for construction contract (IAS-11)
12. Accounting for Taxes on income (IAS-12)
13. Presentation of current assets and liabilities (IAS-13)
14. Reporting Financial information by segment (IAS-14)
15. Information Reflecting the effect of changing prices (IAS-15)
16. Accounting for property, plant and equipment (IAS-16)
17. Accounting for leases (IAS-17)
18. Revenue Recognition (IAS-18)
19. Employers Accounting for retirement benefit (IAS-19)
20. Government Grants and Disclosure of Government assistance (IAS-20)
21. Accounting for effects of changes in Foreign Exchange rates (IAS-22)

3.3 GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (GAAP)

Certain principles and convention the preparation of accounts. Let us consider these principles here so that you have them in mind and observe their applications as you proceed on your studies. GAAP can be divided into 3 groups.

a. Accounting concepts
b. Accounting bases
c. Accounting policies

3.3.1 Accounting Concepts

Accounting concepts are broad basic assumptions which underline the periodic financial accounts of business enterprises. They are practical rules rather than theoretical ideals and are therefore capable of variations and evolution as accounting thought and practice are developed. The concepts are

i. Going concern
ii. Consistency
iii. Matching
iv. Conservation or prudence
v. Realisation
vi. Entity
vii. Objectivity
viii. Materiality
ix. Substance over form
x. Historical cost

3.3.2 Accounting Bases

These are the methods which have been developed by an enterprise for expressing or applying fundamental accounting concepts to financial transactions and items.

Example of matters for which different accounting methods exist are;

i. Depreciation of fixed assets
ii. Treatment and amortisation of intangible
iii. Stocks and work in progress
iv. Long term contract accounting

3.3.3 Accounting Policies

Accounting policies embrace the principles, bases, conventions, rules and procedures adopted by the enterprise in preparing and presenting financial statements.

The International Accounting Standard No.1 identifies three considerations which should govern the selection and application of accounting policies by management;

ix. Prudence
iii. Substance
iv. Materiality

3.4 USERS OF ACCOUNTING INFORMATION

Users of accounting information can be divided into two broad categories;

a. Internal users
b. External users

Internal Users are involved in making day-to-day decisions and in monitoring decisions related to purchasing, hiring, production payments, sales, collections, financing, investments and similar operating duties. Such internal users would include members of the management team, the directors of a corporation and employees of an economic entity.

a. Management: The managers of a company have a responsibility to all other users of the financial statements (creditors, owners, government agencies, customers, suppliers, workers and society in general). They must constantly monitor the firms financial position and performance and take corrective action where necessary. Before they can take action, however, they must understand the company's major strength and weakness. Financial statement analysis is one of the tools management uses for identifying problem having to do with operating efficiency, asset utilisation and debt-equity management. Problems that must be solved if a firm is to meet its short and long run profitability, liquidity and solvency goals.
b. Employee: These are the workers of the business. They also help in ascertaining the pre-determined goal of the company. They also need the

financial statement in order to know that enough profit is being made. It also enables them bargain for improved working conditions. It also assists in evaluating job security by ascertaining the profit margin. The employees likewise needs the financial statement to know how the business is going on, if the set goals are being achieved.

External Users are not directly in the operating decisions of an organisation. One key user group is stockholders. When investors decide to acquire stock in a company, they will require information on its financial conditions and its past, present and expected future performance.

The extent to which accounting information is helpful to such decision makers cannot be overstated. Key external users of financial accounting information include;

i. Stockholders
ii. Creditors
iii. Prospective investors and creditors
iv. Regulators
v. Consumers
vi. Competitors
vii. Prospective employees
viii. The Internal Revenue service
ix. Such other interested parties as, researchers, legislators, union leader, potential market entrants.

Each of these groups has different interest and objectives when examining accounting information making it difficult to design one report which fulfils all their needs. In fact, a multitude of financial accounting reports are generated by a single corporation, including various fillings with government agencies and regulations, loan application and tax returns.

	Users	Purpose	Information needed
1	Management	For the purpose of control assets To ascertain the efficiency of management policies To ascertain the proportion of costs incurred and revenue generated	Detail of assets Detail of costs and revenues Profitability level
2	Shareholders’ investment analysis	To enable them make the appropriate investment decisions such as buying and selling of shares.	Profitability level of rate of return on investment.
3	Lenders including Banks	To enable them decide whether to loan grant more facility or not.	Liquidity of the firm. Interest coverage. Ratio of debt of equity.

	Users	Purpose	Information needed
4	Employees	To enable them bargain for improved working conditions To ascertain their job security	Profitability level of the firm. Liquidity
5	Tax authorities	To determine the amount of tool payable for the company.	Details of revenue and expenses
6	Auditors	General audit purpose and to enable them form their opinion on the company's state of affairs	All relevant books and record in order to base their opinion as true and fair.
7	General public	To determine the extent of the social responsibility of the firm rendered to the general public.	Benefit derived from services.

Session Review

You have reviewed the accounting standards, historical development of the Nigerian Accounting Standard Board (NASB) statements issued by the Board and the relationship between the Board and other international bodies such as IAS. You have also also examined the generally accepted accounting principles SSAP and its application. Example include Accounting Concepts, Accounting bases and Accounting policies. Finally, you considered users of accounting information and their needs.

Assessment

SAQ 3.1 (tests Learning Outcome 3.1)
List ten statements of Accounting Standards issued by NASB.

SAQ 3.2 (tests Learning Outcome 3.2)
List fifteen statements of Accounting Standards issued by International Accounting Standard.

SAQ 3.3 (tests Learning Outcome 3.3)
Distinguish between Accounting Concepts, Accounting bases and Accounting policies giving specific examples of each with suitable explanations.

SAQ 3.4 (tests Learning Outcome 3.4)
Users of accounting information are classified into two;

i. State the two
ii. List the users under each category and state their information needs.

Resources

Articulate Presentation

This is a complimentary resource to facilitate the quick delivery of this session. It is available in your course pack (Schoolboard disc / online page), and also linked here.

Schoolboard

Access your schoolboard app, or visit www.schoolboard.edutechportal.org/introductiontomicroeconomics to access updated online activities and resources related to the units of this Study Session.

Study Session 4
FINAL ACCOUNTS OF A COMPANY

INTRODUCTION

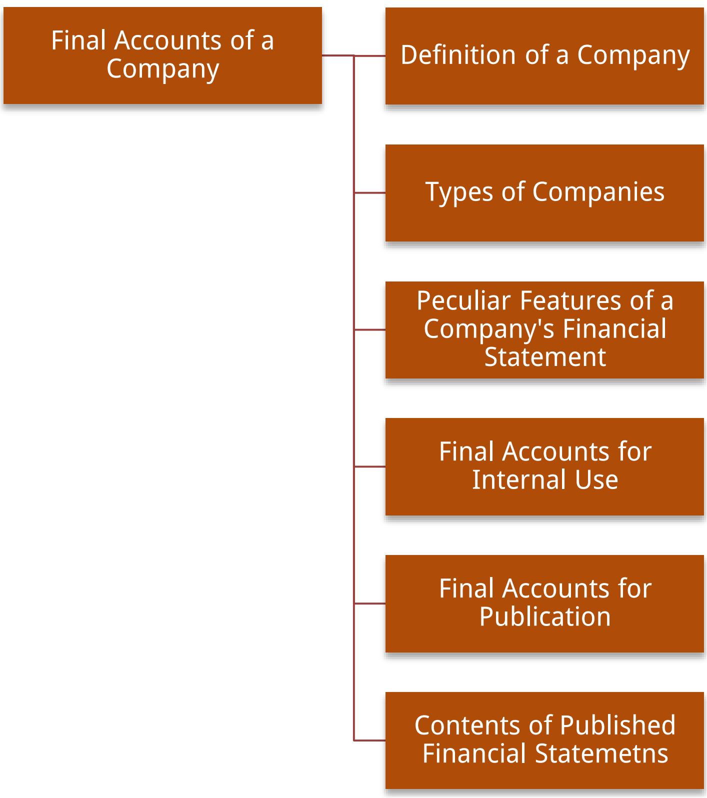
In this session, you will distinguish a company from other businesses based on the special features it has and the manner in which its accounts are prepared.

