The Institute of Chartered Accountants of Nigeria (ICAN)

**SKILLS LEVEL EXAMINATION**

**2019**

**Mock Exam**

**(3 hours)**

# Financial reporting

# Answers

## 1 Barry

(a) **Statement of profit or loss for the year ended 31st August 20X1**

| | ₦000 |
|---|---|
| Revenue | 30,000 |
| Cost of sales (w1) | (19,650) |
| Gross profit | 10,350 |
| Distribution costs (w1) | (1,370) |
| Administrative expenses (w1) | (1,930) |
| Profit from operations | 7,050 |
| Finance costs | (350) |
| Profit before tax | 6,700 |
| Tax (w2) | (2,500) |
| Profit after tax | 4,200 |

(b) **Statement of financial position as at 31st August 20X1**

| | ₦000 | ₦000 |
|---|---|---|
| **Assets** | | |
| **Non-current assets** | | |
| Property, plant and equipment | | 39,600 |
| Current assets | | |
| Inventory | 4,600 | |
| Trade and other receivables (7,400 + 200) | 7,600 | |
| Cash and cash equivalents | 700 | |
| | | 12,900 |
| **Total assets** | | 52,500 |
| **Equity and liabilities** | | |
| Capital and reserves | | |
| Equity shares | | 21,000 |
| Share premium | | 2,000 |
| Revaluation reserve | | 4,700 |
| Accumulated profits | | 11,800 |
| Total equity | | 39,500 |
| **Non-current liabilities** | | |
| Borrowings | | 5,200 |
| **Current liabilities** | | |
| Trade and other payables | 5,300 | |
| Taxation (2,100 + 400) | 2,500 | |
| | | 7,800 |
| **Total equity and liabilities** | | 52,500 |

(c) **Statement of changes in equity for the year ended 31st August 20X1**

| | Share capital | Share premium | Revaluation reserve | Retained profits | Total |
|---|---|---|---|---|---|
| | ₦000 | ₦000 | ₦000 | ₦000 | ₦000 |
| Balance at beginning of year | 21,000 | 2,000 | 0 | 7,500 | 30,500 |
| Dividends paid | | | | (200) | (200) |
| Profit for the period | | | | 4,200 | 4,200 |
| Other comprehensive income: | | | | | |
| Revaluation of non current assets | | | 5,000 | | 5,000 |
| Transfer of excess depreciation on revaluation | | | (300) | 300 | 0 |
| Balance at end of year | 21,000 | 2,000 | 4,700 | 11,800 | 39,500 |

(d) **Reconciliation of opening and closing property, plant and equipment**

| | Land | Buildings | Plant & machinery | Fixtures & fittings | Assets under construction | Total |
|---|---|---|---|---|---|---|
| | ₦000 | ₦000 | ₦000 | ₦000 | ₦000 | ₦000 |
| Cost/ Valuation | | | | | | |
| At 1 Sept 20X0 | 10,000 | 9,000 | 20,100 | 10,000 | 400 | 49,500 |
| Additions | - | - | - | - | 50 | 50 |
| Reclassification | - | - | 450 | - | (450) | - |
| Revaluation | 1,000 | 1,000 | - | - | - | 2,000 |
| At 31 Aug 20X1 | 11,000 | 10,000 | 20,550 | 10,000 | - | 51,550 |
| Depreciation | | | | | | |
| At 1 Sept 20X0 | - | 3,000 | 4,000 | 3,700 | - | 10,700 |
| Revaluation | - | (3,000) | - | - | - | (3,000) |
| Charge for year | - | 1,000 | 2,550 | 700 | - | 4,250 |
| At 31 Aug 20X1 | - | 1,000 | 6,550 | 4,400 | - | 11,950 |
| Net book value | | | | | | |
| At 31 Aug 20X1 | 11,000 | 9,000 | 14,000 | 5,600 | - | 39,600 |
| At 1 Sept 20X0 | 10,000 | 6,000 | 16,100 | 6,300 | 400 | 38,800 |

(e) **Private sector and public sector**

The private sector is the part of a nation's economy which is owned and controlled by private individuals or organisations. Private sector organisations include limited companies, partnerships and sole traders.

