THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

SKILLS LEVEL EXAMINATION – PILOT QUESTIONS

STRATEGIC BUSINESS REPORTING

INSTRUCTION: **YOU ARE REQUIRED TO ATTEMPT FIVE OUT OF SEVEN QUESTIONS IN THIS PAPER**

SECTION A: **COMPULSORY QUESTION** **(30 MARKS)**

QUESTION 1

(a) Platinum holds investments in two other entities; Jewel and Metal. The statements of financial position of the three entities as at March 31, 2025, are as follows:

	Platinum	Jewel	Metal
	₦'000	₦'000	₦'000
Assets:			
Non-current assets:			
Property, plant and equipment (Note 1)	135,000	100,000	110,000
Investments (Notes 1 and 2)	139,000	15,000	Nil
	274,000	115,000	110,000
Current assets:			
Inventories (Note 4)	45,000	32,000	27,000
Trade receivables (Note 5)	50,000	34,000	35,000
Cash and cash equivalents	10,000	4,000	8,000
	105,000	70,000	70,000
Total assets	**379,000**	**185,000**	**180,000**
Equity and liabilities			
Equity:			
Share capital (₦1 per share)	120,000	80,000	60,000
Retained earnings	163,000	44,000	55,000
Total equity	283,000	124,000	115,000

Non-current liabilities:			
Long-term borrowings	40,000	25,000	30,000
Deferred tax	20,000	8,000	10,000
Total non-current liabilities	60,000	33,000	40,000
Current liabilities:			
Trade and other payables	30,000	22,000	20,000
Short-term borrowings	6,000	6,000	5,000
Total current liabilities	36,000	28,000	25,000
Total equity and liabilities	**379,000**	**185,000**	**180,000**

Notes:

Note 1 – Platinum's investment in Jewel

On April 1, 2024, Platinum purchased 60 million shares in Jewel for an immediate cash payment of ₦100 million. The retained earnings of Jewel at April 1, 2024 was ₦35 million.

It is the group's policy to value the non-controlling interest in subsidiaries at the date of acquisition at fair value. The fair value of an equity share in Jewel as at April 1, 2024 was estimated at ₦1·70. This fair value is considered by the directors of Platinum to be an appropriate basis for measuring the non-controlling interest in Jewel on April 1, 2024.

The terms of the business combination provide for the payment of an additional ₦15 million to the former shareholders of Jewel on March 31, 2026. On April 1, 2024, Platinum's credit rating was such that it could have borrowed funds at an annual finance cost of 8%. The statement of financial position of Platinum included this investment at its original cost of ₦100 million.

The directors of Platinum carried out a fair value exercise to measure the identifiable assets and liabilities of Jewel as at April 1, 2024. The following matters emerged:

(i) A property having a carrying value of ₦40 million (depreciable amount ₦24 million) had a fair value of ₦60 million (depreciable amount ₦36 million). The estimated future economic life of the depreciable amount of the property as at April 1, 2024 was 30 years.

(ii) Plant and equipment having a carrying value of ₦51 million, had a fair value of ₦54 million. The future economic life of the plant as at April 1, 2024 was estimated to be three years.

The fair value adjustments have not been reflected in the individual financial statements of Jewel. In the consolidated financial statements, the fair value adjustments will be regarded as temporary differences for the purposes of computing deferred tax. The rate of tax to apply to temporary differences is 30%.

The goodwill arising on acquisition of Jewel has not suffered any impairment since April 1, 2024.

Note 2 – Platinum's investment in Metal

On October 1, 2024, Platinum paid ₦39 million for 30% of the equity shares of Metal. This investment gave Platinum significant influence over Metal. The retained earnings of Metal on October 1, 2024 was ₦60 million. You can ignore any deferred taxation implications of the investment by Platinum in Metal. The investment in Metal has not suffered any impairment since October 1, 2024

Note 3 – Jewel's investment

Jewel's investment is a strategic equity investment in Silver – key supplier. This investment does not give Jewel control or significant influence over Silver. Silver is not a joint venture for Jewel. The investment in Silver is correctly classified as available for sale and on April 1, 2024, was included in the financial statements of Jewel at its fair value of ₦15 million.

The fair value of the investment in Silver on March 31, 2025, was ₦17 million. In the tax jurisdiction in which Jewel is located, unrealised profits on the revaluation of equity investments are not subject to current tax. Any such profits are taxed only when the investment is sold.

Note 4 – Inter-company sale of inventories

The inventories of Jewel and Metal at March 31, 2025, included components purchased from Platinum during the year at a cost of ₦10 million to Jewel and ₦12 million to Metal. Platinum generated a gross profit margin of 25% on the supply of these components. You can ignore any deferred tax implications of the information in this note.

Note 5 – Trade receivables and payables

The trade receivables of Platinum included ₦5 million receivable from Jewel and ₦4 million receivable from Metal, in respect of the purchase of components (see Note 4). The trade payables of

Jewel and Metal do not include any amounts payable to Platinum. This is because on March 29, 2025, Jewel and Metal paid ₦5 million and ₦ 4 million, respectively to Platinum to eliminate the balances. Platinum received and recorded these payments on April 2, 2025.

Required:

Prepare the consolidated statement of financial position of Platinum as at March 31, 2025.

(25 Marks)

(b) The International Accounting Standards Board (IASB) issued the revised *Conceptual Framework for Financial Reporting* in March 2018.

Required:

Discuss the benefits of developing an agreed conceptual framework and the **extent** to which it can be used to resolve practical accounting issues. (5 Marks)

(Total 30 Marks)

SECTION B: YOU ARE REQUIRED TO ATTEMPT TWO OUT OF THE THREE QUESTIONS IN THIS SECTION (40 MARKS)

QUESTION 2

Julius Adel Plc. operates in the engineering industry and prepares financial statements in accordance with IFRS Accounting Standards. The management of Julius Adel Plc. was appointed in 2023, following a prolonged period of underperformance against other companies in the engineering sector.

Julius Adel Plc. operates multiple manufacturing plants across Nigeria. Industry analysts suggest that the company needs substantial investment in its plant and equipment to enhance productivity. Currently, its production costs rank among the highest in the sector. In response to market pressures, Julius Adel Plc. adopted a competitive low-pricing strategy for its products during the second half of 2023.

You are a business analyst to Kappa & L'Alberto which is a competitor of Julius Adel Plc. The Chairman of Kappa & L'Alberto Plc. has sent you some extracts from 2024 financial statements of Julius Adel Plc. and asked you to analyse them. He has been surprised by the increase in net profit and the strong cash flows of Julius Adel Plc., given its pricing policy and its perceived cost structure.

Unlike its competitors, Kappa & L'Alberto Plc. has successfully outsourced the manufacturing of component parts to low-cost foreign economies in an attempt to improve profitability. The Chairman has provided you with the following performance indicators derived from the latest financial statements of Kappa & L'Alberto:

Kappa & L'Alberto – performance indicators

	2024
Return on capital employed	14.7%
Gross profit margin	23.1%
Operating profit margin	12.0%
EBITDA/Revenue	27.0%
Revenue per employee	₦28,100
Revenue growth (year on year)	0.3%
Cash return on capital employed	22.4%
Cash from operations to profit from operations	1.9 times

The following information has been provided for Julius Adel Plc:

Julius Adel Plc.