Learning Outcomes

When you have studied this session, you should be able to:

4.1 define a company.
4.2 highlight the types of companies
4.3 point out the peculiar features of a company's financial statement
4.4 distinguish the company from other businesses.
4.5 prepare company accounts for internal use.

Session Preview



Study Session Duration

This Study Session requires a one hour of formal study time. You may spend an additional two hours for revision.

4.1 DEFINITION OF A COMPANY

A company can be defined as a body corporation (i.e. an aggression of persons or individuals) having a distinct legal responsibility and personality created by or under.

i. Companies and Allied Matters Decree (CAMA 1990)
ii. An enabling statute of government.

However, this session only deals with companies formed under CAMA 1990.

4.2 TYPES OF COMPANIES

i. Limited Company: - There are two types; the first type are companies limited by shares in which the liability of members, in the event of liquidation is limited to the amount remaining unpaid on shares allotted to them. The other type of limited companies limited by guarantees in which the liability of members is limited to the amount which they have agreed to contribute in the event of liquidation.
ii. Unlimited Company: - This is a company in which the liability of members extends beyond the amount remaining unpaid on the shares allotted to them.
iii. Private Company: - This is a company which has the following characteristics:
    - Rights of transfer of shares restricted
    - Number of members limited to 50.
    - The public cannot subscribe for its shares
iv. Public Limited Company: - This is a company other than a private limited company. Its shares may or may not be quoted on the stock exchange.

4.3 PECULIAR FEATURES OF A COMPANY'S FINANCIAL STATEMENT

There are some peculiar items which appear only in the financial statement of a company. These include;

a. Directors fee/remuneration and auditors fees: These should be deducted before arriving at the profits before tax.
b. Share capital;

c. Authorised share capital: This is the amount of capital which the company has been authorised to raise.
d. Issued capital: This is the portion of the authorised capital which has been issued to subscribers.
e. Called-up capital: This is the portion of the issued capital on which the directors have called upon the shareholders to pay the instalment due.
f. Paid-up capital: This is the portion of the called-up capital which has been paid-up by the shareholders.
g. Taxation: Companies are changeable to tax in their own capacity.
h. Appropriate account: This is the account where the profit after tax is shared (appropriated) items normally found in this account include transfer to reserves, interim dividend paid and proposed dividend.
i. Reserves: Reserves are amounts set aside out of profits earned by the company which are not designed to meet any liability, contingency, commitment, or diminution in value of assets known to exist at the balance sheets date.
j. Debentures: A debenture is a written acknowledgement of a debt owed by a company normally containing provisional clauses on payment of interest and repayment of capital.
k. Proposed dividend: This is the amount of dividend which has been declared by the company's directors and approved at the Annual General Meeting by members. This amount is charged to appropriate account.

4.4 FINAL ACCOUNT FOR INTERNAL USE

The content of the final accounts of a company for the internal use of management is subject to the dictates of the directors. For example purposes, the final accounts for internal use is not much different from those of other business organisations except for the appearance of the peculiar items mentioned.

Illustration

You are given the following trial balance of Nikky Limited as at 31st December, 1991.

	DR ₦	CR ₦
Authorised and issued share capital.		
Ordinary shares of 50k each		
12% preference shares of ₦1 each		100,000
Share premium		100,000
Profit and loss Account 1/1/91		50,000
10% Debentures		50,000
Stocks		100,000
Motor vehicle at cost	200,000	
Prov. for depreciation on motor vehicle	100,000	
Machinery at cost		60,000
Prov. for depn. on machinery	120,000	
Building at cost		50,000
Sales	230,000	
Purchases		750,000
Discounts	350,000	
Returns	3,000	
Carriage on purchases	3,000	1,000
General Expenses	2,000	
Advertising	200,000	
Creditors	10,000	
Debtors		145,000
Prov. for doubtful debts	200,000	
Prov. for taxation at 1/1/91		6,000
Taxation paid		35,000
Debenture interest	30,000	
Bank balance	5,000	
		5,000
	1,453,000	1,453,000

You are also given the following information

a. General expenses include
   i. Rates for 12 months ended 31/3/92 N4,000
   ii. Insurance for 12 months ended 31/12/91 N2,000, half of which relates to the directors private house.
b. The charges for audit services N10,000 needs to be included
c. The provision for tax on profits for the year ended 31/12/91 is to be made at N48,000.
d. A debtor for N20,000 had gone bankrupt; the provision for doubtful debts to be 5% of debtors balance.
e. Closing stock at 31/12/91 was N180,000
f. Depreciation is to be provided on motor vehicle at N20,000 and on machinery at N10,000.
g. The building are to be revalued upwards by N30,000.

h. A dividend of 10kobo per share is proposed and N10,000 is to be transferred to general reserves.

You are required to draw up the final accounts of the company, for internal use, for the year ended 31st December, 1991.

Solution:

Trading and profit and loss account for the year ended 31st December 1991

	₦	₦
Sales		750,000
Cost of good sold		(3,000)
Less cost of goods sold		747,000
Opening stock	200,000	
Purchases	350,000	
Purchase returns	(1,000)	
Carriage inwards	2,000	
Cost of goods sold	551,000	
Closing stock	180,000	
Cost of goods sold		371,000
Gross profit		376,000
Add Discount received		1,000
		377,000
Less Expenses		
Discount Allowed	3,000	
General Expenses (W.I.)	198,000	
Advertising	10,000	
Debenture interest (10% of ₦100,000)	10,000	
Bad debts	20,000	
Increase in provision for bad debts		
[(5% x ₦180,000) – ₦6,000]	3,000	
Depn. of motor vehicle	20,000	
Depreciation of machinery	10,000	
Audit fees	10,000	284,000
Profit before taxation		93,000
Taxation (W.2)		43,000
Profit after taxation		50,000
Appropriations		
Preference dividend (12% x ₦100,000)	12,000	
Proposed ordinary dividends		
(10k x 200,000)	20,000	
Transfer to general reserves	10,000	42,000
Retained profits for the year		8,000
Retained profit brought forward		50,000
Retained profit carried forward		58,000

NIKKY LIMITED

Balance sheet as at 31st December, 1991

	₦	₦	₦
Fixed Assets			
Buildings	260,000	-	260,000
Machinery	120,000	60,000	60,000
Motor vehicles	100,000	80,000	20,000
	480,000	140,000	340,000
Current Assets			
Stock		180,000	
Debtors (₦200,000 – ₦20,000)	180,000		
Less prov. for doubtful debts			
(5% x ₦180,000)	(9,000)	171,000	
Prepaid rates		1,000	
Directors Current Account (₦2,000 ÷ 2)		1,000	
		353,000	
Current liabilities			
Creditors			
Accrued expenses (₦10,000 + ₦5,000)	145,000		
Bank draft	15,000		
Proposed ordinary dividends	5,000		
(10k x ₦200,000sh)			
Preference dividend (12% x 100,000)			
Provision for taxation	20,000		
Long-term liabilities	12,000		
10% Debentures	48,000	245,000	108,000
			448,000
			(100,000)
Net Assets			348,000

