CHAPTER TWO

HOW TO PREPARE FINANCIAL STATEMENTS OF LIMITED LIABILITY COMPANIES FOR PUBLICATION

At the end of this lecture, students must be able to understand how to prepare financial statements of limited liability companies for publication. Specifically, students should be able to:

2.1 Explain the contents of SAS 2, IAS 5 and CAMA 1990.
2.2 Explain the purpose of publication of financial statements;
2.3 Explain the roles of statute with regards to disclosure of information in the statements of Accounting Policies;
2.4 Outline the arguments for and against more detailed disclosure;
2.5 Identify the items of information to be disclosed in the Statements of Accounting Policies;
2.6 Identify items of information required to be disclosed in the Profit or Loss Account or Income Statement
2.7 Explain the manner in which the items of information in a profit and loss Account or Income Statement are disclosed;
2.8 Explain the items of information to be disclosed in balance sheet;
2.9 Explain manner in which the items of information prepared in balance sheet are to be disclosed;
2.10 Explain the items of information to be included in the Accounts and how they are to be presented;
2.11 Explain the meaning of the Cash Flow Statement and its purpose;
2.12 Identify the various format of the Cash Flow Statement;
2.13 Explain the concepts of "Value Added";
2.14 Explain the manner in which the items Value Added Statement are to be presented;
2.15 Explain the usefulness of the five-year financial summary;
2.16 Identify the items of information to be included in the five-year Financial Summary;
2.17 Prepare financial statement for publication.

2.1 The contents of SAS2, IAS 5, IFRS 1 and CAMA 1990.

This relates to the framework for the preparation of financial statements for publication. This is also referred to as the financial reporting framework and includes:

(a) The legal framework such as the Companies and Allied Matters Act (CAMA) 1990 as amended to date;
(b) The professional framework, both local and international.
This relates more to accounting and reporting standards. In Nigeria, the local standard is the statement of Accounting Standards (SAS) while the international dimension is covered by the International accounting Standards (IAS) and the International Financial reporting standards (IFRS).
(c) Regulatory framework as established by statutory and trade regulators. It includes:
   (i) The Investment and Securities Act (ISA) 2007 regulating companies quoted on the Nigerian stock Exchange;
   (ii) Banks and Other Financial Institutions' Act (BOFIA) which regulates activities in the banking and other financial industries such as finance houses and stock broking businesses;
   (iii) The Nigerian insurance Act (NIA) which regulates insurance business in Nigeria; and
   (iv) The pensions Reform Act (PRA) which regulates activities of pension administrators and other participants in that segment of Nigerian economy.

The Companies and Allied Matters Act[CAMA]1990 is one of the main statutory framework for the preparation, presentation and disclosure of financial statements in Nigeria. Section 331 of CAMA 1990 specifies the nature of accounting records to be kept while section 334 prescribes the contents of the financial statements.

SAS 2 relates to information to be disclosed in financial statements and complies substantially with the International Accounting Standard [IAS] number5 on the same issue. The revised IAS 1 later superseded the earlier IAS 5 and IAS 13, all relating to disclosure of accounting policies information to be disclosed in financial statements [IAS 5] and presentation of current assets and current liabilities [IAS 13]. Hence the contents of SAS 2, IAS 5 and CAMA 1990 are similar. IFRS 1 covers all

2.2 The purpose of publication of financial statements

Financial statements are the media through which the economic performance of an entity is communicated to interested parties and stakeholders at the end of a given period.

The prime purpose of the publication of financial statements hence is to inform stakeholders about the financial performance of an entity within a given period of time-usually a year. Such need becomes more prominent in view of agency relationship between shareholders in a company and the management of such entity. The shareholders, who are mainly investors in the entity need economic data to evaluate corporate performance and decide whether to retain their investments orarbitrage or dispose off. Other stakeholders like the government, communities, creditors, workers and bankers, have their varying and distinct information needs.

2.3 The roles of statue with regards to disclosure of information in the Statement of Accounting Policies

Part X1 of CAMA, chapter 1 from section 331 through section 356 deals with the accounting requirements of a company. From note 2.2 above, it is evident that the informationrequirement of the various stakeholders vary considerably. While shareholders may value data on profitability, earnings and dividends payout, investors may be concerned about the interest cover, the quality of assets offered as securities and the reliability of cash flow. Government may focus on data relating to employment, social corporate responsibility as well as capability to pay relevant taxes, corporate, PAYE etc.