Statement of profit or loss

	Year ended Sept. 30, 2024	**Year ended Sept. 30, 2023**
	₦'000	**₦'000**
Revenue	27,920	26,990
Cost of sales	(22,310)	(21,340)
Gross profit	5,610	5,650
Operating expenses	(2,410)	(2,680)
Profit from operations	3,200	2,970
Finance costs	(850)	(970)
Profit before tax	2,350	2,000
Tax	(530)	(650)
Profit after tax	1,820	1,350

No dividends have been declared in respect of earlier years.

Julius Adel Plc.

Cash flow statement

	Year ended Sept. 30, 2024		Year ended Sept. 30, 2023	
	₦'000	₦'000	₦'000	₦'000
Cash flows from operating activities				
Cash generated from operations (Note)		9,090		5,610
Interest paid		(950)		(1,240)
Tax paid		(430)		(710)
Net cash from operating activities		7,710		3,660
Cash flows from investing activities				
Purchase of tangible non-current assets	(6,510)		(3,010)	
Proceeds on sale of non-current assets	-		10	
Net cash used in investing activities		(6,510)		(3,000)
Cash flows from financing activities				
Borrowings repaid		(500)		–
Increase in cash and cash equivalents		700		660
Cash and cash equivalents brought forward		1,500		840
Cash and cash equivalents carried forward		2,200		1,500

Note: Reconciliation of profit before tax to cash generated from operations

	N'000	N'000
Profit before tax	2,350	2,000
Finance costs	850	970
Depreciation	4,210	3,950
Decrease/(increase) in inventories	300	(230)
Decrease/(increase) in receivables	700	(650)
Increase/(Decrease) in trade payables	680	(430)
Cash generated from operations	9,090	5,610

Extract from notes to the financial statements of Julius Adel Plc.

Accounting policy – tangible non-current assets

All tangible non-current assets are stated at cost less accumulated depreciation and impairment losses. Depreciation is computed, using the straight-line method or using estimates of average useful lives.

During the year, Julius Adel Plc. conducted a reassessment of the useful lives and residual values of all tangible non-current assets. As a result of changes in the pattern of economic-benefit consumption, adjustments were made to the useful lives and residual values of certain non-current assets located at the head office. These adjustments were treated as changes in accounting estimates, in accordance with **IAS 8 – Accounting Policies, Changes in Accounting Estimates and Errors**. The impact of this change was a reduction in depreciation expense, reflected in operating expenses, amounting to **₦320,000 per annum** for the year ended **30 September 2024** and subsequent years.

Additional information for Julius Adel Plc.

	2024	**2023**
Gearing (net debt / equity)	33.2%	41.2%
Operating profit margin	11.5%	11.0%
Return on capital employed (ROCE)	9.8%	9.3%
Average number of employees	1,170	1,210
Cash return on capital employed	28.0%	17.6%
EBITDA	₦7,410,000	₦6,920,000
Inventory turnover	4.1 times	3.4 times
Trade receivables collection period	92 days	99 days
Trade payables payment period	49 days	40 days

Required:

(a) Prepare a report analysing the financial performance and cash flows of Julius Adel Plc.
(Your answer should identify matters that you consider should be further investigated). (18 Marks)

(b) Comment on the usefulness of EBITDA (earnings before interest, taxation, depreciation and amortisation) when analysing the performance and cash flows of Julius Adel Plc. (2 Marks)

(Total 20 Marks)

QUESTION 3

(a) Ikoyi Nigeria Limited, has a reporting date of December 31, 2024. It prepares its financial statements in accordance with International Financial Reporting Standards. The company develops biotech products for pharmaceutical companies. These pharmaceutical companies then manufacture and sell the products. The company receives stage payments during product development and a share of royalties when the final product is sold to consumers. A new accountant has recently joined the Finance Department of Ikoyi Nigeria Limited and has raised a number of queries.

In 2023, Ikoyi Nigeria Limited, acquired a development project through a business combination and recognised it as an intangible asset. The Commercial Director decided that the return made from the completion of this specific development project would be sub-optimal. As such, in October 2024, the project was sold to a competitor. The gain arising on derecognition of the intangible asset was presented as revenue in the financial statements for the year ended December 31, 2024, on the grounds that development of new products is one of the company's ordinary activities. Ikoyi Nigeria Limited has made two similar sales of development projects in the past, but none since 2017.

Required:

Advise the accountant on the appropriateness of the accounting treatment for the sale. (5 Marks)

(b) **(i)** While searching for some invoices, the accountant found a contract which Ikoyi Nigeria Limited had entered into on January 1, 2024, with Lekki Nigeria Limited, another entity. The contract allows Ikoyi Nigeria Limited to use a specific aircraft owned by Lekki Nigeria Limited for a period of three years. Ikoyi Nigeria Limited is required to make annual payments.

On January 1, 2024, costs were incurred negotiating the contract. The first annual payment was made on December 31, 2024. Both of these amounts have been expensed to the statement of profit or loss.

There are contractual restrictions concerning where the aircraft can fly. Subject to those restrictions, Ikoyi Nigeria Limited determines where and when the aircraft will fly, and the cargo and passengers which will be transported.

Lekki Nigeria Limited is permitted to substitute the aircraft at any time during the three-year period for an alternative model and must replace the aircraft if it is not working. Any substitute aircraft must meet strict interior and exterior specifications outlined in the contract. There are significant costs involved in outfitting an aircraft to meet the specifications of Ikoyi Nigeria Limited.

The accountant requires advice as to the correct accounting treatment of this contract.

Required:

Advise the accountant on the matters set out above with reference to International Financial Reporting Standards. (7 Marks)

(ii) The new accountant has been reviewing the financial reporting processes of Ikoyi Nigeria Limited. She has recommended the following:

- All purchases of property, plant and equipment below ₦500 should be written off to profit or loss. The accountant believes that this will significantly reduce the time and cost involved in maintaining detailed financial records and producing the annual financial statements.
- A checklist should be used when finalising the annual financial statements to ensure that all disclosure notes required by specific IFRSs and IASs are included.

Required:

Discuss the acceptability of the two proposals stated above, taking into consideration the concept of materiality.

(Your answer should refer to IFRS Practice Statement 2: *Making Materiality Judgements).*

(8 Marks)

(Total 20 Marks)

QUESTION 4

(a) IFRS Practice Statement 1 *Management Commentary,* provides a broad, non-binding framework for the presentation of management commentary which relates to financial statements which have been prepared in accordance with IFRSs. The management commentary is within the scope of the *Conceptual Framework* and, therefore, the qualitative characteristics will be applied to both the financial statements and the management commentary.

Required:

(i) Discuss the arguments for and against issuing IFRS Practice Statement 1 *Management Commentary,* as a non-binding framework or as an IFRS. (4 Marks)

(ii) Discuss how the qualitative characteristics of understandability, relevance and comparability should be applied to the preparation of the management commentary. (4 Marks)

(b) As a result of rising property prices, Palm Nigeria Limited purchased five buildings during the current period in order to benefit from further capital appreciation. Palm Nigeria Limited has never owned an investment property before. In accordance with IAS 40 – Investment Property, the directors are aware that buildings can be measured using either the fair value model or the cost model. However, they are concerned about the potential impact of this accounting policy choice on how current and prospective investors interpret the company's financial performance, position, and cash flows.

Required:

Discuss the potential impact which this choice in accounting policy will have on investors' analysis of the financial statements of Palm Nigeria Limited.