Financed by	₦	₦
Share Capital		
Authorised, Issued And Called Up		
100,000 12% Preference Shares of ₦1 Each		100,000
200,000 ordinary shares of 50k each		
		100,000
Reserves		200,000
Revaluation Supplies		
Share Premium	30,000	
General Reserves	50,000	
Retained Profits	10,000	
Shareholders Funds	58,000	148,000
		348,000
Workings		
(W.1) General Expenses		
General Expenses Per Trial Balance		
Less Prepaid Rates 3/12 X ₦4,000		200,000
Insurance On Directors & Private House (₦2,000 ÷ 2)		(1,000)
		(1,000)
		198,000

(W.2) Taxation

Taxation paid	₦30,000	Balance b/d	₦35,000
Balance old	₦48,000	P&L Account (balancing figure)	₦43,000
	₦78,000		₦78,000
		Balance b/d	₦48,000

4.5 FINAL ACCOUNTS FOR PUBLICATION

Final accounts for publication must be drawn up in accordance with the formats set out in CMD 1990 and the provisions of relevant statements of accounting standards the vertical format of the profit and loss accounts and the balance as contained in section c of schedule 2 to the CMD 1990 are shown below.

Format of Balance Sheet

Fixed Assets ₦	₦	₦
Land and Buildings		X
Plant and Machinery		X
Fixtures, Fittings, Tools and Equipment		X
Construction-in-progress		X
Prepayment for stocks in transit		X
		X
Long Term Investments		
Shares in group companies	X	
Loans to group companies	X	
Shares in related companies	X	
Other investment other than loans	X	
Other loans	X	
Own shares	X	
Bond, debentures and federal Government Development Stocks	X	X
Deferred Charges		
Development costs	X	
Concessions, patent, licence etc.	X	
Goodwill	X	
Prepayments for services to be received	X	X
	X	
Current Assets		
Stocks	X	
Debtors	X	
Short term investments	X	
Cash at hand and in bank	X	
	X	
Creditors Amount falling due within 1 year		
Debenture loans	X	
Bank loans and overdraft	X	
Payment received on account	X	
Trade creditors	X	
Bills of exchange payable	X	
Amounts owed to group companies	X	
Amount owed to group companies	X	
Other creditors (including PAYE and NSTF)	X	
Accruals and deferred income	X	
	X(X)	
Net current assets (liabilities)		X
Total assets less current liabilities		X
Creditors; amount falling due after more than 1 year		
Debenture loans	X	
Bank loans and overdraft	X	

Payment received on account	X	
Trade creditors	X	
Bills of exchange payable	X	
Amounts owed to group companies	X	
Amount owed to related companies	X	
Accruals and deferred income	X	
		(X)
		X
Provision for liabilities and charges		
Pension and similar obligations	X	
Taxation including deferred taxation	X	
Other provisions	X	(X)
Net assets		XX
Capital and Reserves		
Called-up share capital		X
Share premium account		X
Revaluation reverses		X
Other Reserves		
Capt. Redemption Reserves fund	X	
Reserve for own shares	X	
Reserves provided for by the articles of association	X	
Other Reserves	X	X
Retained profits	X	X
Shareholders funds		XX

Format of Profit and Loss Account

	₦	₦
Turnover		X
Cost of sales		(X)
Gross profit		X
Distribution costs	X	
Administrative expenses	X	(X)
		X
Other operating income		X
		X
Income from shares in group companies	X	
Income from shares in related companies	X	
Income from other fixed assets investment	X	
Other interest receivable and similar incomes	X	X
Written off investments	X	X
Interest payable and similar charges	X	(X)
Profit/loss on ordinary activities before tax		X
Tax on profit/loss on ordinary activities		(X)
Profit/loss on ordinary activities after tax		X
Extra-ordinary incomes	X	
Extra-ordinary charges	(X)	

Extra-ordinary profit/loss	X	
Tax on extra-ordinary profit/loss	(X)	
		X
Other taxes not shown under the above items		(X)
Profit/loss for the financial year		X
Appropriations		
Dividends paid and proposed	X	
Transfers to/from reserves	X	(X)
Retained profits/loss for the year		X
Retained profit/loss brought forward		X
Retained profit/loss carried forward		X
Earnings per share		X kobo
Dividend per share		X kobo

4.6 CONTENTS OF PUBLISHED FINANCIAL STATEMENTS

Section 334 (2) of the Companies and Allied Matter Decree (CMD) 1990 stipulates that the financial statements of companies shall include:

i. Statement of Accounting policies
ii. The balance sheet as at the last day of the 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 account
v. The Auditors Report
vi. The Debtors Report
vii. A statement of the source and application of funds
viii. A value added statement for the year
ix. A five-year financial summary
x. In the case of a holding company, the group financial statements

Session Review

In this Study Session, you:

- defined a company
- highlighted the types of companies
- pointed out the peculiar features of a company’s financial statement
- distinguished the company from other businesses
- prepared company accounts for internal use

Resources

Articulate Presentation

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Study Session 5

CASH FLOW STATEMENT

INTRODUCTION

The traditional statement of sources and applications of funds has been replaced by a statement of cash flows. Amongst shortcomings of the statement of sources and applications of funds are:

i. Has a weak title
ii. Looks like a bookkeeping schedule
iii. Lacks sub-groupings and organisation.
iv. It is too long
v. Has a confused focus
vi. Combines in one statement elements of cash profit reconciliations, funds flow fact, the statement of sources and application of funds focuses on working capital movements rather than on liquidity of the enterprise.

The main feature of a cash statement, which also measures charges in the financial position of two periods is that the charges in the financial position are grouped under three headings namely,

1. Cash flows from operating activities
2. Cash flow from investing activities and,
3. Cash flows from financing activities.

"Cash" is used to mean actual cash and short term investments capable of being turned into cash within a short-while, otherwise called cash and cash equivalent.

Learning Outcomes

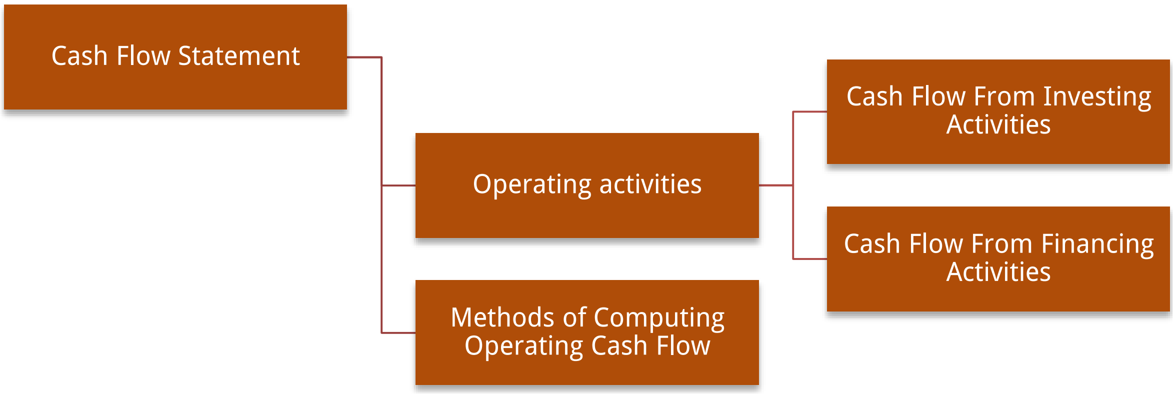
When you have studied this session, you should be able to:

5.1 state the objective of cash flow statement.
5.2 highlight the various components of cash flow statement.
5.3 prepare cash flow statement from the annual accounts.

