

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

Apapa Plc. has owned 85% of the ordinary share capital of Wharf Plc. for some years. The shares were bought for ₦255m and Wharf Plc.'s reserves account at the time of purchase was ₦20m.

On February 28, 20X3, Apapa Plc. sold 40m of the shares of Wharf Plc. for ₦160m. The only entry made in respect of this transaction has been the receipt of the cash, which was credited to the 'investment in subsidiary' account. No dividends were paid by either entity in the period.

You are provided the following information:

Statements of profit or loss and other comprehensive income

For the year ended May 31, 20X3

	<i>Apapa Plc.</i>	<i>Wharf Plc.</i>
	<b>₦'m</b>	<b>₦'m</b>
<i>Profit before tax</i>	130	60
<i>Income tax expense</i>	<u>(40)</u>	<u>(20)</u>
<i>Profit for the year</i>	90	40
<i>Other comprehensive income, net of tax</i>	<u>20</u>	<u>10</u>
<i>Total comprehensive income for the year</i>	<u>110</u>	<u>50</u>

## Statements of financial position

As at May 31, 20x3

	N'm	N'm
<b>Non-current assets:</b>		
Property, plant and equipment	535	178
Investment in Wharf Plc.	<u>95</u>	<u>=</u>
	<u>630</u>	<u>178</u>
<b>Current assets:</b>		
Inventories	320	190
Trade receivables	250	175
Cash	<u>80</u>	<u>89</u>
	<u>650</u>	<u>454</u>
	<u>1,280</u>	<u>632</u>
<i>Equity</i>		
Share capital (N1.00 per ordinary share)	500	200
Reserves	<u>310</u>	<u>170</u>
	<u>810</u>	<u>370</u>
<b>Current liabilities:</b>		
Trade payables	295	171
Income tax payable	80	60
Provisions	<u>95</u>	<u>31</u>
	<u>470</u>	<u>262</u>
	<u>1,280</u>	<u>632</u>

No impairment losses have been necessary in the group financial statements to date.

Assume that the gain as calculated in the parent's separate financial statements will be subject to corporate income tax at a rate of 30% and that profit and other comprehensive income accrue evenly throughout the year.

Apapa Plc., elected to measure the non-controlling interests in Wharf Plc. at fair value at the date of acquisition. The fair value of the non-controlling interests in Wharf Plc. was ~~N45~~m at the date of acquisition. No control premium was paid on acquisition.

**Required:**

Prepare:

a) (i) The statement of profit or loss and other comprehensive income and a statement of changes in equity

(total) of Apapa Plc. for the year ended May 31, 20X3. (5

Marks)

(ii) The consolidated statement of profit or loss and other comprehensive income of Apapa Plc.

for the same period. (6

Marks)

(iii) A consolidated statement of financial position as at May 31, 20X3. (8

Marks)

(iv) A consolidated statement of changes in equity (total) for the year ended May 31, 20X3. (2

Marks)

b) The following information relates to the pension scheme of Patience Pass All Limited for the year ended April 30, 2016:

	N'000
Plans assets as at May 1, 2015	96,000
Defined benefit obligation as at May 1, 2105	100,000
Service cost for the year ended as at April 30, 2016	8,000
Discount rate as at May 1, 2015	10%
Re-measurement loss in the year ended April 30, 2016	4,000
Past service cost May 1, 2015	6,000

Pension costs have not been included in the total comprehensive income, as the company's accountant is not yet qualified and lacks sufficient knowledge of the requirements under IAS 19 – Employee Benefits.

**Required:**

Demonstrate how the above transaction would be accounted for under the provisions of *IAS 19 - Employee Benefits*, including relevant extracts to the financial statements for the year ended April 30, 2016. (5

Marks)

- c) Related party relationships are a common aspect of commercial activity. The objective of IAS 24 – Related Party Disclosures, is to ensure that financial statements include the necessary disclosures to inform users of the potential impact of related party relationships on the financial results.

**Required:**

Explain **Two** (2) importance of disclosing related party relationships and transactions in financial statements. (4

Marks)

(Total 30  
Marks)

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

**QUESTION 2**

- a) After reviewing its published financial statements, the directors of Okpara Ltd., a coal mining company based in Enugu State, concluded that the statements contain limited environmental information and do not adequately address the diverse needs of users.

Although recognising and measuring the financial impact of environmental issues presents challenges, Okpara Ltd. includes the following environmental disclosures in its financial statements:

- the release of minerals and naturally occurring impurities, including heavy metals;
- the loss of natural fishing and recreational areas; and
- soil erosion, sedimentation, noise, and dust.

**Required:**

- i) Explain factors which motivate companies to disclose social and environmental information in their financial statements. (4 Marks)
- ii) Identify **Four** (4) specific difficulties in recognising and measuring the financial effects of environmental matters. (6 Marks)

- b)** "Integrated reporting is based on the idea that sustainability and financial reporting are fundamentally interconnected, and that combining them can provide greater value."  
 — *Bob Massie, Co-founder of the Global Reporting Initiative*

**Required:**

Explain how integrated reporting merges sustainability reporting and financial reporting. (10 Marks)

**(Total 20 Marks)**

**QUESTION 3**

Banana Ltd. (BL) is an established company in the printing industry. Its main activity is artwork and printing of letterheads and brochures. Its revenue is mainly from repeat business from its existing customers. Revenue has declined in recent years as many former customers are now able to design and print their own letterheads and use websites rather than brochures to promote their products.

The company uses old printing machinery and production is labour intensive although relatively unskilled. It has owned the same city-centre premises for the past 40 years.

Island Ltd. used to be a similar business to Banana Limited. However, a few years ago it appointed Mary Brown as the new managing director and she developed a new business strategy. The company moved away from traditional printing and expanded into designing logos and web page design, which were established as two separate divisions. It also invested heavily in computer equipment and bespoke software and employed skilled staff. The company moved from its city-centre premises to cheap rented accommodation in a rural location.

The draft financial statements of Banana and Island for the year ended August 31, 20X6 are set out below.

**Statements of profit or loss**  
**For the year ended August 31, 20X6**

	<b>Banana Ltd (BL)</b>	<b>Island Ltd (IL)</b>
	<b>₦'000</b>	<b>₦'000</b>
Revenue	9,200	8,700
Cost of sales		
Materials	(1,830)	(440)
Labour	(2,280)	(3,900)
Overheads	<u>(2,100)</u>	<u>(2,200)</u>
Gross profit	2,990	2,160
Distribution costs	(460)	(140)
Advertising costs	(70)	(180)
Administrative expenses	<u>(350)</u>	<u>(370)</u>
Profit from operations	2,110	1,470
Finance costs	<u>(90)</u>	<u>(260)</u>
Profit before tax	2,020	1,210
Tax	<u>(670)</u>	<u>(310)</u>
Profit for the year	<u><u>1,350</u></u>	<u><u>900</u></u>

**Statements of financial position**  
**At August 31, 20X6**

<b>Banana Ltd (BL)</b>	<b>Island Ltd (IL)</b>
<b>₦'000</b>	<b>₦'000</b>

**Assets:**

## Non-current assets

Property, plant and equipment	<u>8,160</u>	<u>6,540</u>
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**Current assets:**

Inventories	650	60
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Trade and other receivables	950	730
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Cash and cash equivalents	<u>20</u>	<u>10</u>
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	<u>1,620</u>	<u>800</u>
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Total assets	<u>9,780</u>	<u>7,340</u>
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**Equity and liabilities:**

Issued capital - ₦1.00 ordinary shares	4,530	4,300
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Retained earnings	<u>2,960</u>	<u>100</u>
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Equity	<u>7,490</u>	<u>4,400</u>
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## Non-current liabilities

Borrowings	1,000	2,600
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**Current liabilities:**

Trade payables	550	20
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Other payables	<u>740</u>	<u>320</u>
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	<u>1,290</u>	<u>340</u>
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Total equity and liabilities	<u>9,780</u>	<u>7,340</u>
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**Additional information:**

	<b>Banana Ltd (BL)</b>	<b>Island Ltd (IL)</b>
Gross profit percentage	33%	25%
Operating margin percentage	23%	17%
Earnings before interest, tax, depreciation, Amortization	₦2,610,000	₦2,880,000
Trade payables payment period - days	45	28
Average number of employees	270	161

**Required:**

- a) Compare and contrast the performance and financial position of Banana and Island.