The public sector is the part of a nation's economy which is under the control of government. Public sector entities include national governments, regional governments (for example, state, provincial, territorial), local governments (for example, city, town) and their component entities (for example, departments, agencies).

The purpose of financial reporting is to provide information useful to users. The objectives of financial reporting are therefore determined by reference to the users and their information needs.

**Private sector**

The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity.

Those decisions involve buying, selling or holding equity and debt instruments, and providing or settling loans and other forms of credit.

Users are interested in the assets and liabilities of the entity and how the net assets are used to generate profit and cash flow.

**Public sector**

Public sector entities exist to provide a service rather than to make a profit. They raise money from citizens (through taxes and fees) and from lenders in order to be able to provide the services.

Public sector entities are accountable for the management and use of resources to those that provide the resources and those that depend on the delivery of necessary services.

The objectives of financial reporting by public sector entities are to provide information about the entity that is useful to users for accountability purposes and for decision-making purposes

Given that the primary objective of most public sector entities is to deliver services rather than to make profits, the performance of such entities can be only partially evaluated by examination of financial position, financial performance and cash flows.

Some information that might be of key interest to users of financial statements of public sector entities cannot be provided by financial statements. However, although financial statements cannot fulfil all of the users' information needs, they still provide useful information that allows users to judge:

- whether resources have been acquired economically and used efficiently and effectively to achieve its service delivery objectives;
- how management has discharged its responsibilities for safekeeping and managing resources of the entity; and
- the extent to which the resources are available to support future service delivery.

Having said that there are certain intrinsic limitations that might prevent financial statements drafted according to IFRS as providing a full picture of financial position and performance of public sector bodies;

- Non-exchange transactions are a large feature of public sector activity. In a non-exchange transaction one party receives value from another without directly giving approximately equal value in exchange.
- The level and quality of services received by an individual is not normally directly related to the level of taxes assess.

- Financial statements do not readily provide information that enables users to understand the scope and impact of non-exchange transactions.
- Commitments arising from public sector programmes do not meet the definition of a liability and are not recognised in financial statements.
- The power to raise taxation does not meet the definition of an asset and is not recognised in the financial statements.
- Assets are held for their service potential rather than the reporting to generate cash flows. This makes it difficult to arrive at a relevant measure of value of such assets.

***Workings***

1 **Allocation of expenses**

| | Cost of sales | Admin | Distrib |
|---|---|---|---|
| | **₦000** | **₦000** | **₦000** |
| Raw materials consumed | 9,500 | | |
| Manufacturing overheads | 5,000 | | |
| Increase in inventories | (1,400) | | |
| Staff costs (70%/20%/10%) | 3,290 | 940 | 470 |
| Distribution costs | | | 900 |
| Depreciation | | | |
| Building (50%/50%) | 500 | 500 | |
| Plant and machinery | 2,550 | | |
| Fixtures and fittings (30%/70%) | 210 | 490 | |
| | 19,650 | 1,930 | 1,370 |

2 **Accumulated profits brought forward**

| | | |
|---|---|---|
| | **₦000** | **₦000** |
| Accumulated profits carried forward per question | | 14,000 |
| Less tax charge | | |
| - Current year estimate | 2,100 | |
| - Underprovision in previous year | 400 | |
| | | (2,500) |
| Add transfer of excess depreciation on revalued building | | 300 |
| | | 11,800 |

## 2 Brooklyn

### 1 Development expenditure

IAS 38 on intangibles requires that research and development be considered separately:

research – which must be expensed as incurred

development – which must be capitalised where certain criteria are met.

It must first be clarified how much of the ₦3 million incurred to date (10 months at ₦300,000) is simply research and how much is development. The development element will only be capitalised where the IAS 38 criteria are met. The criteria are listed below together with the extent to which they appear to be met.