Professionally most economic data generated by a company may be presented in diverse ways resulting in diverse outcome. Income statement could be measured in many ways using accrual or cash basis. The methodology for deriving key elements in the income statements such as depreciation also varies. For stock valuation, LIFO, FIFO and Weighted Average are common examples with difference effects of income statement. To avoid confusion and enhance uniformity, consistent application of accounting standards and credibility of financial statements, hence, disclosure requirement are defined by the Companies and Allied Matters Acts 1990, the Accounting Standards as well other legislations like BOFIA for banks . With the IFRS as the Reporting framework, a complete self of financial statements include:

1. Statement of financial positions- balance sheet;
2. Statement of comprehensive income – profit and loss;
3. Statements of changes in equity;
4. Statement of cash flows- cash flows statement;
5. A description of accounting policies; and
6. Notes to the financial statements.

Most of these documents are expressly mentioned in the CAMA 1990 as essential.

. 2.4 **Arguments for and against more detailed disclosure**

Most disclosures relates to the needs of investors and capital markets exclusively,. This may not be good enough to serve the information need of other stakeholders such as employees, communities, government etc. the need for more concern for the information need of other corporate constituencies such as creditors employees and for the public in general has been advanced as basis for more detailed disclosure especially in the European country form a narrower perspective of shareholder and market orientation emphasis on the concepts of fairness and corporate governance have reduced discrepancies in disclosed laws.

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2.5 Identify the items of information to be disclosed in the Statement of Accounting Policies

Categories of disclosures in contemporary financial ………

1. Significant accounting policies description of accounting policies adopted by the entity relevant to understanding the line items on the face of the ……and the basis of the accounting policies of the entity.
2. Component of items- such as breakdown of the items into smaller categories, movement analysis or other information about a line item.
3. Factual information about the entity- such as addresses, names of group entities, compositions of share capital and dividend payments.
4. Judgments and reasons- Judgments made in the process of applying accounting policies and management decisions and reasons for the policies/decisions selected/made.

See ‘Evolving nature of financial reporting: Disclosure and its Auditing Implications.’

2.6 Identify items of information required in the Profit and Loss Account or Income Statement.

The following information should be disclosed;

i. Turnover/Sales – showing any difference between local and export sales.
ii. Cost of sales
iii. Gross profit
iv. Selling and distribution expenses
v. Other income
vi. Interest charges
vii. Administration expenses

viii. Profit before tax
ix. Tax
x. Profit after tax
xi. EPS & DPS

2.7 Explain the manner in which the items of information are disclosed.

For the companies listed on the Nigerian Stock Exchange [NSE] compliance with the International Financial Reporting Standards (IFRSs) is mandatory with effect from January 1, 2012.

In this regard, information about the company is required in a

i. A separate income statement followed immediately by a statement of other components of comprehensive income comprehensive income include;
   a. Revenue;
   b. Finance costs;
   c. Share of profit or loss of associated and joint ventures;
   d. Tax expenses;
   e. The total gain or loss on discontinued operations, comprising the post-tax profit or loss of discontinued operations and He post-tax gain or loss recognized on the re-measurement to their value less costs to sell, or on the disposal of the assets or disposal groups constituting a disposal groups;
   f. Profit or loss for the period attributable to non-controlling interest and owners of the parent;
   g. Each component of other comprehensive income classified by nature;
   h. Share of other comprehensive income of associates and joint ventures accounted for using the equity method; and
   i. Total comprehensive income for the period attributable to non-controlling interest and owners of the parent, also
   j. The amount if income tax for each component of other comprehensive income, including reclassification adjustments either in the statement of comprehensive income [SCI] ………….

On the face of the Statement of Comprehensive Income (SCI) or in the notes, other relevant information includes:

i. Analysis of expenses based on either their nature or function.
ii. Where expenses are classified by function disclosure is required of the following;
   a. Depreciation charges for tangible assets;
   b. Amortization charges for the intangible assets;
   c. Employee benefits expensive; and
   d. Dividends recongnised and the related amount per share.