Your analysis should take into consideration the markets in which they operate. (15 Marks)

- b) Discuss the usefulness and limitations to investors in Island of segment reporting, taking into consideration that Island has divisions in logo and web page design. (5 Marks)

(Total 20

Marks)

#### QUESTION 4

- a) Anthony Limited, a manufacturing and retail company, prepares its financial statements in accordance with International Financial Reporting Standards (IFRS), with a reporting date of December 31, each year.

To boost sales of one of its older products, the company launched a promotional campaign titled "*Something for Free*", which included complimentary maintenance services for the first two years. Under this offer, on October 1, 2019, Anthony Limited sold goods to a supermarket chain for ₦4.4 million. Typically, the product has a list price of ₦5 million, and a two-year maintenance contract would normally be sold separately for ₦0.5 million. However, the entire transaction was recorded as revenue at ₦4.4 million.

**Required:**

Justify the appropriate accounting treatment for the above transaction in the financial statements of Anthony Limited for the year ended December 31, 2019, taking into consideration the provisions of *IFRS 15: Revenue from Contracts with Customers*. (6

Marks)

- b) Justify whether each of the following scenarios is most likely to be classified as a discontinued operation in the current year's financial statements, taking into consideration the provisions of IFRS 5: Non-Current Assets Held for Sale and Discontinued Operations:

- i) A reportable operating segment that was designated as held for sale after the financial year-end, but before the financial statements were authorised for issue.

(3 Marks)



- ii) A business division that was classified as held for sale and correctly reported as a discontinued operation in the prior year's financial statements. However, the sale has not been completed by the current year-end due to referral to the Securities and Exchange Commission (SEC), which is not expected to conclude its review until six months after the year-end. (3 Marks)
- c) Maryland Ltd. purchased a 6% ₦50 million bond on August 1, 2018 at a 10% discount to par value. Expenses of purchase were ₦500,000. The bond is due for redemption on July 31, 2028 at par. The effective annual interest rate to maturity is 7.3%. Maryland intends to hold the bond until its maturity date.

**Required:**

In accordance with *IFRS 9: Financial Instruments*, how much should be recognised in Maryland financial statements in respect of the above transaction for the year ended July 31, 2019 (to two decimal places)?

(4 marks)

- d) Ojota Ltd. is a large manufacturing company. Wherever possible, it structures its operations to take advantage of any financial assistance available from national and local authorities.

During the year, the company decided to relocate some of its other operations to a local development area, which offers attractive labour costs and tax incentives. The local government agreed to contribute ₦200,000 as a result of the company setting up in the local development area. There are no particular conditions as to what the money should be spent on. The cash was received on August 1, 2019.

**Required:**

Explain the financial reporting treatment of the above in the financial statements of Ojota Limited for the year ended December 31, 2019, taking into consideration the provisions of *IAS 20: Accounting for Government Grants and Disclosure of Government Assistance*.

(4 Marks)

(Total 20  
Marks)

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

**QUESTION 5**

The directors of Peninsula Plc. are reviewing the impact of IFRS 2 - *Share-based Payment*, on the financial statements for the year ended May 31, 20X5, as they will adopt the IFRS.

However, the directors of Peninsula Plc. have expressed concerns about applying the standard and have presented the following arguments against recognising an expense for share-based payments:

- (i) **Perceived lack of cost:** The directors believe that share options do not represent a cost to the company and, therefore, should not result in an expense being charged to the statement of profit or loss.
- (ii) **Conceptual framework concerns:** They argue that the expense recognised under IFRS 2 does not align with the definition of an expense as outlined in the Conceptual Framework.
- (iii) **Impact on earnings per share:** The directors are concerned about the dual impact of IFRS 2 on earnings per share, first, through the recognition of an expense in the income statement, and second, through the dilution effect in the calculation of diluted earnings per share.
- (iv) **Discouragement of share option plans:** They fear that the accounting treatment of share-based payments may negatively affect the company and potentially discourage the introduction of new share option schemes.

**The following share option schemes were in existence as at May 31, 2015:**

<i>Director's name</i>	<i>Grant date</i>	<i>Options granted</i>	<i>FV of options at grant date</i> N	<i>Exercise price</i> N	<i>Performance condition</i>	<i>Vesting date</i>	<i>Exercise date</i>
Seyi Bayonle	June 1, 2013	20,000	5	4.50	A	6/2015	6/2016

Olu Daramola	June 1, 2014	50,000	6	6	B	6/2017	6/2018
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The price of the company's shares at May 31, 2015 was ₦12 per share and at May 31, 2014 was ₦12.50 per share.

The performance conditions which apply to the exercise of executive share options are as follows:

**Performance condition A**

The share options do not vest if the growth in the company's earnings per share (EPS) for the year is less than 4%.

The rate of growth of EPS was 4.5% (2013), 4.1% (2014), 4.2% (2015). The directors must still work for the company on the vesting date.

**Performance condition B**

The share options do not vest until the share price has increased from its value of ₦12.50 at the grant date (June 1, 2014) to above ₦13.50. The director must still work for the company on the vesting date.

No director has left the company since the issue of the share options and none is expected to leave before June 2017. The shares vest and can be exercised on the first day of the due month.

The directors are uncertain about the deferred tax implications of adopting IFRS 2. Peninsula Plc. operates in a country where a tax allowance will not arise until the options are exercised and the tax allowance will be based on the option's intrinsic value at the exercise date.

Assume a tax rate of 30%.

**Required:**

- (a) Explain reasons why share-based payments should be recognised in financial statements and why the directors' arguments are unacceptable.  
(7 Marks)
- (b) Discuss (with suitable calculations) how the directors' share options would be accounted for in the financial statements for the year ended May 31, 20X5, including the adjustment to opening balances.  
(8 Marks)

(Total 15  
Marks)

### QUESTION 6

- (a) At the recent general meeting of XYZ Limited, a shareholder requested clarification from the Managing Director regarding the criteria used to determine whether certain financial instruments are classified as equity or debt. The shareholder noted that some instruments with similar characteristics are treated differently in the financial statements and expressed concern that the directors may not fully appreciate the implications of these classifications for investors and their interpretation of the company's financial position.

**Required:**

- i) Explain the key differences in the classification of debt and equity instruments under IFRSs. (6 Marks)
- ii) Explain why it is important for entities to understand the financial reporting implications of classifying an instrument as debt or equity. (4 Marks)

- (b) The Finance Director of Foodco. Limited has proposed incorporating cryptocurrencies into the company's investment strategy. While the board is familiar with the nature of cryptocurrencies, it has requested clarification on how such assets would be presented in the financial statements. The Finance Director has suggested that they be accounted for as a financial asset, but has acknowledged uncertainty regarding whether this treatment aligns with the requirements of IFRSs and the Conceptual Framework.