- The project must be believed to be technically feasible. This appears to be so as the feasibility has been acknowledged.
- There must be an intention to complete and use/sell the intangible. Completion is scheduled for June 20X6
- The entity must be able to use or sell the intangible. Interest has been expressed in purchasing the know-how on completion
- It must be considered that the asset will generate probable future benefits. Confirmation is required from Brooklyn as to the extent of interest shown by the pharmaceutical companies and whether this is of a sufficient level to generate orders and to cover the deferred costs.
- Availability of adequate financial and technical resources must exist to complete the project. The financial position of Brooklyn must be investigated. A grant is being obtained to fund further work and the terms of the grant, together with any conditions, must be discussed further.
- Able to identify and measure the expenditure incurred. A separate nominal ledger account has been set up to track the expenditure.

If all of the above criteria are met, then the development element of the ₦3m incurred to date must be capitalised as an intangible asset. Amortisation will not begin until commercial production commences.

### 2 Non-current asset held for sale

IFRS 5 on non-current assets held for sale and discontinued operations requires that where a non-current asset is being held for sale, rather than for continued use in the business, it must be re-classified in the statement of financial position, re-measured and depreciation must cease to be charged.

For the asset to be classified as “held for sale” it must be available for immediate sale in its present condition and the sale must be highly probable. This requires that:

The appropriate level of management are committed to the plan

An active programme is underway to locate a buyer

The asset is being marketed at a realistic price

Completion of the sale is anticipated within one year of classification.

From the information provided, an agent has been instructed by the plant manager, which suggests that the organisation is committed to the plan to sell the asset. Confirmation is required that the price of ₦175,000 is realistic. The asset has been out of use now for 9 months and this may suggest that the target price is too high and that a sale may not be achieved within the year.

If reassurance as to the above conditions can be obtained, the asset must be reclassified in the statement of financial position as "Non-current assets held for sale", positioned under current assets. It should be re-measured to ₦168,000 being the lower of carrying amount (₦170,000 see below) and fair value less costs to sell (₦175,000 x 96%). The write down of ₦2,000 should be charged to the profit or loss for the year. Depreciation should cease from the date of classification.

***Workings***

The fair value less cost to sell is ₦175,000 – 4% agents fees = ₦168,000

Carrying value is:

| | |
|---|---|
| Cost | ₦260,000 |
| Residual value | ₦ 60,000 |
| Depreciable amount | ₦200,000 |
| Useful life | 5 years |
| Annual depreciation | ₦40,000 |

The current carrying value of ₦140,000 shows that the asset has received three years of depreciation by the 30th June 20X5. If classified as held for sale, depreciation should have ceased on 30th September 20X5 and 3 months of depreciation should be added back, giving a revised carrying value of ₦170,000.

3 **Provision**

Although the claim was made after the reporting period, IAS 10 considers this to be an adjusting event after the reporting period. The employment of the individual dates back to 20X2 and so the lawsuit constitutes a current obligation for the payment of damages as a result of this past event (the employment).

The amount and the timing are not precisely known but the likelihood of payment of damages by Brooklyn is probable and so a provision should be made for the estimated amount of the liability, as advised by the lawyer. Disclosure, rather than provision, would only be appropriate if the expected settlement was possible or remote, and the lawyer's view is that a payment is more likely than not.

It is not appropriate to calculate an expected value where there is only one event, instead a provision should be made for the most likely outcome. The lawyer has various views on the possible payout, but the most likely payout is ₦500,000 as this has a 50% probability. As settlement of the provision is not anticipated until 20X8, the provision should be discounted back at 8% to give a liability of ₦476,280.

Provided that the payment from the insurance company is virtually certain, this should be shown as an asset, also at its discounted value of ₦47,628, being 10% of the provision.

In both cases the discounting should be unwound over the coming three years through profit or loss.

## 4 Revaluation

IAS 16 on Property, Plant and Equipment does not impose a frequency for updating revaluations. It simply requires a revaluation where it is believed that the fair value of the asset has materially changed. Hence, if in the past there have been material differences between the carrying amount and fair value at the 5 yearly review then Brooklyn should consider having more frequent valuations following on from this year's valuation.