(Your answer should refer to key financial performance ratios). (12 Marks)

(Total 20 Marks)

SECTION C: YOU ARE REQUIRED TO ATTEMPT TWO OUT OF THE THREE QUESTIONS IN THIS SECTION (30 MARKS)

QUESTION 5

IFRS 16 - *Leases,* sets out guidance for accounting for contracts that are classified as leases. It can be stated that the application of certain IFRS 16 principles is an example of "substance over form".

On April 1, 2019, Mass Followers Limited entered into a contract to acquire a specialised piece of equipment. The agreement provided for four annual payments of ₦15.5 million, commencing on March 31, 2020. In addition, payment of a deposit of ₦30 million was required on April 1, 2019. The agreement also provided that Mass Followers Limited could buy the residual asset outright at the end of the term for a nominal sum of money. On April 1, 2019, the fair value of the equipment was ₦80 million. The present value of the agreed deposit and lease payments is also ₦80 million. On April 1, 2019, the effective finance cost implicit in the contract is 9.2%. The equipment has a useful economic life of 5 years.

Required:

(a) Discuss the concept of 'substance over form' and **explain** why applying the principles of IFRS 16, is a good example of the concept being applied. (6 Marks)

(b) Demonstrate, with appropriate calculations, the accounting entries required to record the transaction above for the year ended March 31, 2020. (5 Marks)

(c) Present relevant extracts from the statement of profit or loss and other comprehensive income for the year ended March 31, 2020 and the statement of financial position as at that date. (4 Marks)

(Total 15 Marks)

QUESTION 6

IFRS 9 - *Financial Instruments,* sets out the principles and rules for the appropriate accounting treatment of most financial instruments. In particular, it deals with loans between entities, both from the perspective of the lender and the borrower.

Premium Plc. invests in bonds. Sometimes, it trades these bonds by flipping them quickly for profit. Others are held for the long term.

Details of two particular bonds purchased on August 1, 2018, are as follows:

	'Atlas'	'Radar'
Nominal value of bond	₦45 million	₦30 million
Coupon interest rate	4%	5%
Purchase price of bond	₦38.5 million	₦28 million
Effective yield to maturity	6.75%	7.8%

The 'Atlas' bond was purchased with a view to holding it for the long term, drawing the interest and principal as it becomes payable.

The 'Radar' bond was bought at a deep discount, and the aim is to wait until the market value increases, and then sell it on at a profit. On July 31, 2019, the 'Radar' bond had a fair value of ₦27.5 million.
In both cases, the coupon is payable on July 31 each year, and has been paid as promised.

Required:

(a) Discuss the accounting treatment required by IFRS 9 for recognition and measurement of financial assets, such as bonds, paying particular attention to the tests required to decide between alternative treatments. (7 Marks)

(b) In the case of each bond above, outline the accounting treatment required by IFRS 9, for year ended July 31, 2019. (8 Marks)

(Total 15 Marks)

Question 7

Adelowo Plc. is a public limited company which produces a range of luxury Italian food products which are sold to restaurants, shops and supermarkets. It prepares its financial statements in accordance with International Financial Reporting Standards.

The directors of the company receive a cash bonus, if the reported profits for each year, exceed a predetermined target. The company exceeded its performance target for the year ended December 31, 2024. However, forecasts for 2025 are pessimistic, driven by economic uncertainty and stagnant wage growth across the country.

Provisions

A newly appointed accountant at Adelowo Plc. observed that the provisions balance as at December 31, 2024, was significantly higher than in the previous year. Upon inquiry, the Finance Director explained that the increase was due to substantial changes in food safety and hygiene regulations, which are set to take effect in 2025. As a result, the company will need to retrain a large portion of its workforce. Although the retraining has not commenced, a provision of ₦2 million has been recognised to cover the estimated cost.

However, the Finance Director responded dismissively to the accountant's inquiry, stating that such questions were a waste of time and implying that they could negatively affect her prospects for future pay increases and bonuses.

Wheat contract

Adelowo Plc. purchases significant quantities of wheat for use in its bread and pasta products. These are high-value products on which the company records significant profit margins. Nonetheless, the price of wheat is volatile and so, on November 1, 2024, it entered into a contract with a supplier to purchase 500,000 bushels of wheat in June 2025 for ₦5 a bushel. The contract can be settled net in cash.

Adelowo Plc. has entered into similar contracts in the past and has always taken delivery of the wheat. On December 31, 2024, the price of wheat had fallen. The Finance Director recorded a derivative liability of ₦0.5 million on the statement of financial position and a loss of ₦0.5 million in the statement of profit or loss. Wheat prices may rise again before June 2025. The accountant is unsure if the current accounting treatment is correct but feels uncomfortable approaching the Finance Director again.

Required:

Discuss the ethical and accounting implications of the above situations from the perspective of the accountant. **(15 Marks)**

SUGGESTED SOLUTIONS

Solution 1

All the figures are in thousands except where specifically stated otherwise

(a) Consolidated statement of financial position of Platinum

As at March 31, 2025

	₦
Assets	
Non-current assets:	
Property, plant and equipment (₦135,000 + ₦100,000 + ₦19,600 + ₦2,000 (W1))	256,600
Goodwill (W2)	15,760
Investment in associate (W6)	36,600
Available for sale investment	17,000
	325,960
Current assets:	
Inventories (₦45,000 + ₦32,000 – ₦2,500 (W4)	74,500
Trade receivables (₦50,000 + ₦34,000 – ₦5,000 (inter-company)	79,000
Cash and cash equivalents (₦10,000 + ₦4,000 + ₦5,000 (cash in transit)	19,000
	172,500
Total assets	498,460
Equity and liabilities	
Equity attributable to equity holders of the parent	
Share capital	120,000
Retained earnings (W4)	163,086
Other components of equity (W5)	1,050
	284,136
Non-controlling interest (W3)	36,355
Total equity	320,491

Non-current liabilities:

Long-term borrowings (₦40,000 + ₦25,000)	65,000
Deferred tax (₦20,000 + ₦8,000 + ₦600 (W1) + ₦6,480 (W7))	35,080
Total non-current liabilities	100,080
Current liabilities:	
Trade and other payables (₦30,000 + ₦22,000)	52,000
Deferred consideration (₦12,860 (W2) + ₦1,029 (W4))	13,889
Short-term borrowings (₦6,000 + ₦6,000)	12,000
Total current liabilities	77,889
Total equity and liabilities	498,460

Workings –

Working 1 – Net assets table – Jewel

	April 1, 2024	March 31, 2025
	₦	₦
Share capital	80,000	80,000
Retained earnings:		
Per accounts of Jewel	35,000	44,000
Property adjustment – see below	20,000	19,600
Plant and equipment adjustment – see below	3,000	2,000
Deferred tax on fair value adjustments	(6,900)	(6,480)
Revaluation of AFS investment (see below)	-	1,400
Net assets for the consolidation	131,100	140,520

The post-acquisition profit is ₦9,420 (₦140,520 – ₦131,100).

Of this amount, ₦1,400 is taken to other reserves, and ₦8,020 (₦9,420 – ₦1,400) to retained earnings.

Note re: post-acquisition depreciation adjustments

For the property, this is ₦400 (₦36,000 – ₦24,000) x 1/30). This makes the closing adjustment ₦19,600 (₦20,000 – ₦400).

