

REGULATORY FRAMEWORK OF FINANCIAL REPORTING

1.0 LEARNING OBJECTIVES

After studying this chapter, the reader will be able to understand the:

- ◆ Need for the existence of a regulatory framework;
- ◆ Various regulatory framework for corporate financial reporting;
- ◆ Composition, functions and powers of the Nigerian Accounting Standards Board;
- ◆ Processes involved in the production of an accounting standard; and
- ◆ Current Statements of Accounting Standards issued by NASB.

1.1 INTRODUCTION

Regulation of accounting information is aimed at ensuring that users of financial statements receive a minimum amount of information that will enable them take meaningful decisions regarding their interest in a reporting entity. The bodies responsible for these regulations are often statutory agencies such as the Accounting Standards Board, Securities and Exchange Commission and the Stock Exchange. The bulk of this framework is usually contained in Accounting Standards. The Nigerian Accounting Standards Board is the body responsible for the issuance of Accounting Standards in Nigeria. This board, was initially an advisory body responsible for the production of standards that will serve as a guide to Accountants in the preparation of financial statements. Until 2003, when the Nigerian Accounting Standards Board Act was enacted, which now makes it mandatory for accountants preparing corporate reports to adhere strictly to the provisions of the Accounting Standards issued by the board, the standards were treated as just generally accepted accounting principles. This mandatory approach arises from the fact that there is the need to:

- (a) ensure uniformity in the preparation and presentation of corporate reports throughout the country;
- (b) ensure that accountants comply with the Generally Accepted Accounting Principles in the discharge of their functions;
- (c) ensure that the standards comply with existing regulatory frameworks;
- (d) ensure that the standards comply with the domestic accounting need of our country.

With the passing into law of the NASB Act 2003, the NASB is now the

only body recognized by law for the development, issuance and review of accounting standards for preparers and users of financial statements.

1.2 OTHER REGULATORY FRAMEWORK

Other institutions responsible for the regulation of accounting information in Nigeria include:

- (a) The Central Bank of Nigeria (CBN);
- (b) The Nigerian Insurance Commission (NAICOM);
- (c) The Securities and Exchange Commission.

Each of these regulatory authorities has an enabling law that guides the activities of the various institutions operating in the sector. The CBN has the Banks and Other Financial Institutions Act (BOFIA) 1991, NAICOM has the Nigerian Insurance Act 2003, while the Securities and Exchange Commission has the Investment and Securities Act, 1999. These Acts provide some specific requirements relating to the Accounts of every corporate entity within its fold. BOFIA, for instance provides specific requirements relating to the minimum paid up capital, statutory reserves, lending limit, classification of assets, returns and publication of annual accounts by banks. The Insurance Act also provides for the minimum paid up capital, types and classification of insurance businesses, statutory deposit, books and accounting records to be kept, maintenance of technical reserves and solvency margin required by all insurance businesses in Nigeria. The Investment and Securities Act on the other hand makes provision for the registration of capital market operators, public offer and sale of securities and mergers, take-over and acquisitions. All these requirements are made to supplement the elaborate provisions of the Nigerian Accounting Standards.

1.3 COMPOSITION, FUNCTIONS AND POWERS OF THE NIGERIAN ACCOUNTING STANDARDS BOARD

1.3.1 Composition

The NASB was established in 1982 to issue accounting standards in Nigeria which will take into cognizance our peculiar business environment, customs, laws and level of economic development. From inception to date, the membership of the Board changed considerably from 8 to 13, 13 to 14 and to the present arrangement which provided for a four strata membership comprising of 17 members all of whom are appointed by the President. The present membership as provided under S. 2(2) of NASB Act, includes:

- (a) The Chairman;
- (b) Two members each from the Institute of Chartered Accountants of Nigeria (ICAN) and the Association of National Accountants of Nigeria (ANAN).
- (c) A representative each from the following:

- (i) Federal Ministry of Commerce;
 - (ii) Federal Ministry of Finance;
 - (iii) Central Bank of Nigeria;
 - (iv) Nigerian Accounting Association (NAA);
 - (v) Corporate Affairs Commission;
 - (vi) Federal Inland Revenue Service;
 - (vii) Nigerian Deposit Insurance Corporation;
 - (viii) Securities and Exchange Commission;
 - (ix) Auditor General for the Federation;
 - (x) Accountant General of the Federation;
 - (xi) Chartered Institute of Taxation of Nigeria; and
 - (xii) Nigerian Association of Chambers of Commerce, Industries, Mines and Agriculture .
- (d) The Executive Secretary of the Board.
- Each member of the Board shall hold office for a period of four years or on such terms or conditions that may be specified in their letters of appointment.

1.3.2 Functions of the Board

The Board's functions as provided in S. 6 of the Act, include the following:

- (a) Developing and publishing in public interest, accounting standards to be observed in the preparation of financial statements;
- (b) Reviewing from time to time the accounting standards developed in line with the prevalent social, economic and political environments;
- (c) Promoting and enforcing compliance with accounting standards developed or reviewed by the Board;
- (d) Promoting the general acceptance and adoption of standards by preparers of financial statements;
- (e) Receiving from time to time notices of non-compliance with its standard from the preparers, users and auditors of an account;
- (f) Receiving copies of all qualified reports together with detailed explanations for such qualifications from auditors of the accounts within a period of 60 days from the date of such qualifications;
- (g) Advising the Minister on the making of regulations under S. 356 of Companies and Allied Matters Act;
- (h) Advising the Federal Government on matters relating to accounting standards; and
- (i) Performing such other duties which, in the opinion of the Council, are necessary or expedient to ensure the efficient performance of the functions of the Board under this Act.