**Required:**

Advise the directors on whether cryptocurrencies should be classified as a financial asset, with reference to relevant IFRSs and the Conceptual Framework.

(5 Marks)

(Total 15  
Marks)

## QUESTION 7

- (a) Mrs. Maryam Mustapha, a Chartered Accountant and Head of Internal Audit at Nupe Communications Authority (NCA), is preparing to submit a bid for an internal audit services contract. A new member of her team, Mr. Bala Bello, was recently recruited from the Internal Audit Service and previously worked in the department responsible for designing the tender. Although Bala was not directly involved in the tender process, his former colleague, who remains a close friend is responsible for drafting the tender specifications and overseeing the evaluation.

Bala has seen some of the tender requirements and has offered to share potentially useful information with Maryam to support the bid preparation. However, this information is confidential and should not be disclosed to any bidding party.

The tender process is open to both internal and external providers, with a strong emphasis on encouraging external bids. The evaluation criteria have been structured accordingly. If the contract is awarded to an external provider, Maryam's future role within the organisation may be uncertain. While she recognises that using insider knowledge would be unethical and inappropriate, she is tempted to use the confidential information to improve her chances of securing the contract.

### **Required:**

Advise Mrs. Maryam Mustapha on **Three** (3) courses of action she should take in order to act ethically in the tendering process given in the above scenario.

(5 Marks)

- (b) Ojuelegba Ltd. is a local construction company operating in a sector where regulations require employers to provide personal protective equipment (PPE) for all employees. The company failed to comply with this requirement, resulting in a serious and costly injury to a plumber during the course of work. The injured employee has filed a lawsuit against the company.

The company's solicitors are preparing a vigorous defense and have estimated that potential compensation could amount to ₦17,000, to cover the injured party's costs. However, a court ruling is not expected for at least another year.

### **Required:**

Explain the aspects of the Conceptual Framework that can assist the accountant in determining the appropriate accounting treatment for the situation (3 Marks)

- (c) In preparing financial statements, selecting the appropriate currency for recording transactions is essential for ensuring clarity and consistency. IAS 21- *The Effects of Changes in Foreign Exchange Rates*, provides guidance on determining an entity's **functional currency**, the currency of the primary economic environment in which the entity operates.

**Required:**

Discuss the concept of entity's *functional currency* and *how it may be determined* in accordance with IAS 21: *The Effects of Changes in Foreign Exchange Rates*.

(4 Marks)

- (d) IFRS 10: Consolidated Financial Statements, establishes the principles for preparing and presenting consolidated financial statements. It requires entities to consolidate all entities they control. Under IFRS 10, control is defined by three key elements:

- **Power over the investee** – the ability to direct relevant activities.
- **Exposure or rights to variable returns** – from involvement with the investee.
- **The ability to use power to affect returns** – the capacity to influence the amount of those variable returns.

This framework ensures that financial statements reflect the economic realities of control and provide a comprehensive view of the group's financial position.

**Required:**

- i) Explain *Consolidated Financial Statements*. (1

Mark)

- ii) Identify **Four** (4) circumstances under which a company may gain control over another company but *will not be allowed* to prepare consolidated financial statements. (2

Marks)

(15

Marks)

## SUGGESTED SOLUTIONS

### Solution 1

a) (i)

Apapa Plc.

#### Statement of profit or loss and other comprehensive income

For the year ended May 31, 2013

	N' 000
Profit before gain on disposal of shares in subsidiary	130
Gain on disposal of shares in subsidiary (W5)	<u>100</u>
<i>Profit before tax</i>	230
Income tax expense ( <del>N</del> 40 + (W5) <del>N</del> 30)	<u>(70)</u>
<i>Profit for the year</i>	160
<i>Other comprehensive income, net of tax</i>	<u>20</u>
<i>Total comprehensive income for the year</i>	<u><u>180</u></u>

	N'm
<i>Statement of changes in equity (Total)</i>	
Balance at June 1, 2012 ( <del>N</del> 810 – <del>N</del> 110)	700
Total comprehensive income for the year	<u>180</u>
Balance at May 31, 2013	<u><u>880</u></u>

(ii)

Apapa Plc. Group

#### Consolidated statement of profit or loss and other comprehensive income

For the year ended May 31, 2013

	N'm
<i>Profit before tax</i> ( <del>N</del> 130 + <del>N</del> 60)	190
Income tax expense ( <del>N</del> 40 + <del>N</del> 20)	<u>(60)</u>

<i>Profit for the year</i>	130
<i>Other comprehensive income, net of tax</i> ( <del>₦20</del> + <del>₦10</del> )	<u>30</u>
<i>Total comprehensive income for the year</i>	<u>160</u>
Profit attributable to:	
Owners of the parent	122
Non-controlling interests [ <del>(₦40 x 9/12 x 15%)</del> + ( <del>₦40</del> x 3/12 x 35%)	<u>8</u>
	<u>130</u>
Total comprehensive income attributable to:	
Owners of the parent	150
Non-controlling interests [ <del>(₦50 x 9/12 x 15%)</del> + ( <del>₦50</del> x 3/12 x 35%)	<u>10</u>
	<u>160</u>

(iii)

### Apapa Plc. Group

Consolidated statement of financial position

As at May 31, 2013

	<b>₦'m</b>
<b><i>Non-current assets:</i></b>	
Property, plant and equipment ( <del>₦535</del> + <del>₦178</del> )	713
Goodwill (W2)	<u>80</u>
	<u>793</u>
<b><i>Current assets:</i></b>	
Inventories ( <del>₦320</del> + <del>₦190</del> )	510
Trade receivables ( <del>₦250</del> + <del>₦175</del> )	425
Cash ( <del>₦80</del> + <del>₦89</del> )	<u>169</u>
	<u>1,104</u>
Total assets	<u>1,897</u>
<i>Equity attributable to owners of the parent</i>	
Share capital <del>₦1.00</del> ordinary shares	500
Reserves (W3)	<u>477.5</u>
	977.5
<i>Non-controlling interests (W4)</i>	<u>157.5</u>
	<u>1,135.0</u>
<b><i>Current liabilities:</i></b>	
Trade payables ( <del>₦295</del> + <del>₦171</del> )	466
Income tax payable ( <del>₦80</del> + <del>₦60</del> + (W5) <del>₦30</del> )	170
Provisions ( <del>₦95</del> + <del>₦31</del> )	<u>126</u>
	<u>762</u>
	<u>1,897</u>