Revaluations should be regular and not timed simply when property prices are at a peak. It is not acceptable for Brooklyn to defer its next revaluation while values are low. If property prices do fall in 20X6, then it may be necessary to perform an impairment test in accordance with IAS 36 *Impairment of assets*.

If it is believed that an asset value has moved materially, then all assets in that class must be revalued. Hence it is not sufficient for Brooklyn to just revalue the London property.

IAS 16 does not require the valuation to be performed by an external party, and so the use of the property manager to conduct the valuations is acceptable. Notes to the financial statements will disclose that he is not independent of the company.

## 3 Mbanefo Ltd

**Mbanefo Ltd – Statement of profit or loss extracts year ended 31 March 20X8**

| | ₦ |
|---|---|
| Loss on disposal of plant – see note below ((90,000 – 60,000) – 12,000) | 18,000 |
| Depreciation for year (wkg (i)) | 75,000 |
| Government grants (a credit item) – see note below and (wkg (iv)) | (19,000) |

Note: the repayment of government grant of ₦3,000 may instead have been included as an increase of the loss on disposal of the plant.

**Mbanefo Ltd – Statement of financial position extracts as at 31 March 20X8**

| | Cost | Accumulated depreciation | Carrying amount |
|---|---|---|---|
| | ₦ | ₦ | ₦ |
| Property, plant and equipment (wkg (v)) | 360,000 | 195,000 | 165,000 |
| Non-current liabilities | | | |
| Government grants (working (iv)) | | | 39,000 |
| Current liabilities | | | |
| Government grants (working (iv)) | | | 27,000 |

***Workings***

(i) Depreciation for year ended 31 March 20X8

| | ₦ |
|---|---|
| On acquired plant (working (ii)) | 52,500 |
| Other plant (working (iii)) | 22,500 |
| | 75,000 |

(ii) The cost of the acquired plant is recorded at ₦210,000 being its base cost plus the costs of modification and transport and installation. Annual depreciation over three years will be ₦70,000. Time apportioned for year ended 31 March 20X8 by 9/12 = ₦52,500.

(iii) The other remaining plant is depreciated at 15% on cost

| | ₦ |
|---|---|
| (b/f 240,000 – 90,000 (disposed of) x 15%) | 22,500 |

(iv) Government grants

| Transferred to income for the year ended 31 March 20X8: | ₦ |
|---|---|
| From current liability in 20X7 (10,000 – 3,000 (repaid)) | 7,000 |
| From acquired plant (see below): | 12,000 |
| | 19,000 |

| Non-current liability | |
|---|---|
| b/f | 30,000 |
| transferred to current | (11,000) |
| on acquired plant (see below) | 20,000 |
| | 39,000 |

| Grant on acquired plant is 25% of base cost only = ₦48,000 | |
|---|---|
| This will be treated as: | ₦ |
| To income in year ended 31 March 20X8 (48,000/3 x 9/12) | 12,000 |
| Classified as current liability (48,000/3) | 16,000 |
| Classified as a non-current liability (balance) | 20,000 |
| | 48,000 |

Note: government grants are accounted for from the date they are receivable (i.e. when the qualifying conditions for the grant have been met).

| Current liability | |
|---|---|
| Transferred from non-current (per question) | 11,000 |
| On acquired plant (see above) | 16,000 |
| | 27,000 |

(v)

| | Cost<br>₦ | Accumulated depreciation<br>₦ | Carrying amount<br>₦ |
|---|---|---|---|
| Property, plant and equipment | | | |
| Balances b/f | 240,000 | 180,000 | 60,000 |
| Disposal | (90,000) | (60,000) | (30,000) |
| Addition (w (ii)) | 210,000 | 52,500 | 157,500 |
| Other plant depreciation for year (wkg (iii)) | | 22,500 | (22,500) |
| Balances at 31 March 20X8 | 360,000 | 195,000 | 165,000 |