Study Session Duration

This Study Session requires a one hour of formal study time. You may spend an additional two hours for revision.

Session Preview



5.1 OPERATING ACTIVITIES

Operating activities involve the normal trading activities of an enterprise – production and delivery of goods and services and the other support activities. They consist of;

1. Payments for the purchase stock, other goods and services from suppliers for cash.
2. Payment of salaries, wages and other staff costs.
3. Payments of expenses
4. Cash receipts from sale of goods and services.
5. Dividends from associated and subsidiary companies.
6. Income tax paid

5.1.1 CASH FLOW FROM INVESTING ACTIVITIES

Cash flow from investing activities include the following;

1. Payment to acquire fixed assets.
2. Payment to acquire investments in subsidiary.
3. Payments to acquire investment in other entities.
4. Loans made and payment to acquire debts.
5. Receipts from sale and disposal of fixed assets.
6. Receipts from sale of investments in subsidiary.
7. Receipts from sale of investments in other entities.
8. Receipts from repayments or sale of loans made in other entities.
9. Interest received
10. Dividend received from non-associated or subsidiary companies

5.1.2 Cash Flows from Financing Activities

Financing activities involve raising capital for the enterprise whether in the form of shares, debentures or loans. Cash flows from financing activities include;

a. Receipts from issue of shares
b. Receipts from issue of debentures, loans, notes and bonds.
c. Receipt from long and short term borrowings.
d. Repayment of amounts borrowed.
e. Capital elements of finance lease rental payments.
f. Redemption of shares and debentures
g. Purchase of own shares
h. Payment of expenses, commission on any issue of shares, debentures, loans, notes, bonds, or other financing.
i. Interest paid
j. Dividend paid

5.2 METHODS OF COMPUTING OPERATING CASH FLOWS

There are two methods of preparing the cash flow statements namely;

1) Direct method
2) Indirect method

Only indirect method will be used in computation for this lesson.

Indirect Method: The indirect method starts with the net profit before interest dividend received and income tax and than adjusts for non-cash transactions and charges in working capital other than cash and cash equivalents. This is the method generally adopted in preparing the sources and applications of funds, the difference being that the working capital aspect of the later is now shown together with the net profit and adjustments for non-cash items.

Illustrations I

Prepare a cash flow statement for Abidemi Limited for the year ended 31st December 1998 as required under SAS 18. The profit and loss account balance sheet and cash account for Abidemi Limited for the year 1998 are given.

	₦	₦
Sales		1,300,000
Less cost of goods sold		600,000
Less expenses		700,000
Wages	400,000	
Other costs	120,000	
Depreciation	100,000	
Interest	20,000	640,000
		60,000
Proposed dividend		(8,000)
Retained profit for the year		52,000

Balance sheet as at 31st December, 1998

	₦	₦	₦	₦
Fixed asset at cost		900,000		760,000
Less accumulated depreciation		460,000		360,000
		440,000		400,000
Current Assets				
Stock	80,000		100,000	
Trade debtors	30,000		40,000	
Cash	40,000	150,000	20,000	160,000
		590,000		560,000
Less Current Liabilities				
Trade Creditors	55,000		50,000	
Accrual wages	5,000		10,000	
Proposal Dividends	8,000	(168,000)	10,000	(70,000)
		522,000		490,000
Financed by				
Debentures		180,000		200,000
Ordinary share capital		200,000		200,000
Retained profit		142,000		90,000
		522,000		490,000

Cash Account For 1998

	₦		₦
Opening balance	20,000	Wages	405,000
Cash from customer	1,310,000	Other operating exp.	120,000
		Cash paid to suppliers	575,000
		Interest paid	20,000
		Cash paid for FA	140,000
		Cash paid to debenture holders	20,000
		Dividends paid	10,000
		Closing balance	40,000
	1,330,000		1330,000

Solution: - Using the "Indirect Method" cash flow statement for the year ended 31st December 1998.

Net cash from operating activities	₦	₦
Profit for the year before tax		60,000
Non cash items charges/credited		
Depreciation		100,000
Decrease in Stock		20,000
Decrease in Debtors		10,000
Net cash from operating activities		190,000
Net cash from investing activities		
Fixed Assets Acquired		(140,000)
Net cash from financing activities		
Payment to debentures holders	20,000	
Dividend paid	10,000	(30,000)
Net increase in cash/cash equivalent		20,000
Net cash/cash equivalent at beginning		20,000
Net cash/cash equivalent at close of the year		40,000

Tutorial Note

All figures from profit and loss account and balance sheet charges.

Illustration

Murzi Nigeria Limited has its balance sheets as at 31st December 1996 and 1997 as follows

Share Capital	1996 ₦	1997 ₦	Fixed Assets	1996 ₦	1997 ₦
₦1 ordinary shares	30,000	40,000	Cost	48,500	60,000
Share premium		5,000	Depreciation	12,000	16,000
Revenue Reserves	2,000	3,500		36,500	44,000
General Reserves	500	2,000	Investment		25,000
Debenture Redemption			Stock	10,000	13,000
Reserve fund	2,000	2,500	Debtors	14,000	14,500
15% loan (2,000)		29,500	Bank		11,000
Creditors	4,000	10,000			
Bank overdraft	5,000				
Dividend	6,000	7,000			
Taxation	11,000	8,000			
	60,500	107,500		60,500	107,500

Fixed assets which had cost N12,500 and which had been depreciated by N7,500 were sold for N7,000.

You are required to;

Prepare a cash flow statement in accordance with SAS 18.

Solution: Murzi Nigeria Limited

Cash flow statement for the year ended 31st December, 1997

Cash flow from operating activities

Profit before tax	₦18,500
Depreciation for the year	11,500
Profit for disposal of assets	(2,000)
Tax paid	(11,000)
Increase in stock	(3,000)
Increase in debtors	(500)
Increase in creditors	6,000
	19,500

Cash flow from financing activities

Share capital issued for cash	15,000	
Proceeds from disposal of fixed assets	7,000	
Loan Received	29,500	
Dividend paid	(6,000)	45,500
Cash flow for investing activities		
Fixed assets acquired	(24,000)	
Investment	(25,000)	(49,000)
Net increase in cash/cash equivalent		16,000
Cash/cash equivalent at beginning of the year		(5,000)
Net cash/cash equivalent at the close of the year		11,000

Workings; (1) Revenue Reserve (1997) 3,500

Previous year brought forward (1996) (2,000) 1,500

Add Applications

General Reserves	1,500	
Debenture Redemption		
Reserve Fund	500	
Dividend	7,000	9,000
		10,500
Add Taxation		8,000
Profit before tax		18,500

Workings; Provision for Depreciation Account

		₦		₦
2.	Disposal account Balance c/d	7,500 16,000	Balance b/d Addition (P&L Ak)	12,000 11,500
		23,500		23,500
			Balance b/d	16,000

3.	Profit on Disposal			
	₦			
	Cost			12,500
	Depreciation			(7,500)
	Book value			5,000
	Proceeds			7,000
	Profits			2,000
Fixed Assets Account				
	Balance b/d	48,500	Disposal	12,500
	Bank	24,000	Balance b/d	60,000
		72,500		72,500
	Balance b/d	60,000		

Session Review

In this Study Session, you learnt:

- the objectives of cash flow statement.
- highlighted the various components of cash flow statement.
- prepared cash flow statement from the annual accounts.