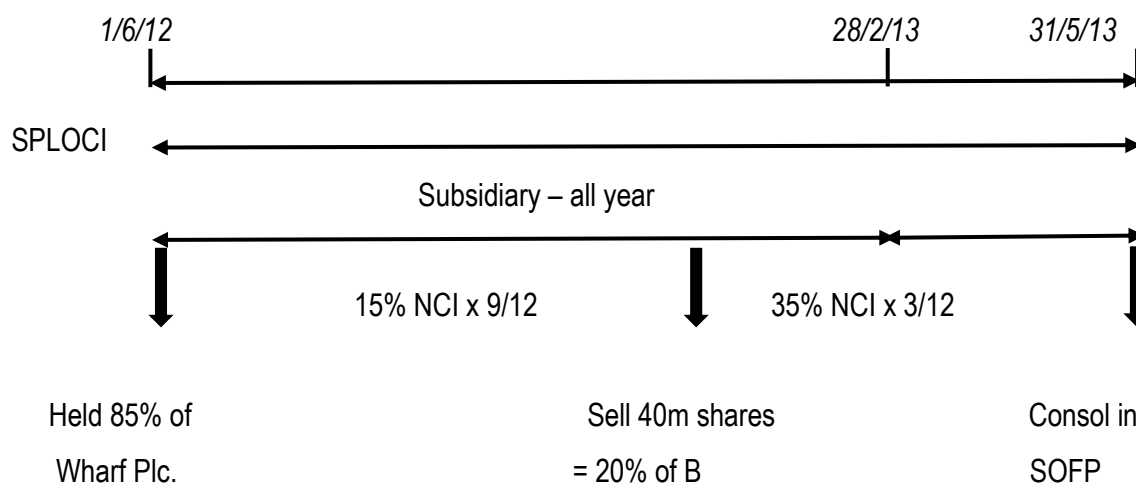
(iv)

**Statement of changes in equity (total column)**

	<b>Group N'm</b>	<b>NCI N'm</b>	<b>Total N'm</b>
Balance at June 1, 2012:			
( <del>N</del> 500 + (W7) <del>N</del> 285) / ( <del>N</del> 45 + ((W7) <del>N</del> 100 x 15%))	785	60	845
Adjustment to parent's equity on sale of non-controlling Interests ((W6) 72.5 – (W5) 30)	42.5		42.5
Increase in non-controlling interests ((W6) 71.5 + 16)		87.5	87.5
Total comprehensive income for the year	<u>150</u>	<u>10</u>	<u>160.0</u>
Balance as at May 31, 2013 (from SOFP)	<u>977.5</u>	<u>157.5</u>	<u>1,135.0</u>

*Workings*

**1. Timeline**



The parent retained control of 65% after disposing off 20% from 85% holding.

**2. Goodwill**

	<b>N'm</b>	<b>N'm</b>
Consideration transferred		255
Non-controlling interests (at fair value)		45
Fair value of identifiable net assets at acquisition:		
Share capital	200	
Pre-acquisition reserves	<u>20</u>	<u>(220)</u>
		<u>80</u>

3. **Group reserves at May 31, 2013**

	<b>Apapa Plc.</b>	<b>Wharf Plc.</b>	<b>Wharf Plc.</b>
		85%	65% ret'd
	N'm	N'm	N'm
Per question/at date of disposal (170 – (50 x 3/12))	310	157.5	170
Adjustment to parent's equity on disposal (W6)	72.5		
Tax on parent's gain (W5)	(30)*		
Reserves at acquisition (W2) / date of disposal (as above)		<u>(20)</u>	<u>(157.5)</u>
		<u>137.5</u>	<u>12.5</u>

Group share of post-acquisition reserves:

Wharf Plc. – 85% (N137.5 x 85%)	116.9
Wharf Plc. – 65% (N12.5 x 65%)	<u>8.1</u>
	<u>477.5</u>

\* Tax recognised directly in reserves in the consolidated financial statements as the item it relates to is recognised in reserves

4. **Non-controlling interests (SOFP)**

	<b>N'm</b>
NCI at acquisition (W2)	45
NCI share of post-acquisition reserves:	
Wharf Plc. (N137.5 x 15%)	<u>20.6</u>
	65.6
Wharf Plc. (N12.5 x 35%)	4.4
Increase in NCI (W6)	<u>87.5</u>
	<u>157.5</u>

5. **Gain on disposal of shares in parent's separate financial statements**

	N'm
Fair value of consideration received	160
Less original cost of shares ( $\text{N}255 \times 20\% / 85\%$ )	<u>(60)</u>
Parent gain	100
Less tax on parent's gain (30%)	<u>(30)</u>
	<u>70</u>

6. **Adjustment to parent's equity on disposal of shares in group financial statements**

	N'm
Fair value of consideration received	160.0
Increase in NCI in net assets and goodwill at disposal ((W4) $\text{N}65.6 \times 20\% / 15\%$ )	<u>(87.5)</u>
	<u>72.5</u>

OR (as a double entry):

	N'm	N'm
Debit Cash	160	
Credit Non-controlling interests ((W4) $65.6 \times 20\%/15\%$ )		87.5
Credit Parent's equity (balancing figure)		72.5

7. **Reserves brought forward**

	Apapa Plc. N'm	Wharf Plc. N'm
Per question (31/5 / 13)	310	170
Less: comprehensive income for the year	(110)	(50)
Reserves at acquisition		<u>(20)</u>
		<u>100</u>
Group share of post-acquisition reserves:		
Wharf Plc. ( $100 \times 85\%$ )		<u>85</u>
		<u>285</u>

b) **Pension cost recognised for the year would be:**

	N'000
Current service cost	8,000
Net interest cost (10% of $\text{N}100\text{m} - \text{N}96\text{m}$ )	400
Past service cost	<u>6,000</u>

Net service cost recognised in profit or loss	14,400
Re-measurement in other comprehensive income	<u>4,000</u>
Net cost for the year in other comprehensive income	<u>14,800</u>

IAS 19, does not actually specify where service cost and net interest cost should be presented. As a result, it is acceptable to include the net interest cost in finance costs.

IAS 19, states that past service cost should be recognised immediately and the past service cost will be included in the defined benefit obligation at May 1, 2015. Thus, there is no need to calculate an interest cost on the past service cost.

### **Statement of profit or loss**

	<b>N'000</b>
Net service cost recognised in the profit or loss	(14,400)
Re-measurement in other comprehensive income	(4,000)

#### **c) Importance of related party disclosures**

- i) Investors typically invest in a business with the expectation that it operates to maximise profits for the benefit of its shareholders. This implies that transactions are conducted at arm's length between informed and willing parties. However, the presence of related parties may lead directors to make decisions that favour another entity, potentially at the expense of their own shareholders.

Such actions may include selling goods or services to related parties at below-market prices, purchasing goods or services at inflated rates, refraining from competing with a related entity, or providing guarantees or collateral for another party's loans.

- ii) Disclosure of related party relationships is especially critical during the sale of a business. A company may benefit from significant support, such as customer referrals, supplies, services, or advice from family members or group companies. These advantages may be withdrawn once the company is sold, potentially affecting its future performance.

- iii) Related party transactions are not inherently illegal or undesirable. However, shareholders and potential investors must be informed of any material related party transactions to make well informed investment and stewardship decisions.

## **Solution 2**

### **a) i) Factors which encourage companies to disclose social and environmental information in their financial statements**

- Public interest in corporate social responsibility is steadily increasing. Although, financial statements are primarily intended for investors and their advisers, there is growing recognition that companies actually have a number of different stakeholders. These include, customers, employees and the general public, all of whom, are potentially interested in the way in which a company's operations affect the natural environment and the wider community. These stakeholders can have a considerable effect on a company's performance. As a result, many companies now deliberately attempt to build a reputation for social and environmental responsibility. Therefore, the disclosure of environmental and social information is essential.
- There is also growing recognition that corporate social responsibility is actually an important part of an entity's overall performance. Responsible practice in areas, such as reduction of damage to the environment and recruitment increases shareholder value. Companies that act responsibly and make social and environmental disclosures are perceived as better investments than those that do not.
- Another factor is growing interest by governments and professional bodies. Although there are no IFRSs that specifically require environmental and social reporting, it may be required by company legislations. There are now a number of awards for environmental and social reports and high quality disclosure in financial statements. These provide further encouragement to disclose information.