## Ratios

| | Chris | Caroline |
|---|---|---|
| **Gross profit % =** | | |
| $\frac{\text{Gross profit}}{\text{Sales}} \times 100$ | $\frac{90,000}{150,000} \times 100 = 60\%$ | $\frac{490,000}{700,000} \times 100 = 70\%$ |
| **Net profit % =** | | |
| $\frac{\text{Net profit}}{\text{Sales}} \times 100$ | $\frac{44,895}{150,000} \times 100 = 30\%$ | $\frac{270,830}{700,000} \times 100 = 39\%$ |
| **Return on capital employed =** | | |
| $\frac{\text{Profit before interest and tax}}{\text{Share capital and reserves+Long-term debt capital}} \times 100$ | $\frac{61,500+500}{207,395+10,000} \times 100 = 28.5\%$ | $\frac{371,000+12,000}{565,580+250,000} \times 100 = 47\%$ |
| **Asset turnover =** | | |
| $\frac{\text{Sales}}{\text{Share capital and reserves+Long-term debt capital}} \times 100$ | $\frac{150,000}{207,395+10,000} = 0.7 \text{ times}$ | $\frac{700,000}{565,580+250,000} = 0.85 \text{ times}$ |
| **Current ratio =** | | |
| $\frac{\text{Current assets}}{\text{Current liabilities}}$ | $\frac{50,000}{22,605} = 2.2 \text{ times}$ | $\frac{153,250}{117,670} = 1.3 \text{ times}$ |
| **Quick ratio =** | | |
| $\frac{\text{Current assets excluding inventory}}{\text{Current liabilities}}$ | $\frac{50,000-12,000}{22,605} = 1.7 \text{ times}$ | $\frac{153,250-26,250}{117,670} = 1.1 \text{ times}$ |

*Table continues*

| | Chris | Caroline |
|---|---|---|
| **Average time to collect =** | | |
| $\frac{\text{Trade receivables}}{\text{Sales}} \times 365$ | $\frac{37,500}{150,000} \times 365 = 91$ days | $\frac{105,000}{700,000} \times 365 = 55$ days |
| **Average time to pay =** | | |
| $\frac{\text{Trade payables}}{\text{Cost of purchases}} \times 365$ | $\frac{22,605}{60,000} \times 365 = 137$ days | $\frac{117,670}{210,000} \times 365 = 204$ days |
| **Inventory turnover =** | | |
| $\frac{\text{Inventory}}{\text{Cost of sales}} \times 365$ | $\frac{12,000}{60,000} \times 365 = 73$ days | $\frac{26,250}{210,000} \times 365 = 46$ days |
| **Gearing ratio =** | | |
| $\frac{\text{Long - term debt}}{\text{Share capital and reserves}} \times 100$ | $\frac{10,000}{207,395} \times 100 = 4.8\%$ | $\frac{250,000}{565,580} \times 100 = 44\%$ |
| **Interest cover =** | | |
| $\frac{\text{Profit before interest and tax}}{\text{Interest charges in the year}}$ | $\frac{61,500 + 500}{500} = 124$ times | $\frac{371,000 + 12,000}{12,000} = 32$ times |

**Commentary**

**Profitability**

The return on capital employed achieved by Chris (28.5%) is substantially lower than that achieved by Caroline (47%). This variation in performance is also seen at the gross profit (60% compared to 70%) and net profit levels (30% compared to 39%).

The variation in gross profit percentage could be caused by differences in sales mix, inventory valuation methods or mark-up.

Since these entities operate in the same sector it is unlikely that their selling prices differ significantly. However, Caroline, as a much larger entity, may be able to negotiate better prices from its suppliers.

Caroline is also more efficient at using its assets. It is generating 85c per ₦1 of assets whereby Chris is only generating 70c per ₦1.

**Efficiency/liquidity**

The liquidity of both entities appears satisfactory, although Caroline has less funds tied up in its current assets. Caroline is also more efficient at collecting its debts (55 days compared to Chris's 91 days), and takes a longer credit period from its suppliers.