For the plant and equipment, this is ₦1,000 (₦54,000 – ₦51,000) x 1/3). This makes the closing adjustment to be ₦2,000 (₦3,000 – ₦1,000).

Note re: revaluation of the investment

The carrying value should be ₦17,000, an increase of ₦2,000 from ₦15,000 shown in the draft accounts of Jewel. The related deferred tax is ₦600 (₦2,000 x 30%) so the net adjustment is ₦1,400 (₦2,000 – ₦600).

Working 2 – Goodwill on consolidation (Jewel)

	₦
Cost of investment:	
Cash	100,000
Deferred consideration (₦15,000 / (1·08)2)	12,860
Fair value of non-controlling interest at date of acquisition (₦20,000 x ₦1·70)	34,000
	146,860
Net assets as at April 1, 2023 (₦131,100 (W1))	(131,100)
Goodwill equals	15,760

Working 3 – Non-controlling interest in Jewel

	₦
Fair value at date of acquisition (W2)	34,000
25% of post-acquisition profits (₦9,420 (W1))	2,355
	36,355

Working 4 – Retained earnings

	₦
Platinum	163,000
Interest on deferred consideration (₦12,860 (W2) x 8%)	(1,029)
Jewel (75% x ₦8,020 (W1))	6,015
Metal (30% x (₦55,000 – ₦60,000))	(1,500)
Unrealised profits on sales to Jewel (₦10,000 x 25%)	(2,500)
Unrealised profits on sales to Metal (₦12,000 x 25% x 30%)	(900)
	163,086

Working 5 – Other components of equity

	₦
75% x ₦1,400 (W1) – the revaluation of the AFS investment	1,050

Working 6 – Investment in Metal

	₦
Cost	39,000
Share of post-acquisition losses (W4)	(1,500)
Unrealised profits (W4)	(900)
	36,600

Working 7 – Deferred tax on temporary differences

Fair value adjustments:

	April 1, 2024	March 31, 2025
	₦	₦
Land adjustment	20,000	19,600
Plant and equipment adjustment	3,000	2,000
Net taxable temporary differences	23,000	21,600
Related deferred tax (30%)	6,900	6,480

(b) The need for a conceptual framework

The financial reporting process aims to deliver information that supports sound business and economic decision-making. To achieve this, a **conceptual framework** provides the theoretical foundation for identifying which transactions should be recognised, how they should be measured, and how they should be presented to users of financial statements.

While the framework is theoretical in nature, its ultimate objectives are highly practical. It guides the development of consistent and coherent accounting standards.

In the absence of a conceptual framework, accounting standards may evolve in a disorganised, reactive manner, as seen in some countries, where rules are created to address immediate issues without a unified direction. When a framework is in place, standard setters can develop accounting principles based on a solid, agreed-upon foundation.

Without such a framework, fundamental concepts may be revisited repeatedly across different standards, leading to contradictions and inconsistencies. This undermines clarity and compromises the “true and fair view” that financial reporting strives to achieve.

Moreover, a lack of guiding principles can result in a rules-based system that is more susceptible to manipulation. For instance, if a rule mandates a specific accounting treatment, once a transaction meets a certain percentage threshold, it may incentivize unethical behavior, such as structuring transactions to meet that threshold and achieve a desired accounting outcome (for example, keeping liabilities off the statement of financial position).

Finally, a conceptual framework strengthens the independence of standard setters by providing a basis to resist political and lobbying pressures. Only proposals that align with the framework’s principles would be considered acceptable.

Can it resolve practical accounting issues?

A conceptual framework cannot offer definitive solutions to every issue faced by standard setters. However, it does provide guiding principles that help in evaluating alternatives and narrowing the range of acceptable options. The **IASB** aims to base all future **IFRSs** on the principles outlined in the Conceptual Framework, which should help reduce inconsistencies across standards.

Despite its value, the framework is unlikely to resolve all practical accounting challenges. Several factors contribute to this limitation:

(i) **Diverse user needs**: Financial statements serve a wide range of users, making it difficult to design a single framework that meets everyone's requirements.

(ii) **Varied purposes**: The diversity in user expectations may necessitate different accounting standards tailored to specific purposes, each potentially based on distinct conceptual foundations.

(iii) **Implementation complexity**: It remains uncertain whether having a conceptual framework actually simplifies the process of developing and applying accounting standards compared to working without one.

Solution 2

(a) **XYZ Consultants**

Date

The Chairman
Kappa & L'Alberto Plc.
1, Sodiya Street,
Lagos.

Re: Analysis of the Financial Performance and Cash Flows of Julius Adel Plc.

I refer to the meeting held with your good self, in respect of the above subject matter and wish to report as follows:

Introduction

The financial statements and ratios provided by the directors appear to show strong net profit growth and improved cash inflows during 2023 and 2024. Profit after tax increased by almost 35% on modest revenue growth of 3.4%. Cash inflows are strong.

Increased investment has been made in capital expenditure and gearing has reduced significantly.

Profitability

The ROCE has increased to 9.8% from 9.3%. This is significantly below the ROCE of Kappa & L'Alberto (14.7%). This may be due to the operating structure of the two businesses.

Kappa & L'Alberto has outsourced the manufacture of key components and this will probably have a favourable effect on capital employed compared to that of Julius Adel Plc., which has its own manufacturing capability and has invested heavily in capital expenditure during the current year.

Julius Adel Plc.'s profitability has benefited from the year-on-year reduction in the depreciation expense arising from the reassessment of the useful lives and residual values of certain assets. Without this change, the profit from operations would have reduced by ₦90,000 (₦3,200,000 - ₦2,970,000 - ₦320,000) and the ROCE would have probably reduced (the effect on capital employed of the change is far less significant than that on PBIT).

The change in depreciation expense involves the exercise of judgement by management. A skeptical interpretation may be that it represents an easy way to increase profitability.

However, IAS 8 and IAS 16, provide guidance on the annual reviews required and their subsequent treatment and disclosures. The disclosures quantify the effect on the financial statements and improve comparability.

Revenue has increased by 3.4% year on year. Julius Adel Plc. has initiated an aggressive pricing policy. This would indicate that sales volume growth would be greater than the growth in sales revenue. In addition, sales mix between products will also affect the year-on-year analysis.

The growth in the revenue of Kappa & L'Alberto Plc. is only 0.3% and this may have been adversely affected by Julius Adel Plc.'s policy for increasing sales volumes.

Revenue per employee has increased by 7% (from ₦22,306 to ₦23,863). The average number of employees reduced by 3.3%. There appears to have been an improvement in efficiency which may be attributable to the significant capital expenditure in 2024. The full benefits from this expenditure may not have been fully realised and the performance in 2025 may further benefit from the expenditure.

The revenue per employee of Kappa & L'Alberto is greater than that of Julius Adel. This reflects the fact that Julius Adel Plc. manufactures its own product, whereas Kappa & L'Alberto outsources production.

The gross profit margin declined from 20.9% to 20.1%. This reduction may have been influenced by the pricing policy, which appears to have had an adverse impact on the current year's performance. Offsetting this, however, are potential efficiencies introduced by the new management team through capital expenditure initiatives. It is important to note that changes in depreciation expense would not have affected the gross margin, as depreciation is classified under operating expenses.