### **ii) Difficulties in recognising and measuring the financial effects of environmental matters**

- There is often a considerable delay between the activity that causes an environmental issue, such as the contamination of a site due to industrial activity and its identification by the entity or the regulators.

- Accounting estimates do not necessarily have an established historical pattern and can exhibit wide ranges of reasonableness because of the number and nature of assumptions underlying the determination of these estimates.
- Environmental laws and regulations are evolving, and interpretation can be difficult or ambiguous. Consultation with an adviser may be necessary to assess their impact on the measurement of assets and liabilities.
- Liabilities can arise other than as a result of legal or contractual obligations, for example, a voluntary commitment.

**b) How integrated reporting merges sustainability reporting and financial reporting**

The value generated by an organisation through a strategy that delivers both financial performance and sustainable outcomes cannot be fully captured by separate financial and sustainability reports, especially when there is no clear connection between profit figures and sustainability impacts. Integrated reporting addresses this gap by promoting a more cohesive and efficient approach to corporate reporting, aimed at enhancing the quality and relevance of information available to stakeholders.

An integrated report is a single annual document that, unlike traditional financial reports, encompasses governance, social, environmental, and financial issues. It is designed with all stakeholders in mind, not just shareholders, and requires collaboration across various departments within the organisation. Furthermore, it considers both past performance and future prospects. The Integrated Reporting Framework offers guidance on the principles and content that should be included in such reports.

The framework identifies three key components of an integrated report:

- **Capitals:** These are the resources used by an organisation to create value. They include financial capital as well as non-financial capitals, such as human, social, and natural capital.
- **Guiding principles:** These outline how an integrated report should be prepared. They include traditional financial reporting principles like materiality and reliability, alongside sustainability-focused principles, such as stakeholder engagement and future orientation.
- **Content elements:** These cover both financial and sustainability aspects and include: organisational overview and external environment, governance, business model, risks and

opportunities, strategy and resource allocation, performance, outlook, and basis of preparation.

### Solution 3

#### Banana Ltd

- (a) Comments on performance and financial position

Analysis

Additional relevant ratios

	Banana Ltd	Island Ltd
Return on capital employed	24.9%	21.0%
Return on shareholders' funds (equity)	18.0%	20.5%
Net asset turnover	1.08	1.24
Non-current asset turnover	1.13	1.33
Current ratio	1.26	2.35
Quick ratio	0.75	2.18
Inventory turnover — days	38.20	3.35
Trade receivables collection period — days	37.69	30.63
Gearing	13.4%	59.1%
Interest cover	23.44	5.65
Revenue per employee — N'000	N34.07	N54.04

#### Performance

Return on capital employed in Banana Ltd (BL) is higher than Island Ltd (IL). However, Banana Limited premises are stated at cost and since the company has owned them for over 40 years the market value will probably have increased. If the premises were measured at fair value and depreciation based on this amount, the profits of the company would be lower and capital employed higher. This would result in a lower ROCE which may be more comparable with that of Island Limited, which does not own property but pays what is assumed to be a market rent.

The return on shareholders' funds is higher in Island. This is due to Island being a more highly geared company - see below.

Although revenue is higher in Banana than Island in 20X6, it is suggested that Banana is losing customers, and therefore it is probable that its revenue has fallen compared to the previous year.

Island may have increasing revenue as it attracts new customers; it has only been in the new market for a few years.

Banana has a higher gross profit percentage than Island but the make-up of cost of sales is different:

- Banana has more materials cost — due to its product being 'hard' copy requiring paper and ink rather than 'electronic'.
- Island has more labour costs — it employs fewer people than Banana but its staff are more skilled.
- The overheads are similar — Banana is in an expensive city centre, but has owned its premises for a number of years; Island rents premises, but is in a cheaper location. Banana premises are probably undervalued (see above). As discussed, if the premises were measured at fair value it would result in a higher depreciation charge, which would increase the overheads in cost of sales

Distribution costs are greater in Banana — probably due to nature (hard copy) of the product; costs are lower in Island as the product is 'electronic'.

Advertising costs are higher in Island — Island probably spends more as it operates in a new market and Banana spends less as it relies on repeat business.

The operating margin percentage is higher in Banana than Island, but by less than the gross profit percentage. Thus, Island is slightly more efficient with regards to its operating expenses. Its total operating expenses are 7.9% of revenue as compared to Banana's which 9.5% of revenue are.

This is mainly the result of Banana's heavy expenditure on distribution.

Finance costs are higher in Island, which is the result of more debt. This level of interest is not a problem as the interest cover in Island is 5.65, which is comfortable.

The interest cover in Banana is 23.44, which indicates that gearing could be increased, providing Banana with an opportunity to raise additional financing through borrowings, especially since the return on shareholders' funds is less in Banana than Island. Increased debt finance in Banana, if



invested well, will result in increased profits even after the additional finance costs are taken into account. Thus, it would contribute to an increased return on shareholders' funds.

Tax is proportionately less in Island than Banana and this may be the result of its recent capital expenditure compared to Banana.

ROCE = Net margin % × Net asset turnover

Banana 24.9% = 23% × 1.08 (difference due to rounding)

Island 21.0% = 17% × 1.24 (difference due to rounding)

The non-current asset turnover ratio is slightly higher in Island with ₦1.33 revenue generated for each ₦1 non-current assets as compared to Banana's ₦1.13 for each ₦1. Banana's ratio would be even less if its property were carried at fair value, as previously discussed.

The age of machinery held by each company is also relevant:

- Banana has old machinery, some of which could be fully depreciated, which results in a low non-current assets balance and so higher non-current asset turnover.
- Island has new machinery with higher carrying amounts which reduces its non-current asset turnover ratio compared to Banana.

Revenue per employee is higher in Island due to its strategy of employing fewer, but more highly skilled staff. This metric tends to be elevated in high-technology companies compared to manufacturing firms, reflecting differences in workforce composition and value generation.

## **Position**

Gearing in Island is considerably higher than that of Banana at 59%; based on the interest cover and the return on shareholders' funds this appears to be an acceptable level of debt.

The gearing in Banana seems very low – as already discussed, there is capacity to gear up.

The current ratio in Island is an acceptable figure, taking the comments below into consideration.

The current ratio in Banana is low, taking the comments below into consideration.

The quick ratio in Island is similar to the current ratio as Island does not carry much inventory.

The quick ratio in Banana is low which shows the importance to the company of being able to manage inventory control, as well as receivables and payables.

Inventory days in Banana is good at 38 days but in absolute terms inventory is high because material costs are a high proportion of cost of sales.

Inventory days in Island are not important as material cost is a low proportion of cost of sales.

Trade receivable days in each company look good, assuming that the credit period is one month, although Island is better by seven days.

Banana's trade payables period is 45 days. The significance of this depends upon the credit terms. Assuming that these are one month, then this may indicate cash flow problems in Banana, which may lead to difficulties with suppliers.

If trade payables are within the credit terms, this shows good financial management as the period is greater than trade receivable days.

The trade payables for Island are 28 days. Assuming that the credit terms are one month, then this may indicate that Island is paying unnecessarily quickly. However, there may be cash discounts for prompt payment.