**Solvency**

Caroline is much more highly geared than Chris (44% compared to 4.8%). Caroline has the ability to raise debt more easily because of its greater profitability and its property, on which debt can be secured. Both companies can easily cover their interest payments suggesting that neither entity's debt is at risk.

**Conclusion**

Caroline is the stronger entity.

## 5 Kalejaiye Ltd

(a) (i) The depreciable amount of an intangible asset with a finite useful life shall be allocated on a systematic basis over its useful life.

(ii) Amortisation shall begin when the asset is available for use

(iii) Amortisation shall cease at the earlier of the date that the asset is classified as held for sale and the date that the asset is derecognised.

(iv) The amortisation method used shall reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity.

(v) The amortisation charge for each period shall be recognised in statement of comprehensive income.

(b)

**Goodwill Account**

| | | ₦ | | | ₦ |
|---|---|---|---|---|---|
| 1-Jan-X8 | Goodwill recognised **(W1)** | 270,000,000 | 31-Dec-X8 | Impairment of goodwill | 50,000,000 |
| | | | 31-Dec-X8 | Balance b/d | 220,000,000 |
| | | 270,000,000 | | | 270,000,000 |
| 1-Jan-X9 | Balance b/d | 220,000,000 | | | |
| | | | 31-Dec-X9 | Balance b/d | 220,000,000 |
| | | 220,000,000 | | | 220,000,000 |

**Brand**

| | | ₦ | | | ₦ |
|---|---|---|---|---|---|
| 1-Jan-X8 | Brand recognised | 100,000,000 | 31-Dec-X8 | Amortisation | 10,000,000 |
| | | | 31-Dec-X8 | Balance c/d | 90,000,000 |
| | | 100,000,000 | | | 100,000,000 |
| 1-Jan-X9 | Balance b/d | 90,000,000 | 31-Dec-X9 | Amortisation | 10,000,000 |
| | | | 31-Dec-X9 | Impairment of Brand | 13,500,000 |
| | | - | 31-Dec-X9 | Balance c/d | 68,000,000 |
| | | 90,000,000 | | | 90,000,000 |

**W1: Value of goodwill**

| | **₦000** |
|---|---|
| Purchase price (50,000,000 x ₦30 x 90%) | 1,350 |
| Non-controlling interest (10% (₦1,100,000,000 + ₦100,000,000)) | 120 |
| | 1,470 |
| Less: | |
| Fair value of net identifiable assets and liabilities | (1,200) |
| Goodwill on acquisition | 270 |

(c) **Fundamental principles**

Integrity

Objectivity

Professional competence and due care

Confidentiality

Professional behaviour

**Threats to the fundamental principles**

Self-interest threat

Self-review threat

Advocacy threat

Familiarity threat

Intimidation threat

## 6 Handel

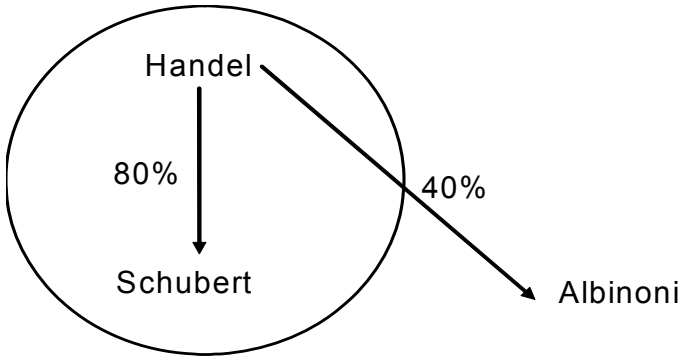
(a) **Consolidated statement of financial position as at 30 September 20X9**

| | ₦ | ₦ |
|---|---|---|
| **Assets** | | |
| Non-current assets | | |
| Property, plant and equipment (697,210 + 648,010) | 1,345,220 | |
| Interest in associate (W6) | 270,800 | |
| Goodwill | 2,000 | |
| | | 1,618,020 |
| Current assets | | |
| Inventory (495,165 + 388,619) | 883,784 | |
| Receivables (385,717 + 320,540 + 6,000) | 712,257 | |
| Cash at bank and in hand (101,274 + 95,010) | 196,284 | |
| | | 1,792,325 |
| Total assets | | 3,410,345 |