Resources

Articulate Presentation

This is a complimentary resource to facilitate the quick delivery of this session. It is available in your course pack (Schoolboard disc / online page), and also linked here.

Schoolboard

Access your schoolboard app, or visit www.schoolboard.edutechportal.org/introductiontomicroeconomics to access updated online activities and resources related to the units of this Study Session.

Study Session 6

VALUE ADDED STATEMENT

INTRODUCTION

The companies and Allied Matters Decree 1990 schedule (2) section a (3) requires that the financial statements should include value added statement.

Learning Outcomes

When you have studied this session, you should be able to:

- discuss the importance of value added statement and why it should be included in the financial statements.
- underscore the relevance of value added statement to published accounts of an organisation.
- calculate or prepare value added statement.

Session Preview

Study Session Duration

This Study Session requires a one hour of formal study time. You may spend an additional two hours for revision.

6.1 WHAT IS VALUE ADDED STATEMENT?

Value Added Statement has been defined as, "additional wealth created through the use of assets by employees and its allocation between employees, providers of loans, shareholders, government and re-investment for further future; A.R. Jennings".

Advantages of Value Added Statement

Value added statement explains how the additional wealth created by the business distributed, the information which conventional profit and loss. Loss account do not explain in an understandable manner for a layman to understand. Other advantages which may be derived by including value added statements into financial statement are:

i. It encourages the workforce to regard themselves as part of a wealth creating and wealth sharing team.
ii. It demonstrates to the workforce that by creating more added value through increased productivity, they can increase productivity, they can increase the amount of wealth applied to them.
iii. It demonstrates to the workforce for the relative slices of added value attributable to them in their different capacities and the amount retained in the business after the taxation liability has been provided.

Disadvantages of Value Added Statement

It is said that there are various things by which value added statements may be prepared which will not make it possible as a useful means of interrelation comparison.

6.2 CONTENT AND FORMAT OF VALUE ADDED STATEMENTS

Sales (excluding VAT)	X	%
Less cost of goods and services	(X)	
Value added by trading	XX	
Investment income		
Share of profit of associated company	X	
Extra ordinary items		
Profit/loss on extra ordinary items	X	
Value Added available for distribution	XX	100%

Applied as follows

To pay employees salaries, wages and benefits	X	%
To pay providers of capital		
Interest	X	X%
Dividend	X	X%
Payable to Government		
Company income tax	X	X%
Retained in the business for maintenance assets for expansion		
Depreciation	X	X%
Retained profit	X	X%
X%	XX	100%

EXAMPLE 1: Kwada-Kwaka Limited

Summarised information for Kwada-Kwaka Limited in respect of the year ended 31st December 1997 is shown as follows:

	₦,000	₦,000
Salaries and wages		585
Material used for production		1350
Depreciation of fixed assets		
Plant and machinery	22.55	
Industrial building	10.125	
Other assets	12.325	45
Turnover		2471.25
Companies income tax		75.00
Dividend to Equity shareholders		41.75
Loan interest paid		33.75
Professional services		266.25
Minority share of profit		
Dividend payable	4.25	
Retained profits	7.00	11.25

From the information above, prepare the following

i. A conventional profit statement
ii. A value added statement
iii. State the purpose of a value added statement as it is used in financial statement.

EXAMPLE 1: Solution

Kwada-Kwaka Limited

i. Conventional operation statement for the year ended 31st December 1997.

	₦,000	₦,000
Turnover		2471.25
Less materials consumed	1350	
Professional services	266.25	
Salaries and wages	585	
Depreciation of assets	45	
Loan interest	33.75	2280.00
Profit before tax		191.25
Taxation on ordinary activities		75.00
Profit after tax		116.25
Minority interest		11.25
Profit after minority interest		105.00
Proposed Dividend		41.75
Retained profit		63.25

ii. Kwada-Kwaka Limited

Value Added Statement for the year 31st December 1997

	₦,000	₦,000
Sales (excluding VAT)		2471.25
Less bought in materials and services		1616.25
		855.100

Applied to pay

	₦,000	₦,000
Employees		
Salaries and wages	585	68.42
Providers of capital		
Interest on loan	33.75	3.95
Dividend to equity and minority		
Shareholders	46	5.38
Shareholders' fund	79.75	9.33
Government company income tax	75	8.77
Retained in business for expansion		
Depreciation	45	5.26
Retained for the year	70.25	8.22
	855	100

EXERCISE: JP Peckers Limited

The following balances have been extracted from the books of JP Peckers Limited for the year ended 31st December 1995. The group charges VAT at the standard rate of 5% on all its output.

	₦,000	₦,000
Turnover (including VAT)		1150
Plant and machinery at cost 1/1/1995	2000	
Acquisition during the year	150	
	2150	
Disposal of plant in year	NIL	
	2150	
Accumulation Depn to 31st December 1995	1100	
Net book value at 31st December 1995		1050
Dividend to equity shareholders (excluding minority)		48
Stocks of raw materials, works in progress and finished goods at 1st January 1995	80	
Raw material bought in the year	300	
Closing stocks of raw materials, work in progress and finished goods		
Bought in services used during the year	100	
Interest on borrowed money		150
Investment income earned during the year		10
Retained profit for the year		9
Minority interest in subsidiary		193
(Excluding ₦5 dividends payable by the subsidiary)		25
Companies income tax		
Wages, salaries and retirement benefits required		138
		115

a. Prepare a conventional operating statement for the year ended 31st December, 1995.
b. Prepare a value added statement for the period
c. State the purposes of the value added statement.

EXERCISE 2: Dalla Galla Plc.

Shown below are balances from book of Accounts of Dalla Galla Plc, a public quoted company for the year ended 31st December 1998.

	₦,000	₦,000
Sales less VAT		62,520
VAT: Input VAT (including VAT on plant and		
machinery ₦320)		950
output tax		1050
Purchases of production materials less VAT		40,310
Deduction from NSITF and income tax		550
Staff welfare		230
Depreciation of Assets		1150
Interest on debenture holders	1230	
Withholding tax thereon	250	980
Professional services		750
Deferred Taxation		450
Dividend to equity shareholders	3,950	
Withholding tax thereon	395	3,555
Payment to Board of Inland Revenue		1650
Retained profit		1250
Production salaries and wages (Net)		13,900

You are required to prepare value added statement as required by CAMA, 1990.

Session Review

In this Study Session, you have learnt:

- the importance of value added statement and why it should be included in the financial statements.
- the relevance of value added statement to published accounts of an organisation.
- how to prepare value added statement.

Study Session 7

FINANCIAL RATIO ANALYSIS

INTRODUCTION

The financial statements of a company can be used to evaluate the financial performance of the company. Financial ratios are most extensively used for the purpose. Ratios analysis helps an investors to determine the strength and weaknesses of a company. It also helps him to assess whether the financial performance and financial strength are improving or deteriorating. Ratios can be used for comparative analysis either with other firms in the industry, through a cross sectional analysis or with the past data through a time series analysis.