Operating expenses have decreased by 10%, now accounting for 8.6% of revenue (2023: 9.9%). However, if depreciation expenses had been calculated consistently year-on-year, operating expenses would have shown a 2% increase. On an adjusted basis, operating expenses as a percentage of revenue have remained relatively stable compared to the previous year (9.8% vs. 9.9%).

Operating profits increased by 7.7%; however, as previously noted, this growth is entirely attributable to changes in depreciation expense. Excluding this impact, the operating margin declined from

11.0% to 10.3%, indicating a reduction in underlying operating profitability. The primary driver of this decline is the reduction in gross margin. Operating margins also remain below those of competitors, such as Kappa and L'Alberto.

Interest cover improved from 3.1 times to 3.8 times, supported by strong cash flows that enabled partial repayment of borrowings, thereby reducing finance costs. While the ratio benefits from the lower depreciation expense, it remains at a comfortable level.

The effective tax rate fell from 32.5% to 22.6%, positively impacting post-tax profits. This change warrants further explanation: had the effective rate remained unchanged, the tax charge would have been approximately ₦230,000 higher.

The overall increase in net profit of ₦470,000 appears commendable. However, this improvement is largely driven by two key factors: the reduction in depreciation expense (₦320,000) and the decrease in the effective tax rate (₦230,000). This suggests that the underlying operational performance has not materially improved.

Profit per employee rose from ₦2,455 to ₦2,735, partly due to a reduction in headcount. However, the change in depreciation policy had a more significant impact on this metric.

EBITDA has shown a substantial increase, as it excludes depreciation, including the additional depreciation arising from recent capital expenditure. The EBITDA-to-revenue ratio stands at 26.5%, which is broadly in line with peers, such as Kappa and L'Alberto (27%). Julius Adel Plc. may be incurring higher depreciation charges due to its more capital-intensive operations.

Cash flow

Net gearing has significantly decreased from 41.2% to 33.2%, primarily driven by strong operating cash flows. These cash flows enabled a reduction in net debt of ₦1.2 million (₦700,000 + ₦500,000), despite substantial investment in tangible non-current assets, an amount 50% higher than the related depreciation expense. Importantly, cash flows are objective and do not require adjustment for comparability due to changes in depreciation accounting estimates.

Operating cash flows have increased markedly, with a notable contribution from reductions in working capital. This reversal of the prior year's negative trend improved cash flows by nearly ₦1.7 million. However, sustaining similar benefits in future periods may prove challenging.

Inventory turnover has improved significantly, potentially reflecting increased sales volumes driven by more competitive pricing strategies.

The trade receivables collection period has shortened but remains above 90 days. This suggests further opportunities to release working capital and enhance cash flows through improved credit control measures.

Improvements have also been made to the trade payables payment period. However, further progress may be constrained without risking supplier relationships.

The ratio of cash from operations to operating profit has increased to 2.8 times, exceeding both last year's figure and the comparable ratio for Kappa & L'Alberto Plc. While this improvement may include one-off benefits from working capital management, it reflects the new management team's focus on enhancing operating cash flow.

These cash flow improvements have also contributed to a stronger cash return on capital employed, which rose from 17.6% to 28.0%, outperforming Kappa & L'Alberto Plc. (22.4%). Notably, cash return on capital employed exceeds ROCE, as it excludes capital expenditure, whereas ROCE includes depreciation.

Capital expenditure increased significantly to ₦6.5 million, up from ₦3 million in the previous year. This substantial investment likely reflects management's efforts to modernise manufacturing processes and reduce production costs. The full benefits of this investment may not yet be reflected in current performance.

No dividends have been declared in either year, which may indicate a strategic decision to retain earnings for reinvestment in property, plant and equipment, in line with the company's capital-intensive growth strategy.

Conclusion

The new management team at Julius Adel Plc. has successfully stabilised the business with a clear focus on turnaround efforts. Their strategy appears to prioritise short-term cash generation, evidenced by tight working capital management and the redeployment of cash into capital investment. These actions have contributed to a reduction in gearing and enhanced overall financial stability.

While the depreciation expense has been reduced, this does not appear to be an attempt to obscure poor performance. Rather, it reflects a deliberate accounting adjustment aligned with broader operational improvements.

Further matters for investigation

- Conduct a comparative analysis of depreciation methods used by Julius Adel Plc. against those employed by Kappa & L'Alberto Plc. and other companies within the engineering sector.
- Compare working capital and liquidity ratios with those of Kappa & L'Alberto Plc. and relevant industry peers to assess operational efficiency.
- Provide detailed insights into the decline in the effective tax rate, clarifying whether the reduction is due to one-off events or indicative of a sustainable long-term rate.
- Break down the pricing policy to distinguish the contribution of volume growth versus price changes in revenue performance.
- Include a statement of financial position analysis to evaluate the efficiency and utilisation of non-current assets.
- Detail capital expenditure allocations, distinguishing between investments in new production facilities and technology upgrades.
- Review the financial statements for changes in key management judgments, identifying any shifts in accounting estimates or assumptions that may have impacted reported performance.

I have commented on areas deemed necessary, nevertheless, kindly get in touch with the undersigned, if there is any aspect of this report that requires further explanation.

Yours faithfully,

For: XYZ Consultants

A. James

Managing Partner

Appendix 1

Examples of relevant additional ratios

	2024	**2023**
Gross profit %	20.1%	20.9%
Operating cost %	8.6%	9.9%
Interest cover	3.8 times	3.1 times
Operating cost % (exc. change in depn)	9.8%	9.9%
Operating margin (exc. change in depn)	10.3%	11.0%
Revenue per employee	₦23,863	₦22,306
Operating profit per employee	₦2,735	₦2,455
EBITDA/Revenue	26.5%	25.6%
Cash from ops to profit from ops	2.8 times	1.9 times
Cash interest cover	9.6 times	4.5 times
Effective rate of taxation	22.6%	32.5%

(b) The usefulness of EBITDA (earnings before interest, taxation, depreciation and amortisation) when analysing the performance and cash flows of Julius Adel Plc.

EBITDA is often considered as a good indicator of profit from operations (underlying performance). It is independent of the capital structure of the entity and is unaffected by the accounting policies for non-current assets. When considering EBITDA for Julius Adel Plc., it is not affected by the changes in the estimates for the useful lives and the residual values of certain assets. In this respect, it is useful in assessing the performance of Julius Adel Plc. It should be remembered that in the long-term, earnings must cover interest, tax, depreciation and amortisation. However, in the short-term, it is a useful performance measure.

EBITDA is commonly used as a proxy for cash generated from operations. However, it does not account for changes in working capital. In the case of Julius Adel Plc., its usefulness as an approximation for cash flow is limited, given the significant fluctuations in working capital, both adverse and favorable, during 2023 and 2024.

Solution 3

(a) **Advice to be given to the accountant on the appropriateness of the accounting treatment for the sale of intangibles**

IFRS 15 - *Revenue from Contracts with Customers,* defines revenue as income arising from an entity's ordinary activities. The ordinary activities of Ikoyi Nigeria Limited do not include the sale of development projects, and notably, no such sales have occurred since 2017. Instead, the company's business model appears to focus on developing products for its customers, who subsequently assume responsibility for production, marketing, and sales. Accordingly, stage payments and royalties represent income derived from the company's core operations and should be recognised as revenue.

Based on this, Ikoyi Nigeria Limited, is incorrect in recognising the gain from the sale of a development project as revenue. In fact, IAS 38 - *Intangible Assets,* explicitly prohibits the classification of a gain on derecognition of an intangible asset as revenue.