| | ₦ | ₦ |
|---|---|---|
| **Equity and liabilities** | | |
| Capital and reserves | | |
| Share capital | | 600,000 |
| Retained earnings (W5) | | 1,357,800 |
| | | 1,957,800 |
| Non-controlling interest | | 204,000 |
| Non-current liabilities (400,000 + 150,000) | | 550,000 |
| Current liabilities | | |
| Trade payables (375,366 + 252,179) (note 2) | | 627,545 |
| Proposed dividends – parent company | | 65,000 |
| – minority interest | | 6,000 |
| | | 698,545 |
| Total equity and liabilities | | 3,410,345 |

***Workings***

(1) **Group structure**



(2) **Net assets**

**Schubert**

| | *Balance sheet date* | | *Acquisition* | | *Post acquisition* |
|---|---|---|---|---|---|
| | ₦ | ₦ | ₦ | ₦ | ₦ |
| Share capital | | 200,000 | | 200,000 | |
| Retained earnings | 850,000 | | 500,000 | | |
| Proposed dividend | (30,000) | | | | |
| | | 820,000 | | 500,000 | 320,000 |
| | | 1,020,000 | | 700,000 | |

(3) **Goodwill**

**Schubert**

| | ₦ |
|---|---|
| Cost of shares | 562,000 |
| Share of net assets acquired (80% × 700,000) (W2) | (560,000) |
| | 2,000 |

(4) **Non-controlling interest**

| | |
|---|---|
| Share of net assets (20% × 1,020,000) (W2) | 204,000 |

(5) **Retained earnings**

| | | ₦ |
|---|---|---|
| Handel | | 1,050,000 |
| Dividends receivable | – Schubert (80% × 30,000) | 24,000 |
| | – Albinoni (40% × 15,000) | 6,000 |
| Proposed dividend | | (65,000) |
| | | 1,015,000 |
| Schubert (80% × 320,000 (W2)) | | 256,000 |
| Albinoni (W6) | | 88,400 |
| Unrealised profit (W7) | | (1,600) |
| | | 1,357,800 |

(6) **Investment in associate**

| | ₦000 |
|---|---|
| Cost | 184,000 |
| Share of post-acquisition profit (40% × [ (478 − 15) − 242) | 88,400 |
| Unrealised profit (W7) | (1,600) |
| | 270,800 |

(7) **Unrealised profit**

| | ₦ |
|---|---|
| *Step 1 – Unrealised profit* | |
| ₦20,000 × $^{25}/_{125}$ | 4,000 |
| *Step 2 – H's share* | |
| ₦4,000 × 40% | 1,600 |

*Step 3 – Double entry*

| | | |
|---|---|---|
| Dr Retained earnings | 1,600 | |
| Cr Investment in associate | | 1,600 |

(b) **Bases of accounting**

**Accruals basis of accounting**

Accruals basis accounting (accruals accounting, the accruals concept) recognises transactions and other events and circumstances in the periods in which those effects occur, even if the resulting cash receipts and payments occur in a different period.

- Revenue from sales and other income should be reported in the period when the income arises (which might not be the same as the period when the cash is received).
- The cost of sales in the statement of comprehensive income must be matched with the sales. Income and 'matching' expenses must be reported in the same financial period.
- Other expenses should be charged in the period to which they relate, not the period in which they are paid for.

**Cash basis of accounting**

Cash basis accounting recognises transactions in the periods in which cash receipts and payments occur.

- Revenue from sales and other income would be reported in the period when the cash is received (which might be in a later period than when the income arose).
- Expenses are charged in the period to which they are paid not the period in which they are incurred.

Over time the accruals based accounting and cash based accounting result in recognising the same amounts. However, transactions might be recognised in different periods under each system.