Financial analysis of a business may be carried out by:

a. Outside supplies of capital e.g. investors and creditors, banks and
b. The firm itself

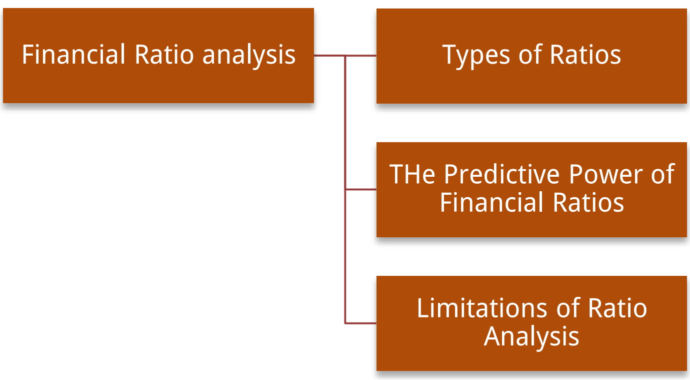
Different ratios measure different aspects of a company's performance or health.

Learning Outcomes

When you have studied this session, you should be able to:

7.1 explain financial ratio analysis
7.2 state the formula for the variance ratios
7.3 compute ratios from financial statements
7.4 interprete financial statements using ratios
7.5 discuss the predictive powers of ratios
7.6 explain the limitations of ratios

Session Preview



Study Session Duration

This Study Session requires a one hour of formal study time. You may spend an additional two hours for revision.

7.1 TYPES OF RATIOS

Financial ratios may be divided into the following

i. Profitability ratios
ii. Liquidity ratios
iii. Coverage or activity ratios
iv. Debt ratios

Profitability Ratios

The profitability of a company can be measured by the profitability ratios. These ratios are calculated by relating the profits either to sales or to investment, or to the equity shares. Thus, we have three groups of profitability ratios. These are listed below

a. $Gross\ profit\ ratio = \frac{Gross\ profit\ sale - cost\ of\ goods\ sold}{sales}$

b. $operating\ profit\ ratio = \frac{earnings\ before\ interest\ and\ tax}{sales}$

c. $net\ profit\ ratio = \frac{earning\ after\ tax\ (EAT)}{sales}$

d. $administrative\ expense\ ratio = \frac{administrative\ expenses}{sales}$

e. $selling\ expenses\ ratio = \frac{selling\ expenses}{sales}$

f. $operating\ expenses\ ratio = \frac{admin\ to\ exp\ and\ selling\ exp}{sales}$

g. $operating\ ratio = \frac{Cost\ of\ goods\ sold + operating\ expenses}{sales}$

Profitability related to investment

a. $return\ on\ assets = \frac{earnings\ after\ tax}{total\ asset}$

b. $return\ on\ capital\ employed = \frac{EBIT}{total\ capital\ employed}$

c. $return\ on\ equity = \frac{EAT}{shareholders\ fond}$

Profitability related to equity shares

a. $Earnings\ per\ share\ (EPS) = \frac{net\ profit\ available\ to\ equity\ shareholder}{number\ of\ equity\ shares}$

b. $Earning\ yields = \frac{EPS}{market\ price\ per\ share}$

c. $Dividend\ yield = \frac{(DPS) dividend\ per\ share}{market\ price\ per\ share}$

d. $Dividend\ payout\ ratio = \frac{DPS}{EPS}$

e. $Price\ earning\ ratio\ (\frac{P}{E}ratio) = \frac{market\ price\ per\ share}{EPS}$

f. $Gross\ profit\ ratio = \frac{Gross\ profit\ sale - cost\ of\ goods\ sold}{sales}$

g. $Gross\ profit\ ratio = \frac{Gross\ profit\ sale - cost\ of\ goods\ sold}{sales}$

h. $Gross\ profit\ ratio = \frac{Gross\ profit\ sale - cost\ of\ goods\ sold}{sales}$

Earning Power

a. $Return\ on\ investment\ (ROI) = \frac{EAT \times sales}{sales}\ or\ \frac{EAT}{total\ asset}$

b. $Return\ on\ capital\ employed\ (ROCE) = \frac{sales}{capital\ employed} \times \frac{EAT}{sales} = \frac{EAT}{capital\ employed}$

LIQUIDITY RATIOS

These measures the company's ability to fulfil its short term obligations and reflect its short term financial strength or liquidity. The commonly used liquidity ratios are;

a. $Current\ ratio = \frac{current\ assets}{current\ liabilities}$

b. $Quick\ ratio\ (acid\ test\ ratio) = curent\ asset - inventory - \frac{prepaid\ expenses}{current\ liabilities}$

c. $Cash\ ratio = \frac{cash\ and\ market\ securities}{current\ liabilities}$

ACTIVITY OR EFFICIENCY RATIOS

These are also known as turnover ratios. These ratios measure the efficiency in assets management. They express the relationship between sales and the different types of assets showing the speed with which these assets generate sales. Important activity ratios are enumerated below

a. $Current\ asset\ turnover = \frac{sales}{current\ assets}$

b. $Fixed\ asset\ turnover = \frac{sales}{fixed\ assets}$

c. $Total\ asset\ turnover = \frac{sales}{total\ assets}$

d. $Inventory\ turnover = \frac{sales}{average\ inventory}$

e. $Debt\ turnover = \frac{sales}{average\ debtors}$

LEVERAGE RATIOS

These ratios also known as capital structure ratios. They measure the company's ability to meet its long term debt obligations. They throw light on the long term solvency of a company. The commonly used leverage ratios are the following;

a. $Debt - equity\ ratio = \frac{long\ term\ debt}{shareholders\ equity}$

b. $Total\ debt\ ratio\ (debt\ or\ total\ asset\ ratio) = \frac{total\ debt}{total\ asset}$

c. $Propeitery\ ratio = \frac{shareholders\ equity}{total\ asset}$

d. $Interest\ coverage\ ratio = \frac{earnings\ before\ interest\ and\ taxes\ (EBIT)}{taxes}$

The first three ratios indicate the relative contribution of owners and creditors in financing the assets of the company. These ratios reflect the safety margin available to the long-term creditors. The coverage ratio measures the ability of the company to meet its interest payments arising from the debt.

7.2 THE PREDICTIVE POWER OF FINANCIAL RATIOS

Empirical studies have been made by a lot of people to test the predictive powers of accounting ratios. Such predictable events have been stated to be

a) Business failure – Insolvency
b) Loans and debt repayment problems
c) Loan application which would be criticised by bank manager, and
d) Prediction of good credit rating

One thing which is common to these studies is the use of multiple ratios rather than one single ratio and ratios are analysed over a period of time.

7.3 LIMITATIONS OF RATIO ANALYSIS

In spite the obvious benefits of ratios analysis there are some limitations to the usefulness of ratios; they include the following;

a) Ratios 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. Another limitation is the fact that ratios are quantifiable data. They cannot provide new quantifiable information like competence of management and staff and changes in the operating environment.
b) Some of the ratios (e.g. ROCE) do not have universally accepted uniform parameters.
c) When carrying out inter-company analysis, different accounting policies adopted by the companies could distort ratios calculated. Company analysis to be meaningful therefore, cognisance must be taken of the different accounting policies so that necessary adjustments are made where the need arises.

Wazobia Ventures

Trading and profit and loss account for the year ended 30th June 1998.