IAS 38, defines an intangible asset as an identifiable non-monetary asset without physical substance. Assets held for sale in the ordinary course of business fall outside the scope of IAS 38 and are instead accounted for under IAS 2 - *Inventories*. The initial classification of the development project as an intangible asset further supports the view that it was not intended for sale in the ordinary course of business.

If the development project was incorrectly classified in prior year financial statements, IAS 8 - *Accounting Policies, Changes in Accounting Estimates and Errors,* requires that the error be corrected retrospectively. However, given the infrequency of such sales, it is unlikely that the asset was misclassified.

(b) (i) Contract

According to IFRS 16 – Leases, a contract is considered to contain a lease if it conveys the right to control the use of an identified asset for a specified period in exchange for consideration. To determine whether a contract grants control over the asset, the customer must evaluate whether they:

- have the right to obtain substantially all of the economic benefits from the use of the identified asset during the lease term; and
- have the right to direct the use of the asset, including decisions regarding how and for what purpose the asset is used.

Ikoyi Nigeria Limited has the right to use a specified aircraft for a three-year period in exchange for annual payments. Although Lekki Nigeria Limited retains the contractual right to substitute the aircraft, doing so would be economically impractical due to the strict specifications outlined in the agreement.

Ikoyi Nigeria Limited appears to have control over the aircraft during the lease term, as no other parties are permitted to use it, and Ikoyi makes key operational decisions—such as determining destinations, cargo, and passenger arrangements. While there are legal and contractual restrictions on the aircraft's use, these are protective rights that define the scope of use but do not negate Ikoyi's right to direct its use.

Based on these factors, the contract meets the definition of a lease under IFRS 16. Although IFRS 16, provides exemptions for leases of less than 12 months or for low-value assets, this contract does not qualify for either exemption as it spans three years and involves a high-value asset. Therefore, a lease liability should have been recognised at the inception of the contract, measured at the present value of future lease payments, using the discount rate implicit in the lease. A finance cost should accrue over the lease term, charged to profit or loss and added to the lease liability. The year-end lease payment should be deducted from the liability and excluded from profit or loss.

A corresponding right-of-use asset should also have been recognized at inception, initially measured at the same amount as the lease liability, plus any initial direct costs incurred by Ikoyi Nigeria Limited. This asset should be depreciated over the three-year lease term, with one year's depreciation expense recognized in profit or loss.

(ii) Materiality

The financial statements of Ikoyi Nigeria Limited should help investors, lenders and other creditors to make economic decisions about providing it with resources. An item is material if its omission or misstatement might influence the economic decisions of the users of the financial statements.

Materiality is not a purely quantitative consideration; an item can be material if it triggers non-compliance with laws and regulations, or bank covenants.

Ikoyi Nigeria Limited should consider materiality throughout the process of preparing its financial statements to ensure that relevant information is not omitted, misstated or obscured.

Property, plant and equipment (PPE)

IAS 16 - *Property, Plant and Equipment,* states that expenditure on PPE should be recognised as an asset and initially measured at the cost of purchase. Writing off such expenditure to profit or loss is, therefore, not in accordance with IAS 16.

According to IAS 8 - *Accounting Policies, Changes in Accounting Estimates and Errors*, financial statements do not comply with International Financial Reporting Standards if they contain material errors, or errors made intentionally in order to present the entity's financial performance and position in a particular way. However, assuming that the aggregate impact of writing off small PPE purchases to profit or loss is not material, then the financial statements would still comply with International Financial Reporting Standards. Furthermore, this decision appears to represent a practical expedient aimed at reducing the time and cost associated with preparing financial statements, rather than a deliberate choice intended to achieve a specific financial statement presentation. If implemented, this policy must be regularly reassessed to ensure that PPE and the statement of profit or loss are not materially misstated.

Disclosure notes

IAS 1 - *Presentation of Financial Statements,* states that application of IFRSs in an entity's financial statements will result in a fair presentation. As such, the use of a checklist may help to ensure that all disclosure requirements within IFRSs are fulfilled. However, IAS 1 and IFRS Practice Statement 2 *Making Materiality Judgements,* both specify that the disclosures required by IFRSs are only required if the information presented is material.

The aim of disclosure notes is to further explain items included in the primary financial statements as well as unrecognised items (such as contingent liabilities) and other events which might influence the decisions of financial statement users (such as events after the reporting period). As such, Ikoyi Nigeria Limited should exercise judgement about the disclosures which it prepares, taking into account the information needs of its specific stakeholders. This is because the disclosure of immaterial information clutters the financial statements and makes relevant information harder to find. Ikoyi Nigeria Limited may also need to disclose information in addition to that specified in IFRS if relevant to helping users understand its financial statements.

Solution 4

(a) (i) The arguments for and against issuing IFRS Practice Statement 1 *Management Commentary* as a non-binding framework or as an IFRS

The IFRS Practice Statement *Management Commentary,* provides a broad, non-binding framework for the preparation and presentation of management commentary. As the Practice Statement is not an IFRS standard, entities applying IFRSs are not required to comply with it unless mandated by their jurisdiction. Non-compliance with the Practice Statement does not affect an entity's compliance with IFRSs.

While the International Accounting Standards Board (IASB) aims to enhance consistency and comparability in financial reporting, these objectives may be undermined by the non-mandatory nature of the Practice Statement. A formal standard would be more likely to ensure consistent application of the principles and practices underlying management commentary (MC).

However, developing a comprehensive standard that accommodates the diverse business models of entities and aligns with all IFRSs presents significant challenges. In some jurisdictions, non-binding guidance receives limited attention, yet the Practice Statement offers regulators a foundation for establishing more authoritative requirements.

The flexibility offered by the Practice Statement enables companies to tailor their disclosures to reflect the unique characteristics of their business. This approach fosters more meaningful insights into the resources, risks, and relationships that influence an entity's value and how these are managed. Additionally, it allows management to provide context to the financial statements and communicate future strategies and objectives, free from the constraints of a rigid, prescriptive standard.

If management commentary were governed by a full IFRS standard, integrating it with IFRS-compliant financial information could raise technical and practical concerns. Additionally, such integration might face resistance from local regulators in certain jurisdictions.

(ii) How the qualitative characteristics of understandability, relevance and comparability should be applied to the preparation of the management commentary

The Conceptual Framework for Financial Reporting states that an essential quality of the information provided in financial statements is that it is readily understandable by users. Accordingly, management commentary (MC) should be written in plain language and presented in a style appropriate to the needs of its primary users, those identified in the Conceptual Framework. The form and content of MC will naturally vary across entities, reflecting differences in business models, strategic priorities, and regulatory environments. Users should be able to easily locate information relevant to their decision-making needs.

Information is considered relevant when it has the capacity to influence users' economic decisions by helping them evaluate past, present, or future events, or by confirming or correcting prior evaluations. Relevant financial information must possess predictive value, confirmatory value, or both. It is the responsibility of management to determine which information is material and should be included in the MC to support users' understanding of the financial statements and fulfill the objectives of the commentary. Excessive disclosure may reduce both relevance and understandability, while omission of material events or uncertainties may leave users with insufficient insight.

Excessive detail can obscure key messages, particularly when entities adopt a boilerplate approach. For instance, listing all potential risks without prioritisation may undermine the objective of relevance. While there is no prescribed number of disclosures, it is essential to communicate their relative significance in a clear and meaningful manner.