It should be noted that presentation of an item as 'extra-ordinary' is no longer allowed.

Format of statement of comprehensive income [showing Expensive classified by function]

	Notes	N'000	N'000	
Sales/Revenue			XXX	
Cost of Sales			(xxx)	
Gross profit			xxx	
Other Income			xxx	
			xxx	
Distribution costs		xxx		
Administration expenses		xxx		
Other operating expenses		xxx		xxx
Finance costs			xxx	
Profit before Tax			(xxx)	
Income after tax				xxx
Earning per share				xxx
Dividend per share				xxx

2.8 Explain the items of information to be disclosed in the Balance Sheet

These include;

i. Fixed Assets- property, plant and equipment
ii. Other long-term Assets- investment in subsidiaries associated … long-term debts, showing their tenure.
iii. Intangible Assets – goodwill, patents, deferred charges e.g pre-incorporation expenses, pre-production/re-organization expenses.
iv. Current Assets
v. Capital and Reserves
vi. Liabilities
vii. General information e.g limits to title on assets or in the notes, an entity may present components of other comprehensive income either:
    - Net of related tax effects or
    - Before related tax effects with one amount shown for the aggregate amount of income tax relating to those components.

k. Reclassification adjustments [amounts reclassification to profit or loss in the current period that were recognized in other comprehensive – income in the current year or period]relating to components of other comprehensive income should be disclosed.

2.9 Explain the manner in which the items of information prepared in the Balance Sheet are to be disclosed

Format 1

Format 2

a. Called up share capital
   Not paid
b. Fixed Assets
c. Long term investments
d. Deferred charges
e. Current Assets
   i. Debtors
   ii. Short-term investments
   iii. Cash at bank and in …..
f. Prepayments and accrued income
g. Profit and loss transferred from P & L account or income statement.

2.10 Explain the items of information to be included in the Notes to the Accounts and how they are to be presented

Items of information (ioi) include:

a. Directors' emoluments
b. Auditors' remuneration
c. Depreciation of fixed assets
d. Staff numbers and remuneration
e. Capital commitments
f. Contingency liabilities
g. Technical service agreements
h. Post balance sheet events.

2.11 Explain the meaning of the cash flow statement and its purpose. IAS 7; IPSA 2

Statement of cash flows means an indication of how liquid resources move in and out of business entities. It identities;

a. The sources of cash inflows
b. The items on which cash was expended during the period , and
c. The cash balance as the reporting period.

The purpose is its provide users of financial statements with reveals the timing and certainty of cash flow within an entity- these are key in decision making. The statement Is an integral part of the financial statements.
Cash equivalents are short-term, highly liquid investments which are readily convertible to know amounts and which are subject to an insignificant risk of changes in value. Being short-term, maturity is usually three months or less from the date of acquisition.

There are two main formats for the preparation of statements of cash flow

I. The 'direct method' and
II. The 'indirect method'.

These are classified and presented into three main activities;

I. Operating activities – using Direct method or Indirect method
II. Investing activities ; and
III. Financing activities.

2.12 Identify the various format of the Cash Flow Statement;

Objective of IAS 7

The objective of IAS 7 is to require the presentation of information about the historical changes in cash and cash equivalents of an entity by means of a statement of cash flows, which classifies cash flows during the period according to operating, investing, and financing activities. The Nigerian Standard (SAS 18) complies substantially with IAS 7.

Fundamental principle in IAS 7

All entities that prepare financial statements in conformity with IFRSs are required to present a statement of cash flows. [IAS 7.1]

The statement of cash flows analyses changes in cash and cash equivalents during a period. Cash and cash equivalents comprise cash on hand and demand deposits, together with short-term, highly liquid investments that are readily convertible to a known amount of cash, and that are subject to an insignificant risk of changes in value. Guidance notes indicate that an investment normally meets the definition of a cash equivalent when it has a maturity of three months or less from the date of acquisition. Equity investments are normally excluded, unless they are in substance a cash equivalent (e.g. preferred shares acquired within three months of their specified redemption date). Bank overdrafts which are repayable on demand and which form an integral part of an entity's cash management are also included as a component of cash and cash equivalents. [IAS 7.7-8]

There are two forms of the Cash Flow Statement. These are:

(i) Direct Method; and
(ii) Indirect Method.