	₦,000	₦,000
Sales		233,000
Less cost of goods sold		170,000
Gross profit		63,000
Less overhead expenses		
Administrative expenses	16,800	
Selling and distribution expenses	15,000	
Other overhead expenses	6,200	38,000
Net profit		25,000

Wazobia Ventures

Illustration 1

The following are the final accounts of a trading organisation; Wazobia Ventures for the year ended 30th June 1998.

Wazobia Ventures

Trading and profit and loss account for the year ended 30th June 1998.

	₦,000	₦,000
Sales		233,000
Less cost of goods sold		170,000
Gross profit		63,000
Less overhead expenses		
Administrative expenses	16,800	
Selling and distribution expenses	15,000	
Other overhead expenses	6,200	38,000
Net profit		25,000

Wazobia Ventures

	₦,000	₦,000	₦,000
Fixed assets			111,000
Current assets			
Stock		18,100	
Debtors		6,000	
Bank		6,800	
		30,900	
Current liabilities			
Creditors	14,000		
Accruals	6,000	20,000	10,900
Working capital			121,900
Long-term loan			25,000
			96,900
Financed by			
Capital			80,000
Retained profits			16,900
			96,900

As at 1st July 1997, stock on hand was valued at N21,500.

The following average ratios relate to the industry in which Wazobia operates.

Gross profit ratio	29.8%
Net profit to sales	12.5%
Working capital ratio	1:4:1
Stock turnover	10.7 times
Return on capital employed	20.2%

You are required to;

i. Compute the ratios above for Wazobia Ventures
ii. Give possible reasons for the difference between Wazobia's ratios and the industry's average ratios.

a.	Gross profit = 63,000 x 100	=	27.0%	29.8%	233,000	1
b.	Net profit to sales = 25,000 x 100	=	10.7%	12.5%	233,000	1
c.	Working capital ratio = 30,900	=	15.1	1:4:1	20,000	
d.	Stock turnover = 170,000	=	8.6 times		10.7 times	
			½(21,500 + 18,100)			
e.	Return on capital employed	= 25,000 x 100	= 25.7%	20.2%	96,900	1

Possible Reasons for Differences

Gross profit ratio: - The gross profit % of Wazobia being lower than the industry average may be due to cheaper pricing by Wazobia or increase in costs which it could not pass onto customers.

Net Profit to sales: - The lower net profit to sales ratio of Wazobia could have been caused by the same factors mentioned above.

Working Capital Ratio: - The slower rate of stock turnover probably caused a build-up of stock in stores which in turn inflated the current assets. This is, possibly, the reason why the working capital ratio of Wazobia is higher than the industry average.

Stock Turnover Ratio: - Possible reasons for the lower stock turn of Wazobia could be slow-moving stock, obsolete stock or overstocking.

Return On Capital Employed (ROCE): - The higher ROCE of Wazobia is an indication of improved efficiency, in utilisation of assets, thus, confirming the improvement in operating efficiency noted earlier.

Illustration 2

The summarised balance sheets and operating results of Wellington Limited for the two years ended 30th September 1998 were as follows:

Balance sheet as at 30th September

	1991 ₦,000	1990 ₦,000
Fixed assets (Net)	16,222	6,941
Current assets		
Stock	62,294	52,196
Debtors	54,859	50,052
Bank	7,234	14,565
	124,387	116,813
Current liabilities		
Creditors	47,055	42,885
Taxation	4,154	3,219
Dividends	2,500	2,250
	53,709	48,354
Net current assets	70,678	68,459
10% Debentures (1997 – 1999)	25,000	25,000
Net Assets	61,900	50,400
Financed by		
Ordinary shares of ₦1 each	12,500	12,500
Revenue reserves	35,874	29,787
Deferred Taxation	13,526	8,113
	61,900	50,400

Operating results for the year ended 30th September

	1991 ₦,000	1990 ₦,000
Sales	672,944	559,071
Profit before interest and taxation	23,412	20,882
Interest payable	2,500	2,500
Taxation	10,506	8,747
Dividend	3,750	3,500

The shares of the company were quoted at N1.20 at 30th September 1991.

You are required to

a. Calculate from the balance sheet and operating results.
   i. Two ratios of interest to creditors
   ii. Two ratios of interest to management and two ratios of interest to shareholders
b. Comment briefly upon the changes between 1990 and 1991.

Solution

	1991	1990
Two ratios of interest to Creditors		
Working capital ratio	$\frac{124{,}387}{53{,}709}$ = 2:3:1	$\frac{116{,}813}{48{,}354}$ = 2:4:1
Quick ratio	$\frac{124{,}387 - 62{,}294}{53{,}709}$ = 1:2:1	$\frac{116{,}183 - 52{,}196}{48{,}354}$ = 1:3:1
Two ratio of interest to management		
ROCE	$\frac{23{,}412}{61{,}900+25{,}000} \times \frac{100}{1}$ = 26.9%	$\frac{20{,}882}{50{,}400+25{,}000} \times \frac{100}{1}$ = 27.7%
Profit margin ratio	$\frac{23{,}412}{672{,}944} \times \frac{100}{1}$ = 3.5%	$\frac{20{,}882}{559{,}071} \times \frac{100}{1}$ = 3.7%
Two ratios of interest to shareholders.		
Earning per share	$\frac{23{,}412 - 2{,}500 - 10{,}506}{12{,}500}$ = 83 kobo	$\frac{20{,}882 - 2{,}500 - 8{,}747}{12{,}500}$ = 77 kobo
Dividend cover	$\frac{23{,}412 - 2{,}500 - 10{,}506}{3{,}750}$ = 2.8times	$\frac{20{,}882 - 2{,}500 - 8{,}747}{3{,}500}$ = 2.8times

Session Review

Ratio analysis is a method of interpreting the financial statements of a company. A single ratio by 8, itself is not of much use. A comprehensive evaluation of the financial performance of a company emerges only from a study of all the important ratios.

Ratios calculated from the financial statements reveal the performance during the past years. For an investor what is important is the future prospects of a company and not its past achievement. From an analysis of past performance, the analyst has to forecast the future prospects of the company. The investment will depend on such forecast.

Assessment

SAQ 7.1 (tests Learning Outcome 7.1)

The following summarised data was extracted from the published accounts of Hima Nigeria Limited for the year ended 31st December 2001.

	₦
Fixed assets	1,300,000
Net current assets	100,000
	1,400,000
Ordinary shares of ₦1 per share	700,000
7% preference shares of ₦1 per share	200,000
Revenue Reserves	300,000
Shareholders fund	1,200,000
8% Debentures	200,000
	1,400,000
Net profit before tax	440,000
Taxation	(230,000)
Net profit after tax	210,000
Dividends paid and proposed	
Ordinary shares	(90,000)
7% preference shares	(14,000)
Retained profit for the year	106,000

Price per ordinary shares (2001) closing quotation ₦2.20.

Required: Calculate for each ordinary share

a. Earnings per share (EPS)
b. Earning yield
c. Dividend yield
d. Price/Earning (P/E) ratio
e. Book value of net assets per share

SAQ 7.2 (tests Learning Outcome 7.2)

The summarised final account of small trading business for year ended 31st December 1991 was as follows;

Trading and profit and loss account for year ended 31st December 1991.