Comparability is another key qualitative characteristic, enabling users to identify and understand similarities and differences across entities and over time. However, comparability between entities can be challenging, as MC is intended to reflect management's perspective and the unique circumstances of each entity. Even within the same industry, companies may differ in what they consider important and how they measure and report it. Although there are precedents for defining and calculating non-IFRS financial and non-financial measures, inconsistencies remain.

Some suggest that the overall effectiveness of financial reporting could be enhanced by strengthening the link between the financial statements and the MC. However, this raises concerns about maintaining a clear distinction between IFRS-compliant financial information and other narrative disclosures.

To improve user understanding, entities should ensure consistency in terminology, definitions, and segment disclosures between the financial statements and the MC.

(b) The potential impact which this choice in accounting policy will have on investors' analysis of the financial statements of Palm Nigeria Limited

Investment properties

In accordance with IAS 40 - Investment Property, buildings should initially be measured at cost.
Under the cost model, investment properties are carried at cost less accumulated depreciation and any impairment losses.

Under the fair value model, investment properties are remeasured to fair value at each reporting date. Gains or losses arising from changes in fair value are recognised in the statement of profit or loss, and no depreciation is charged.

Statement of financial position

Assuming property prices are rising, applying the fair value model under IAS 40 will result in an increase in reported assets on the statement of financial position. In contrast, investment property measured, using the cost model is subject to depreciation, which gradually reduces its carrying amount. As a result, the fair value model may present Palm Nigeria Limited as more asset-rich. This could be viewed positively by stakeholders who value a strong asset base, particularly when assets are used as collateral for securing finance. However, reporting higher asset values can also have drawbacks, for instance, asset turnover ratios may deteriorate, potentially making Palm Nigeria Limited appear less efficient in utilising its assets.

An increase in assets also leads to a corresponding increase in equity. Consequently, the fair value model may result in a more favorable gearing ratio, which could reduce the perceived financial risk and encourage further investment.

Statement of profit or loss

In periods of rising property prices, the fair value model under IAS 40, results in gains being recognised in the statement of profit or loss, thereby increasing reported profits for the period. In contrast, the cost model requires depreciation, which reduces profits. As a result, earnings per share (EPS), a key metric for investors and market analysts, is likely to be higher under the fair value model.

However, fair values can be volatile. In some years, gains may be substantial, while in others, declining property prices may lead to losses. This introduces greater variability in reported profits, which may heighten stakeholders' perception of risk. By comparison, the depreciation expense under the cost model is more predictable, allowing investors to better forecast the future performance of Palm Nigeria Limited.

To provide clearer insight into underlying performance, many entities now present alternative performance measures (APMs), such as EBITDA (earnings before interest, tax, depreciation, and amortisation). Others report 'underlying profit' figures that exclude non-operating or non-recurring items, such as fair value remeasurements of investment properties. While the use of APMs has faced criticism, Palm Nigeria Limited, may find them useful in helping investors assess core business performance from management's perspective and in mitigating the impact of accounting policy choices.

Statement of cash flows

Accounting policy choices do not affect the operating, investing, or financing cash flows reported in the statement of cash flows

Disclosure

Entities applying the cost model for investment properties under IAS 40, are required to disclose the fair value of those properties. These disclosures enhance comparability between entities that use different measurement models, allowing stakeholders to better assess and benchmark financial performance and position across the industry.

Solution 5

(a) The concept of ‘substance over form’ and explain why applying the principles of IFRS 16 is a good example of the concept being applied

Substance over form is a concept that is deemed essential in order that financial statements can be considered to be a faithful representation of reality. It is mentioned in the conceptual framework as part of the qualitative characteristics of financial information, particularly “faithful representation”.
“Form” means the legal construct of a transaction. It can be defined by contract, verbal or written, or simply implied by the actions of the parties to the transaction.
“Substance” refers to the commercial effect of a transaction.

In most cases, the form and substance are exactly the same, and in these cases no issue arises. However, sometimes the commercial reality of a transaction differs from its legal form. This can be due to many factors.
Examples include tax avoidance, limitation of liability, protection of legitimate interests, and indeed intentional misrepresentation of reality.

In these cases where substance and form differ, we are required to account for transactions in accordance with their substance.
One excellent example of a transaction where the substance differs from the form is a lease where substantially all the economic benefits deriving from an asset are transferred from the lessor to the lessee.

The legal form of any lease is that of a rental agreement. The lessor grants the lessee the right to use the asset for a specified period of time in return for a payment. The ownership of the asset remains with the lessor throughout.

For some leases, the commercial substance is different. The terms of some leases are such that the lessee is effectively paying for the entire economic benefit associated with the leased asset, and it is understood that the residual value remaining at the expiry of the lease will be negligible, or will transfer to the lessee for a nominal payment. In this case, the commercial substance of the transaction is more like a purchase with a finance agreement than a lease.

In the above scenario, IFRS 16 requires that the transaction be accounted for as a purchase, and the present value of the lease payments be accounted for as a loan. This is despite the legal fact that ownership title will not transfer to the lessee until all agreed payments have been made. The effect is that the risks and rewards are "in substance" associated with the asset accrue to the lessee. Hence the asset should be accounted for as such.

(b) Appropriate calculations and the accounting entries required to record the transactions for the year ended March 31, 2020

Since the present value of the minimum lease payments equals the fair value of the leased asset, it can be concluded that all risks and rewards associated with the asset are transferred to the lessee from the inception of the lease.

Accordingly, the asset should be capitalised in the books of Mass Followers Limited as of April 1, 2019, and depreciated over a period of five years, starting from that date. The corresponding lease obligation should be recognised as a liability on the same date and amortised, using the effective interest rate of 9.2%.

Journal entries are as follows:

	Debit	**Credit**
	₦'million	**₦'million**
April 1, 2019		
Property, plant and equipment	80	
Lease obligation		80
(Acquisition of plant under lease)		
Lease obligation	30	
Cash		30
(Payment of deposit required under the lease)		
March 31, 2020		
Profit or loss (80 / 5 years)	16	
Cr Accumulated depreciation PPE		16
(Depreciation of leased asset)		

Tutorial note:

IFRS 16, requires that a leased asset be depreciated over the shorter of the lease term or the useful economic life of the asset unless it is virtually certain that the option to purchase will be exercised at the end of the lease term. If so, the useful economic life of the asset should be used. It appears to be virtually certain in this case that the option to purchase will be exercised.

March 31, 2020		
Profit or loss (50 x 9.2%)	4.6	
Lease obligation		4.6
(Finance cost on remaining lease obligation)		
March 31, 2020		
Lease obligation	15.5	
Cash		15.5

Tutorial note:

The closing lease obligation is ₦80 – ₦30 + ₦4.6 - ₦15.5 = ₦39.1 million

This is recorded as a liability at March 31, 2020.