Direct Method

For operating cash flows, the direct method of presentation is encouraged, but the indirect method is acceptable [IAS 7.18]

The**direct method** shows each major class of gross cash receipts and gross cash payments. The operating cash flows section of the statement of cash flows under the direct method would appear something like this:

Cash receipts from customers	xx,xxx
Cash paid to suppliers	xx,xxx

Cash paid to employees	xx,xxx	
Cash paid for other operating expenses	xx,xxx	
Interest paid	xx,xxx	
Income taxes paid	xx,xxx	
Net cash from operating activities	**xx,xxx**	

Indirect Method

The **indirect method** adjusts accrual basis net profit or loss for the effects of non-cash transactions. The operating cash flows section of the statement of cash flows under the indirect method would appear something like this:

Profit before interest and income taxes		xx,xxx
Add back depreciation		xx,xxx
Add back amortisation of goodwill		xx,xxx
Increase in receivables		xx,xxx
Decrease in inventories		xx,xxx
Increase in trade payables		xx,xxx
Interest expense	xx,xxx	
Less Interest accrued but not yet paid	xx,xxx	
Interest paid		xx,xxx
Income taxes paid		xx,xxx
Net cash from operating activities		**xx,xxx**

2.13 The concepts "Value Added"

The concept of "Value Added" explains that the factors of production provide "services" that raise the unit price of a product(x) relative to the cost per unit of intermediate goods used to produce it.

In other words, factors of production modify intermediate goods such that it commands higher prices other conversion to finished goods. For example, cocoa butter is an intermediate good in the process of making bornvita price if 1kg of Bornvita is expected to be higher than the cost of 1kg of cocoa butter because of the value added…………….

In general, 'Value Added' statement is a financial statement which shows how much (wealth) has been created by an entity by using its capacity, capital, manpower, and other resources as well as how the value has been allocated among the varying stakeholders (employees, provide of capital, government and the portion retain for corporate growth) in an accounting period.

Overall, VAS portrays the claims of social, economic and stakeholders in the financial performance of an entity thus implying the relevance of other interest parties aside of shareholders.

2.14 Manner in which the items Value Added Statement are to be presented

The manner of presentation of value added statement [VAS] is to analyze how the wealth or value was created and how it was distributed among the stakeholders as follows;

			N	%
i. Sales to outsiders or third parties		xx		
ii. Purchase of goods & services:				
Local	xx			
Imported		xx	xx	

iii Value Added [i-ii] xx

iv Distributed to the following groups:

a. Employees			xx
b. Government-income tax	xx		
c. Providers of capital-dividends int.	xxxx		
d. Retained in business-for growth			
And assets replacement		xx	
To provide for dep.Of fixed assets xx			
To ……..reserves	xx		

2. 15 The usefulness of the five-year financial summary

The five-year financial summary provides more data on corporate performance spanning between three and five years. This is useful in evaluation of performance in terms of

2. Companion within the years;
   ii Establishment of growth pattern;
   iii Identification of areas of weakness

The five-year financial summary therefore helps stakeholders to make informed decisions given financial figures spanning more than two years.

2.16 The items of information to be included in the five-year financial

Items of information to be included in the five-year financial summary [FYFS] are essentially those relating to the comprehensive income statement and the statement of financial position. Those could be grouped into;

a. Operating Results- usually a summary of the statement of comprehensive income.

i. Turnover
ii. Profit before taxation
iii. Profit after taxation
iv. Dividend declared

b. Assets Employed including;

i. Non-current Assets
ii. Intangible Assets
iii. Investments

iv. Net-current Assets
v. Long-term liabilities and deferred charges.

c. Funds Employed, especially;

i. Issued share capital
ii. Share premium
iii. Reserves

d. Financial Statistics, including;

i. Earnings per share [EPS]
ii. Dividend per share [DPS]
iii. Net and Assets per share [NAPS]

2.17 PREPARATIN OF FINANCIAL STATEMENT

1. Jenrokan Plc., is a company where you work as the Finance Director. The following data has been presented to you for the year ended December 31, 2014.