	₦
Sales	52,000
Gross profit	38,000
	14,000
Less overhead expenses	8,300
	5,700

Balance sheet as at 31st December 1991

	₦	₦
Fixed Assets		27,000
Current Assets		
Stock	4,300	
Debtors	1,200	
Bank/Cash	1,500	7,000
		34,000
Financed by		
Capital		18,000
Retained profits		7,000
		25,000
Long-term loan business associates		5,000
Current liabilities		4,000
		34,000

N.B. Stock on 1st January 1991 was ₦5,000. The average figures of performance for that type and size of business in that area were

Gross profit/Turnover	31.2%
Net profit/Turnover	12.4%
Net profit/Net capital employed	14.2%
Stock turnover	11.8times
Current ratio	1:6:1

Required

a. Calculate the above ratios for the above business
b. Suggest possible reasons for the differences revealed between the ratios in ***a*** above and the average ratios.

Study Session 8
ACCOUNTING FOR ACQUISITIONS AND MERGERS

INTRODUCTION

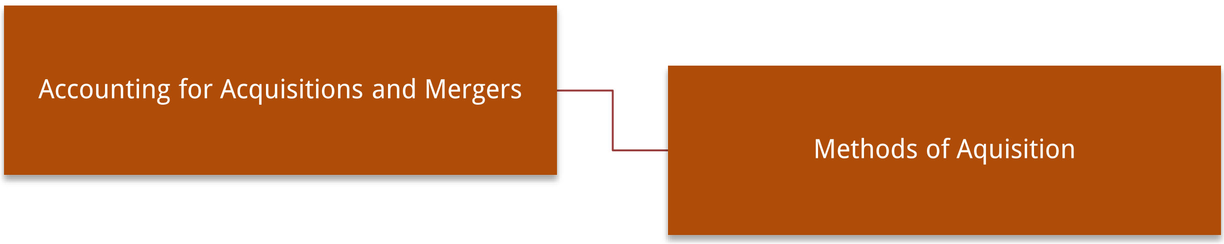
An acquisition is the purchase of a controlling interest in one company by another company. A merger is the joining of two separate companies to form a single company. Mergers are often referred to as "amalgamation" while acquisitions are often called "take over".

Learning Outcomes

When you have studied this session, you should be able to:

8.1 define acquisition and mergers
8.2 distinguish between merger and acquisition
8.3 describe the methods of acquisition and merger
8.4 state the disclosure requirements
8.5 explain the accounting treatment of merger and acquisition

Session Preview



Study Session Duration

This Study Session requires a one hour of formal study time. You may spend an additional two hours for revision.

8.1 METHODS OF ACQUISITION

In acquisition method, the following are the main features.

a. Shares purchases in a subsidiary should be shown at cost less dividends received out of the pre-acquisition profits.

b. Dividends out of pre-acquisition profit cannot be regarded as available for distribution as dividend by the holding company.
c. Assets and liabilities of the subsidiary at the date of acquisition should be shown in the balance sheet at their fair value at the date.
d. The difference at the date of acquisition between the fair value of the purchase consideration and the fair value of the net assets is treated as goodwill while excess value of assets over value of payment is reserve on acquisition.

Only post acquisition profits of subsidiary should be included in the consolidated reserves of the group. The pre-acquisition profits in part of capital cost, any payment of dividend of pre-acquisition is payment out of capital cost, any payment of dividend of pre-acquisition is payment out of capital cost.

Merger Accounting Method

1. Shares issued by the parent are merely the means of achieving the merger no share premium arises.
2. As shares premium is not recognised the cost of the investment in the parents balance sheet is the nominal value of shares issued.
3. Any dividend received by the parent from the subsidiary can be distributed in full by the parent. This means that whole of the subsidiary's reserves can be included in the consolidated balance sheet reserves.
4. The assets of the subsidiary are not re-valued at the date of merger.
5. When the total nominal value of the share issued by the parent is more than the total nominal value of shares of subsidiary.

The difference is deductible from group reserves if the total is less, than the shut fall becomes a non-distributable group reserve.

EXAMPLE

Acquisition Method

Suppose that Maiyanga Limited and Kwada Limited wish to merge together in order to pool interests together to establish a strong competitive market position. The balance sheets of the two companies are as follows:

	Maiyanga Limited ₦,000	Kwada Limited ₦,000
Fixed Assets	150,000	120,000
Net current assets	50,000	30,000
	200,000	150,000
Capital and Reserves		
Ordinary shares of ₦1	80,000	100,000
Reserves	120,000	50,000
	200,000	150,000

The current market value of each company is agreed as:

N2.50 per share of Maiyanga Limited

N2.00 per share of Kwada Limited

It is agreed that Maiyanga Limited should become a holding-cum-trading company and issue

100,000,000 x 2 = 80,000,000 shares

2.50

In exchange of the shares of Kwada Limited because the value of N100,000 Kwada shares N200,000,000 is equivalent to 80,000,000 shares of Maiyanga Limited. Maiyanga will issue shares at a nominal value of N80,000,000 and a market value of N200,000,000. There will be a share premium of N120,000,000.

Solution

Maiyanga Limited

Balance sheet after Merger

	₦,000
Fixed Assets	
Tangible Assets	150,000
Investment in Kwada Limited at cost	200,000
	350,000
Net current assets	50,000
	400,000
Capital Reserves	
Ordinary shares of ₦1 each	160,000
Share premium	120,000
Revenue Reserve	120,000
	400,000

The consolidated balance sheet of the group would be

Maiyanga limited and its subsidiary

Consolidated Balance sheet

	₦,000
Fixed Assets	
Goodwill on consolidation	50,000
Tangible Assets	270,000
	320,000
Net current assets	80,000
	400,000
Capital and Reserves	160,000
Share premium	120,000
Revenue Reserve	120,000
	400,000

Workings

	₦,000		₦,000
Cost of control account		Ordinary shares	100,000
Cost 80,000 x 2.50	200,000	Reserves	50,000
		Goodwill	50,000
	200,000		200,000

Merger Accounting

In our example of the holding-cum-trading company, merger accounting would allows Maiyanga Limited to issue 80,000,000 shares in exchange for 100,000,000 shares of Kwada and the difference between.

The nominal value of shares issued and

The share capital and non-distributable reserves acquired becomes a non-distributable capital reserve of the new company.

The Balance Sheet of Maiyanga Limited

	₦,000
Fixed Assets	
Tangible Assets	150,000
Investment in Kwada Limited	100,000
	250,000
Net current assets	50,000
	300,000
Capital and Reserves	
Ordinary ₦1 share capital	160,000
Capital Reserves	20,000
Revenue Reserve	120,000
	300,000
The Consolidated Balance Sheet would be	
Tangible Fixed Assets	270,000
Net current assets	80,000
	350,000
Capital and Reserves	
Ordinary share capital ₦1	160,000
Capital Reserves	20,000
Revenue Reserve (120,000 + 50,000)	170,000
	350,000

NOTE: There is no goodwill arising on consolidation in merger accounting since no purchase takes place.

The distributable reserves of each company are still distributable after merger.

The capital reserve is the difference between the nominal value of shares of Kwada and its value (N100 – 80).

Session Review

In this Study Session, you learnt about

- acquisition and mergers
- the methods of acquisition and merger
- state the disclosure requirements
- the accounting treatment of merger and acquisition

Resources

Articulate Presentation

This is a complimentary resource to facilitate the quick delivery of this session. It is available in your course pack (Schoolboard disc / online page), and also linked here.

Schoolboard

Access your schoolboard app, or visit www.schoolboard.edutechportal.org/introductiontomicroeconomics to access updated online activities and resources related to the units of this Study Session.

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