In order for the liability to be recorded correctly, it must be split into current and non-current. The current liability is the amount of the ₦39.1 million that will be repaid within 12 months. This is equal to ₦15.5 million, due in 12 months less the finance cost for the next 12 months (₦39.1 x 9.2% = ₦3.6 million), hence, the current liability will be ₦11.9 million.

c) Extracts from the statement of profit or loss and other comprehensive income for the year ended March 31, 2020, and the statement of financial position as at that date

Mass Followers Limited

Statement of profit or loss

For the year ended March 31, 2020 (Extract)

	₦'million
Depreciation of leased asset	16
Finance cost	4.6

Statement of financial position
As at March 31, 2020 (Extract)

	₦'million
Non-current assets:	
Property, plant and equipment (₦80 – ₦16)	64
Non-current liabilities:	
Lease obligation (₦39.1 – ₦11.9)	27.2
Current liabilities:	
Lease obligation	11.9

Solution 6

(a) Accounting treatment required by IFRS 9 for recognition and measurement of financial assets, such as bonds, paying particular attention to the tests required to decide between alternative treatments

Classification of financial assets

There are three sub-classifications that are used for financial assets. These are:

(i) amortised cost;

(ii) fair value through profit or loss; or

(iii) fair value through other comprehensive income.

Amortised cost is used for an asset, if **both** the following two tests are satisfied:

- Cash flow test - The contractual cash flows are solely payments of principal and interest on the principal amount outstanding; and
- Business model test - The asset is being held with the intention of drawing the contractually agreed cash flows for its life.

If **both** tests are met, then the amortised cost classification is required, otherwise, if **either** one fails, fair value should be used. This normally applies to debt instruments expected to be held to maturity.

Fair value through other comprehensive income (FVOCI) is applied to a debt asset when both of the following conditions are met:

- Cash flow test: The contractual cash flows consist solely of payments of principal and interest on the principal amount outstanding; and
- Business model test: The asset is held within a business model that aims to both collect contractual cash flows and sell financial assets.

Fair value through profit or loss is used for all other debt instruments

Subsequent measurement of financial assets

Financial assets are remeasured at each reporting date in accordance with the classification method adopted.

Amortised cost:

- If classified as "amortised cost", the effective interest rate method is applied in arriving at an updated valuation at each reporting date. Amortised cost is the amount at which a financial asset or liability is measured at initial recognition, plus or minus the cumulative amortisation (using the effective interest rate) of any difference between the initially recognised amount and the maturity amount, allowing for any payments in the intervening period.
- The effective interest rate is that rate that exactly discounts the estimated future cash payments or receipts for the life of the instrument to the net carrying value of the instrument.

Fair value:

If classified as "fair value", the asset or liability is revalued to fair value at each reporting date. Gains and losses are normally taken to profit or loss but there are important exceptions:

(i) an irrevocable election was made (in the case of an equity investment not held for trading) to take fair value gains and losses to OCI; and

(ii) the asset is a debt instrument required to be carried at fair value through other comprehensive income due to the business model adopted.

Fair value not capable of reliable measurement:

If the fair value of a financial asset is not capable of reliable measurement (rare), the asset or liability should be measured at cost.

(b) The accounting treatment required by IFRS 9 for the year ended July 31, 2019, in the case of each of the bonds

Atlas

As the bond was purchased with a view to holding it for the long term, the business model test is met. As the bond's cash flows consist solely of interest and principal payments, the cash flow test is met, hence, this bond should be accounted, for using the amortised cost method.

The bond is recorded at its cost, plus any costs to purchase (not relevant here).

		₦'million	**₦'million**
Dr	Financial assets	38.5	
Cr	Cash		38.5

Subsequently, the effective yield to maturity should be used to amortise the bond over the year. This is applied to the opening balance to determine the finance cost (6.75% x ₦38.5 million = ₦2.59875 million or ₦2.6 million)

		₦'million	**₦'million**
Dr	Financial assets	2.6	
Cr	Profit or loss (finance income)		2.6

Finally, the interest payment was paid on July 31, 2019, as promised. This should be 4% of the par value of ₦45 million, or ₦1.8 million. This is treated as a reduction to the financial asset.

		₦'million	**₦'million**
Dr	Cash	1.8	
Cr	Financial assets		1.8

Radar

As this bond was purchased with a view to sell it on, the business model test fails, hence, amortised cost cannot be used to measure the bond. It must be remeasured to fair value at the reporting date.

The bond is recorded at cost, but any costs of purchase would be expensed in this scenario.

		₦'million	**₦'million**
Dr	Financial asset	28	

Cr	Cash		28

On July 31, 2019, the scheduled interest is paid, at 5% of par value ₦30 million, or ₦1.5 million. This is taken to finance income.

		₦'million	**₦'million**
Dr	Cash	1.5	
Cr	Finance income		1.5

Finally, at the reporting date, the bond is remeasured to fair value, ₦27.5 million. This shows a loss of ₦0.5 million which should be taken to profit or loss.

		₦'million	**₦'million**
Dr	Profit or loss (finance costs)	0.5	
Cr	Financial assets		0.5

Solution 7

The ethical and accounting implications of the given scenarios from the perspective of the accountant

Provision

IAS 37 - *Provisions, Contingent Liabilities and Contingent Assets,* states that a provision should only be recognised if:

(a) there is a present obligation from a past event;

(b) an outflow of economic resources is probable; and

(c) the obligation can be measured reliably.

No provision should be recognised because Adelowo Plc. does not have an obligation to incur the training costs. The expenditure could be avoided by changing the nature of the company's operations, and so, it has no present obligation for the future expenditure.

The provision should be derecognised. This will reduce liabilities by ₦2 million and increase profits by the same amount.

Contract

Under IFRS 9 – Financial Instruments, contracts to buy or sell non-financial items that are settled net in cash are generally accounted for as derivatives. However, an exemption applies to contracts entered into for an entity's own use, that is, where the non-financial asset is intended for physical delivery and use in the entity's operations.

In this case, the contract qualifies for the own use exemption, as the company consistently takes delivery of the wheat. Therefore, the contract falls outside the scope of IFRS 9, and recognising a derivative is inappropriate.

The contract is an executory contract, which is not recognised in the financial statements unless it is deemed onerous, in which case, a provision would be required. This particular contract is unlikely to be onerous, given the potential for wheat prices to rise and the expectation that the finished goods incorporating the wheat will be sold at a profit. As such, no provision is necessary, and the contract will remain unrecognised until delivery occurs.

Consequently, the derivative liability should be derecognised, resulting in an increase in reported profits of ₦0.5 million.

Ethical implications

Users of Adelowo Plc's financial statements, such as banks and shareholders, place trust in accountants and rely on them to faithfully represent the effects of the company's transactions. IAS 1 - *Presentation of Financial Statements,* clearly states that faithful representation is achieved when accounting standards are correctly applied.

In this case, both errors made by Adelowo Plc. result in overstated liabilities and understated profits. While these may be unintentional, there are clear incentives to deviate from IFRS and IAS requirements most notably, the company's bonus scheme. Having exceeded the bonus target for 2024, the Finance Director may be attempting to defer 'excess' profits to 2025 to improve the likelihood of meeting next year's target. This creates a self-interest threat to objectivity and may constitute a breach of ICAN's Code of Ethics and Conduct.

The accountant is right to challenge the Finance Director and has an ethical obligation to do so. Despite the Finance Director's intimidating behaviour, the accountant should calmly explain the technical issues and advocate for compliance with accounting standards. If the director refuses to cooperate, the matter should be escalated to other directors and professional advice sought from ICAN. Legal counsel may also be appropriate depending on the severity of the issue. The accountant should maintain detailed records of all conversations and actions taken. If the matter cannot be resolved satisfactorily, resignation should be considered as a last resort.