Trade payable days are less than trade receivables days but there is no indication from other information that it is a problem.

The working capital cycle in Banana is 31 days ( $38 + 38 - 45$ ), which appears to be good, subject to the comments above.

The working capital cycle in Island is 6 days ( $3 + 31 - 28$ ), which is highly efficient, and means that the company does not need to hold much cash. However, this is a high-risk strategy if too much reliance is placed on customers paying on time.

The profit for the period is greater in Banana than in Island but the EBITDA is greater in Island than Banana.

This is the result of more depreciation in Island as Island has newer plant and machinery which, given it is computer equipment, is likely to be depreciated over a short useful life. The depreciation on property and the old equipment in Banana is likely to amount to a lower annual charge.

EBITDA is a measure of the cash flow generated from operations and the superior performance by Island supports the analysis of the working capital above.

**(b) Segment reporting**

Investors are interested in risk and return.

This is easier to assess if companies provide information about the segments, geographical and product, in which they operate.

Segment information may help assess:

- opportunities for growth; and
- future prospects.

The segment information provided should be of high quality as it is consistent with the financial statements with regards to:

- accounting policies; and
- the revenue must agree with the statement of profit or loss.

However, the segment information is subjective and depends on management judgement because management:

- effectively select which segments are reported;
- allocate shared expenses;
- allocate shared assets and liabilities; and
- set inter-segment selling prices.

#### Solution 4

- (a) Under (IFRS 15), each component should be measured separately. As only three months of the maintenance service has been provided, we should only recognize 3/24 of the maintenance fee as revenue in the year ended December 31, 2019. The remainder should be treated as deferred income and recognised as the service is being provided.

The sale of goods should be recognised immediately. Since the total fair value of the individual components exceeds the overall contract price, a discount has clearly been applied. However, as the specific item(s) to which the discount relates are not identified, it would be reasonable to allocate the discount proportionately across all components, using the same percentage.

The discount is 20% based on listed prices (i.e.  $[4.4\text{m}/(5\text{m} + 0.5)] - 1$ ).

	N'm
Sale of goods ( <del>N</del> 5 million x 80%)	4.00
Sale of services (3/12 x <del>N</del> 0.5 million x 80%)	<u>0.05</u>
Revenue to be recognised	<u>4.05</u>

Deferred income should be measured at ~~₦0.35~~ million ( $21/24 \times \text{₦0.5 million} \times 80\%$ )

Revenue retained earnings should, therefore, be reduced by ~~₦0.35~~ million.

**Double entries:**

Debit:	Retained earnings	<del>₦0.35</del> million	
Credit:	Deferred income		<del>₦0.35</del> million

**Alternative presentation for IFRS 15: Revenue recognition**

	<b>₦' million</b>	<b>₦' million</b>
<b>Total transaction price</b>		4.4
<b>Revenue to be recognised:</b>		
<b>Product sale (<del>₦5 million/</del>₦5 million + <del>₦0.5 million</del> x <del>₦4.4m</del> million)</b>	4.00	
<b>Maintenance (3/12 months x <del>₦0.4</del> million)</b>	<u>0.04</u>	<u>4.05</u>
<b>Deferred revenue</b>		( 0.35)

**Five (5) point criteria for recognition of revenue**

Step 1: Identify contract with the customer

Step 2: Identify the performance obligations within the contract

- Sale of product
- Maintenance contract

Step 3: Determine the transaction price – the transaction price is ~~₦4.4~~ million

Step 4: Allocate the transaction price among the performance obligations within the contract

- Based on the standalone selling price of the individual obligations
- Where the standalone selling price is not available, use expected cost plus %
- Where the above is not available, use the residual approach.

In this case, the scenario provides the standalone selling prices, hence, these shall be used to allocate the price. Allocation of transaction price to:

Sales of product: ~~₦0.5 million/~~  $\text{₦5 million} + \text{₦0.5 million} \times \text{₦4.4 million} = \text{₦4}$

Maintenance: ~~₦0.5 million/~~  $\text{₦5 million} + \text{₦0.5 million} \times \text{₦4.4 million} = \text{₦4}$

Step 5: Recognise the revenue over time or at point in time

- Revenue from the product would be recognized during the contract period as control over the product is transferred to the customer.
- Revenue from the maintenance contract would be earned over a period of 24 months, therefore, for the current period, 3/24 months would be recognised as revenue, and the remainder would be deferred.

**b) i)** Classification as held for sale is a non-adjusting event after the reporting period (IAS 10 para 22(c)). Therefore, the definition of a discontinued operation is not met as the assets are neither discontinued in the period nor classified as held for sale at the year end.

**ii)** For an operation that has not yet been sold or abandoned to qualify as a discontinued operation, it must meet the criteria outlined in IFRS 5: Non-Current Assets Held for Sale and Discontinued Operations. These criteria were satisfied as of the previous year-end, however, at the current year-end, the operation has not been sold within the required 12-month period, and the sale is now expected to be delayed significantly.

Nonetheless, IFRS 5 Appendix B permits the continued classification of an asset as held for sale and consequently, as a discontinued operation, if the delay in sale is due to circumstances beyond the entity's control, such as a regulatory review. Provided that all other criteria remain satisfied, which appears to be the case in this scenario, it is appropriate to maintain the classification as a discontinued operation.

**c)** The initial carrying value of the bond will be as follows:

	N'million
Purchase price (90% of N50 million)	45
Add: Purchase costs	<u>0.5</u>
Total asset cost recognised	<u>45.5</u>
Finance income will be recognised at 7.3% of the opening carrying amount of N3.32 million.	

Financial assets measured at amortised costs

	Asset at start	Finance income 7.3%	Interest received 6 %	Asset at end
	₦'million	₦'million	₦'million	₦'million
2018/2019	45.5	3.322	(3)	45.8

**Profit or loss (extract) for the year ended 31/7/2019**

	₦'million
Finance income	3.332

**Statement of financial position (extract) as at 31/7/2019**

	₦'million
Financial assets	45.8

This bond meets the criteria for classifying it as amortised cost. These are:

- the cash flows to be derived from the instrument are solely interest and principal; and
- the entity intends to hold the instrument to draw the contractual cash flows.

Therefore, the amortised cost method is appropriate. Fair value is irrelevant.

**d) The financial reporting treatment of the transaction in the financial statements of Ojota Limited for the year ended December 31, 2019, taking into consideration the provisions of IAS 20: Accounting for Government Grants and Disclosure of Government Assistance**

- The contribution of ₦200,000 by the local government is not dependent on any particular activities of the entity.
- The ₦200,000 should be credited directly to profit or loss as it does not compensate specific expenses.

**Solution 5**

**(a) Why share based payments should be recognised in the financial statements**

IFRS 2: *Share-based Payment*, applies to all share option schemes granted after November 7, 2002.

The directors have put forward several arguments for not recognising the expense of remunerating directors in this way.

***Share options have no cost to the company***

When shares are issued for cash or in a business acquisition, an accounting entry is needed to recognise the receipt of cash (or other resources) as consideration for the issue. Share options (the right to receive shares in future) are also issued in consideration for resources: services rendered by directors or employees. These resources are consumed by the company and it would be inconsistent not to recognise an expense.

***Share issues do not meet the definition of an expense in the IASB Conceptual Framework***

The *framework* defines an expense as a decrease in economic benefits in the form of outflows of assets or incurrences of liabilities. It is not immediately obvious that employee services meet the definition of an asset, and therefore, it can be argued that consumption of those services does not meet the definition of an expense. However, share options are issued for consideration in the form of employee services so that arguably there is an asset, although it is consumed at the same time that it is received. Therefore, the recognition of an expense relating to share based payment is consistent with the *Conceptual Framework*.