Jenrokan Plc.

Trial balance for the year ended December 31, 2014

	N’000	N’000
Turnover		73,470
Rent received		170
Investment income		800
Other interest received		600
Profit on sale of plants		3,600
Purchase of raw materials	28,620	
External charges on raw materials	189	
Wages	7,500	

Salaries	1,560	
Pension cost on employees	1,220	
Depreciation charges for the year:		
Land and buildings	410	
Plant and machinery	5,940	
Furniture and fittings	3,250	
Rent and rates	3,900	
Power and lightening	6,940	
Distribution expenses	2,660	
Audit fees	320	
Sundry expenses	400	
Interest paid on bank overdraft	200	
Bills of exchange payable		100
Trade creditors		12,850
Other creditors		2,000
Income tax brought forward		3,080
Creditors:		
Due after one year		5,550
Others		680
Rationalization cost due to Covid-19 pandemic	2,070	
Prepayments	2,410	
Bank balance	9,210	
Trade debtors	13,560	
Other debtors	90	

Goodwill	500	
Land and building	15,950	
Furniture and fittings	68,830	
Accumulated depreciation		
Land and building		2,700
Plant and machinery		51,350
Furniture and fittings		33,500
Investments – Quoted	2,370	
Unquoted	3,020	
Ordinary share capital - N0.50 per share		63,000
General reserve		500
Profit or loss account		750
Provision for deferred tax		3,010
Stocks:		
Raw materials	10,600	
Work – in- Progress	9,780	
Finished goods	11,530	

Additional information:

(i) Stocks at December 31, 2014

	N'000
Raw materials	12,810
Work-in-progress	11,050
Finished goods	12,580

(ii) Non-current assets acquired in the year:

Plant and machinery	8,500
Furniture and fittings	780

Disposals were as follows:

Plant at cost (Acc. Depr.N2.67m)	3,020

Fittings (acc. Depr. N0.91m) 1,250

(iii) Proposed dividend –six kobo per share

(iv) Provision in the accounts for income tax of N2.4m and capital gains tax on sale of plants of n0.45m is made.

(v) Under provision of income tax in respect of the year ended December 31, 2013 was N0.25m

(vi) Included in wages were director's fee of N0.5m executive director's salary of N2.5m

You are required to prepare the Profit or loss Account for the year ended December 31, 2014 and the statement of financial position for the year then ended, suitable for publication.

QUIZZES

1. The Companies and Allied Matters Act [CAMA] 1990 is one of the main …………… frameworks for the preparation, presentation and ……………. of financial statements in Nigeria.
2. The prime purpose of the publication of financial statements is to inform stakeholders about the …………………..performance of an entity within a given period of time-usually a …………..
3. The revised IAS 1 later superseded the earlier IAS 5 and IAS 13, all relating to ………………….. of accounting policies, information to be disclosed in financial statements [IAS 5] and presentation of current assets and ……………………… [IAS 13]
4. For the companies listed on the Nigerian …………… Exchange [NSE] compliance with the International Financial Reporting Standards (IFRSs) is mandatory with effect from ……………………
5. Items of information to be included in the five-year financial summary [FYFS] are essentially those relating to the comprehensive …………… statement and the …………. of financial position.

REVISION QUESTIONS

1. Briefly explain why published financial statements are highly regulated.
2. (a) State the main connection between SAS 2, IAS 5 & CAMA 1990 1990
   (b) List two sections of the Companies and Allied Matters Act (CAMA) 1990 relevant to the preparation of financial statements.

3. Has the society benefited from more disclosure of financial information? Discuss.

4. Explain why statutory regulations are required for documentation, disclosure and

presentation of financial statements in Nigeria.

ASSIGNMENTS

1. Peruse the following:

(i) SAS 2

(ii) IAS 5 and 13

(iii) IAS 1 (Revised)

(iv) IFRS 1

(v) CAMA Part XI

(vi) BOFIA

(vii) NIA

(viii) PRA – Pensions Reform Act.

2. Summarize IAS (Revised) and IFRS 1