While the expense related to share options is already reflected in the diluted earnings per share (EPS) calculation, it has been argued that recognising the same expense in the statement of profit or loss could distort diluted EPS, effectively accounting for the expense twice. However, this argument is not valid.

There are two distinct events involved:

- (i) the granting of share options, which affects diluted EPS by increasing the number of potential shares; and
- (ii) the consumption of resources, specifically the services provided by directors in exchange for those options, which is recognised as an expense in profit or loss.

The diluted EPS calculation only reflects the potential dilution from the issue of options; it does not adjust basic earnings. Recognising an expense in profit or loss appropriately reflects the consumption of services. Therefore, there is no double counting.

Regarding the concern that accounting for share-based payments may discourage the company from introducing new share option plans, this is a valid consideration. Recognising such expenses does reduce reported earnings. However, it also enhances the transparency and quality of financial reporting, by informing users of the true economic impact of issuing share options as part of remuneration.

Ultimately, IFRS 2, ensures that both management and shareholders are equipped to make informed decisions about the most appropriate and sustainable methods of compensating employees.

**(b) Accounting for share options in the financial statements for the year ended May 31, 2015**

The basic principle of accounting for share options is that an expense is recognised for the services rendered by the directors and a corresponding amount is credited to equity. The transaction is measured at the fair value of the options granted at the grant date and fair value is taken to be the market price. Where (as is usual) options vest only after staff has completed a specified period of service, the expense is allocated to accounting periods over this period of service.

***Options granted to Seyi Bayonle on June 1, 2013***

The performance conditions have been met, and the director is still working for the company at May 31, 2015. As the number of shares that will vest is fixed, the expense is allocated on a straight-line basis to the two years ended May 31, 2015.

***Options granted to Olu Daramola on June 1, 2014***

The performance conditions (the increase in the share price to ₦13.50) have not yet been met. However, such 'market conditions' need not be considered as they are already factored into the fair value of the share options. In terms of the period of service condition, the director is still working for the company and must work for the company for three years before the options vest, so the expense is recognised. Again, the number of shares is fixed, so the expense is allocated on a straightline basis over the three years to May 31, 2017. The expense to be recognised is calculated as follows:



*At June 1, 2014 Year ended May 31, 2015*

	N	N
Seyi Bayonle (20,000 x <del>N</del> 5 x ½)	50,000	50,000
Olu Daramola (50,000 x <del>N</del> 6 x 1/3)	<u>          </u>	<u>100,000</u>
	<u>50,000</u>	<u>150,000</u>

At June 1, 2014, the opening balance of retained earnings was reduced by N50,000 and a separate component of equity was increased by N50,000.

An expense of N150,000 was recognised in statement of profit or loss for the year ended May 31, 2015. Equity (the same separate component as before) was credited with N150,000.

### **Deferred tax implications of the recognition of an expense for directors' share options**

The company will recognise an expense for the consumption of employee services given in consideration for share options granted but will not receive a tax deduction until the share options are actually exercised. Therefore, a temporary difference arises and IAS 12 *Income Taxes*, requires the recognition of deferred tax.

A deferred tax asset (a deductible temporary difference) results from the difference between the tax base of the services received (a tax deduction in future periods) and the carrying value of zero. IAS 12, requires the measurement of the deductible temporary difference to be based on the intrinsic value of the options at the year end. This is the difference between the fair value of the share and the exercise price of the option.

If the amount of the estimated future tax deduction exceeds the amount of the related cumulative remuneration expense, the tax deduction relates not only to the remuneration expense, but to equity. If this is the case, the excess should be recognised directly in equity.

*At June 1, 2014*

Deferred tax asset:

	N
Fair value ( <del>N</del> 20,000 x <del>N</del> 12.50 x 1/2)	125,000
Exercise price of option ( <del>N</del> 20,000 x <del>N</del> 4.50 x ½)	<u>(45,000)</u>
Intrinsic value (estimated tax deduction)	<u>80,000</u>
Tax at 30%	24,000

The cumulative remuneration expense is ~~N~~50,000, which is less than the estimated tax deduction.  
Therefore:

- a deferred tax asset of ~~N~~24,000 is recognised in the opening statement of financial position;
- opening retained earnings is increased by ~~N~~15,000 (50,000 x 30%); and
- the excess of ~~N~~9,000 (30,000 x 30%) goes to equity.

The comparative is re-stated for the options granted on 1 June 2013.

*Year to May 31, 2015*

Deferred tax asset:

	<del>N</del>
Fair value:	
(20,000 x <del>N</del> 12)	240,000
(50,000 x <del>N</del> 12 x 1/3)	<u>200,000</u>
	440,000
Exercise price of options	
( <del>N</del> 20,000 x <del>N</del> 4.50)	(90,000)
( <del>N</del> 50,000 x <del>N</del> 6 x 1/3)	<u>(100,000)</u>
Intrinsic value (estimated tax deduction)	<u>250,000</u>
Tax at 30%	75,000
Less previously recognised	<u>(24,000)</u>
	<u>51,000</u>

The cumulative remuneration expense is ~~N~~200,000, which is less than the estimated tax deduction.  
Therefore:

- a deferred tax asset of ~~N~~75,000 is recognised in the statement of financial position as at May 31, 2015;
- there is potential deferred tax income of ~~N~~51,000 for the year ended May 31, 2015;
- of this, ~~N~~6,000 (~~N~~50,000 x 30% – 9,000) goes directly to equity; and
- the remainder (~~N~~45,000) is recognised in profit or loss for the year.

## **Solution 6**

### **(a) (i) Classification differences between debt and equity**

The differentiation between debt and equity in an entity's statement of financial position is not easily distinguishable for preparers of financial statements. Some financial instruments may have features of debt and of equity, which can lead to inconsistency of reporting which can be confusing for the users of financial statements.

IAS 32 requires the classification to be based on principles rather than driven by perceptions of users. It defines an equity instrument as: 'any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities' (para. 11). It must first be established that an instrument is not a financial liability, before it can be classified as equity.

A key feature of the definition as specified by IAS 32, of a financial liability, is that it is a contractual obligation to deliver cash or another financial asset to another entity. The contractual obligation may arise from a requirement to make payments of principal, interest or dividends. The contractual obligation may be explicit, but it may be implied indirectly in the terms of the contract. An example of a debt instrument is a bond which requires the issuer to make interest payments and redeem the bond for cash.

A financial instrument is an equity instrument only if there is no obligation to deliver cash or other financial assets to another entity and if the instrument will or may be settled in the issuer's own equity instruments. An example of an equity instrument is ordinary shares, on which dividends are payable at the discretion of the issuer. A less obvious example is preference shares required to be converted into a fixed number of ordinary shares on a fixed date or on the occurrence of an event which is certain to occur.

An instrument may be classified as an equity instrument even if it includes a contingent settlement provision, requiring settlement in cash or a variable number of the entity's own shares, provided the contingency is based on an event that is extremely unlikely to occur. In such cases, the provision is not considered genuine. However, if the contingent settlement condition is outside the control of both the entity and the holder, the instrument must be classified as a financial liability.

Additionally, a contract involving the receipt or delivery of an entity's own shares is not automatically classified as an equity instrument. Classification depends on the "fixed-for-fixed" test outlined in IAS 32. If the contract will be settled by exchanging a fixed number of the entity's own equity instruments for a fixed amount of cash, it qualifies as an equity instrument. Conversely, if either the amount of cash or the number of equity instruments to be delivered or received is variable, the contract is classified as a financial asset or liability.

There are other factors which might result in an instrument being classified as debt, such as:

- dividends are non-discretionary;
- redemption is at the option of the instrument holder;
- the instrument has a limited life; and
- redemption is triggered by a future uncertain event which is beyond the control of both the issuer and the holder of the instrument.

Other factors which might result in an instrument being classified as equity, include the following:

- dividends are discretionary;
- the shares are non-redeemable; and
- there is no liquidation date.

Although IAS 32 establishes principles for presenting financial instruments as liabilities or equity, it is not always easy to apply these principles in practice. The IASB acknowledges this difficulty and has issued a discussion paper DP 2018/1 *Financial Instruments with Characteristics of Equity*, to investigate the issues further.

## **(ii) Significance of debt / equity classification for the financial statements**

The distinction between debt and equity is very important for users who analyse the financial statements. The classification can have a significant impact on the entity's reported earnings and gearing ratio, which in turn can affect investment decisions. Companies may wish to classify a financial instrument as equity, in order to give a favourable impression of gearing, but this may in turn have a negative effect on the perceptions of existing shareholders if it is seen as diluting existing equity interests.

The distinction is also relevant in the context of a business combination where an entity issues financial instruments as part consideration, or to raise funds to settle a business combination in cash.

Management is often called upon to evaluate different financing options, and in order to do so must understand the classification rules and their potential effects. For example, classification as a liability generally means that payments are treated as interest and charged to profit or loss, and this may, in turn, affect the entity's ability to pay dividends on equity shares.

**(b) Justification for the treatment of cryptocurrencies as a financial asset with reference to relevant IFRSs and the *Conceptual Framework***

The Finance Director has proposed that Foodco's investment in cryptocurrencies be recorded as a financial asset. According to IAS 32, a financial asset is defined as "cash, an equity instrument of another entity, or a contractual right to receive cash, an equity instrument, or exchange financial instruments on favourable terms" (para. 11). Cryptocurrencies, however, do not meet the definition of cash, as they are not generally accepted as legal tender. Furthermore, they do not confer a contractual right to receive cash or other financial instruments. Therefore, it would not be appropriate for Foodco. Limited to classify the investment as a financial asset under IAS 32.

In the absence of a specific IFRS standard addressing the accounting treatment of cryptocurrencies, the directors must exercise judgement to develop an appropriate accounting policy in accordance with **IAS 8 – Accounting Policies, Changes in Accounting Estimates and Errors**. In doing so, they should consider the following:

- (i) **Relevant IFRSs addressing similar issues:** Cryptocurrencies do not meet the definition of financial assets, nor do they possess physical substance, which excludes them from being classified as property, plant and equipment or inventories. Given their lack of physical substance and their identifiable, non-monetary nature, **IAS 38 – Intangible Assets**, is likely the most appropriate standard to apply.
- (ii) **The conceptual framework:** The investment appears to meet the definition of an asset, namely, a present economic resource controlled by the entity as a result of past events. The directors should also assess the recognition criteria and consider the appropriate measurement basis, particularly in light of the high volatility and valuation uncertainty associated with cryptocurrencies.

- (iii) **Recent pronouncements from national standard-setters and industry practice:** Although guidance in this area remains limited, any relevant developments from national GAAPs that share a similar conceptual framework may offer useful insights.
- (iv) **Usefulness of financial information:** The selected accounting treatment must provide relevant information and faithfully represent the investment to the primary users of the financial statements of Foodco. Limited. This includes, ensuring transparency, reliability, and comparability in how the investment is reported.

## **Solution 7**

### **(a) Ethical courses of action for Mrs. Maryam Mustapha in the tendering process**

#### **(i) Respect confidentiality**

Maryam must not use or refer to any confidential information in her tender proposal. Despite the potential personal advantage, relying on evaluation details that are not publicly available would be unethical and could compromise the integrity of the process.

#### **(ii) Address the offer of information**

She should clearly inform Bala that his offer to share confidential information cannot be accepted, as doing so, would breach the ethical standards outlined in ICAN's Code of Ethics.

#### **(iii) Prevent further disclosure**

Maryam should instruct Bala to refrain from discussing the tender any further. If she has already been exposed to any non-public information, she should disclose this to the tendering department to ensure transparency and allow equal access to all bidders.

#### **(iv) Clarify her position**

She must make it clear to Bala that she will not be using any confidential information and should encourage him to inform his former colleague of this stance. This will help prevent any speculation or rumours that could undermine the credibility of her proposal.

#### **(v) Demonstrate ethical leadership**

By openly communicating her ethical approach, Maryam sets a strong example of professional conduct and integrity, reinforcing the importance of fairness and transparency in the tendering process.

**(b) Relevant aspects of the conceptual framework that can assist the accountant in determining the appropriate accounting treatment for the situation**

The definition of a liability within the conceptual framework can guide the appropriate accounting treatment in this situation. According to the framework, a liability is a present obligation of the entity arising from past events, the settlement of which, is expected to result in an outflow of resources embodying economic benefits. In this case, the past event is the injury sustained by the plumber due to the company's failure to provide personal protective equipment.

A present obligation exists when it is probable that an outflow of resources will be required to settle the obligation. Based on legal advice, the solicitors have assessed that a compensation of ₦17,000 is probable. Therefore, the appropriate accounting treatment involves recognising a liability for the expected payment and simultaneously recognising an expense in the financial statements.

**(c) The functional currency of an entity can be broadly understood as the currency in which the entity primarily operates. Determining the functional currency is a matter of judgment under IAS 21 – The Effects of Changes in Foreign Exchange Rates, and involves assessing the economic environment to which the entity is most significantly exposed.**

For many entities, this judgment is straightforward, as they typically operate within a single economy or currency zone. However, IAS 21 provides guidance for situations where the assessment is more complex, such as when multiple currencies play a significant role in the entity's operations and it is unclear which one is predominant.

To assist in making this determination, IAS 21 outlines several key indicators that the entity should consider:

- the currency that mainly influences sales prices for goods and services;
- the currency in which purchases and operating costs are primarily incurred;
- the currency of the primary sources of financing, such as equity or debt instruments; and
- the currency in which operating cash flows are retained.

These factors help ensure that the chosen functional currency reflects the true economic environment in which the entity operates, thereby supporting accurate and meaningful financial reporting.

**(d) (i) Consolidated Financial Statements**

According to IFRS 10: Consolidated Financial Statements, are the financial statements of a parent and its subsidiaries presented as if they are the financial statements of a single economic entity.

**(ii) Circumstances under which a company may gain control over another company but will not be allowed to prepare consolidated financial statements (Exemption from preparing consolidated financial statements)**

A parent entity is exempt from preparing consolidated financial statements if all the following conditions are met:

- it is either a wholly-owned subsidiary or a partially-owned subsidiary, and the non-controlling interests have explicitly agreed to the exemption;
- its debt or equity instruments are not publicly traded;
- it is not, and has not initiated, the process of filing financial statements with a regulatory authority for the purpose of issuing financial instruments to the public; and
- its ultimate or any intermediate parent prepares consolidated financial statements that are available for public use and comply with IFRS.