1.3.3 Powers

Powers of the Board include the following:

- (a) Identifying accounting statements which require standardization and establish order of priority for addressing them;
- (b) Determining the scope and objectives of each standard;
- (c) Prescribing the methods and procedure for the production of standards;
- (d) Prescribing the time-table for the production of standards;
- (e) Approving discussion papers, exposure drafts and standards;
- (f) Enforcing and approving enforcement of compliance with accounting standards in Nigeria; and
- (g) Exercising such powers as are necessary or expedient for giving effect to the provisions of this Act.

1.4 PROCESS OF PRODUCING AN ACCOUNTING STANDARD

The procedure to be adopted in the production of an accounting standard is provided under S.8 of the Act as follows:

- (a) Choice of a topic for standardisation;
- (b) Prepare and publish exposure draft;
- (c) Allow at least three months for comments by stakeholders;
- (d) Conduct a public hearing where necessary;
- (e) Incorporate all reasonable additional ideas to the documents;
- (f) Issue a statement of accounting standard.

1.5 STATEMENTS OF ACCOUNTING STANDARDS ISSUED

Since its establishment in 1982, the NASB has so far issued thirty (30) accounting standards which include:

- SAS 1 Disclosure of Accounting Policies
- SAS 2 Information to be Disclosed in Financial Statements
- SAS 3 Accounting for Property, Plant and Equipments
- SAS 4 Stocks
- SAS 5 Construction Contracts
- SAS 6 Extraordinary Items and Prior Year Adjustment
- SAS 7 Foreign Currency Conversions and Translations
- SAS 8 Accounting for Employees Retirement Benefits
- SAS 9 Accounting for Depreciation
- SAS 10 Accounting for Banks and Non-Banks Financial Institutions (Part I)
- SAS 11 Leases
- SAS 13 Accounting for Investments
- SAS 14 Accounting in the Petroleum Industry: Upstream Activities
- SAS 15 Accounting for Banks and Non-Banks Financial Institutions (Part II)
- SAS 16 Accounting for Insurance Companies

SAS 17	Accounting in the Petroleum Industry: Downstream Activities
SAS 18	Statement of Cash flows
SAS 19	Accounting for Deferred Taxes
SAS 20	Abridge Financial Statements
SAS 21	Earnings Per Share
SAS 22	Research and Development Costs
SAS 23	Provisions, Contingent Liabilities and Contingent Assets
SAS 24	Segment Reporting
SAS 25	Telecommunications Activities
SAS 26	Business Combinations
SAS 27	Consolidated and Separate Financial Statements
SAS 28	Investments in Associates
SAS 29	Interests in Joint Ventures
SAS 30	Interim Financial Reporting

1.6 SUMMARY AND CONCLUSIONS

This chapter has discussed the various bodies and laws regulating corporate financial reporting in Nigeria. It has also given details about the composition, functions and powers of the Nigerian Accounting Standards Board as well as the process involved in producing an Accounting Standard.

Refer to Comprehensive Questions and Suggested Solutions in Appendix II, page 269.

1.7 REVISION QUESTIONS

1.7.1 MULTIPLE CHOICE QUESTIONS

- Which of the following institutions is not responsible for the regulation of accounting information in Nigeria?
 - Central Bank of Nigeria.
 - Securities and Exchange Commission.
 - Nigeria Accounting Standards Board.
 - Nigeria Insurance Commission.
 - Corporate Affairs Commission.
- The following are represented on the Nigerian Accounting Standards Board except:
 - Institute of Chartered Accountants of Nigeria.
 - Federal Ministry of Commerce.
 - Association of National Accountants of Nigeria,
 - Economic and Financial Crimes Commission.
 - Corporate Affairs Commission.
- One of the following is not part of the processes to be adopted in producing an accounting standard:
 - Choosing a topic for standardization.
 - Preparing and publishing an exposure draft.
 - Allowing at least one month for comments by shareholders.
 - Conducting public hearing if necessary.
 - Incorporating all reasonable additional ideas to the document.

4. Which of the following statements of Accounting Standards governs construction contracts?
 - A. SAS 5
 - B. SAS 10
 - C. SAS 2
 - D. SAS 6
 - E. SAS 4.
5. Statements of Accounting Standards Number 10 and 15 are concerned with:
 - A. Accounting for Investments
 - B. Accounting for Banks and Non-Bank Financial Institutions.
 - C. Leases
 - D. Segment for Reporting.
 - E. Business combinations.

1.7.2 SHORT ANSWER QUESTIONS

1. In Nigeria, Accounting Standards are issued by the.....
2. The acronym "BOFIA" stands for.....
3. Statement of Accounting Standard 29 is to regulate accounting information on.....
4. The subject of SAS 21 is.....
5. Extraordinary Items and Prior Year Adjustments are the subject of SAS.....

Refer to Suggested Solutions in Appendix I, Page 263.

ACCOUNTING AND REPORTING POLICIES

2.0 LEARNING OBJECTIVES

After studying this chapter, the reader will be able to understand the:

- ◆ General and Specific reporting policies;
- ◆ Guidelines for the selection of Reporting Policies;
- ◆ Methods of recognizing Assets and Liabilities;
- ◆ Difference between legal and commercial views of Accounting; and
- ◆ Concepts of “fair presentation” and “true and fair view”.

2.1 INTRODUCTION

Accounting policies are specific bases used by a particular business and regarded as appropriate to the circumstances of the business and suitable for the fair presentation of its results and financial position. Disclosure of accounting policies becomes necessary in circumstances where alternative treatments for a number of items appearing in financial statements exist. As a guide to users of financial statements, prepares of an entity's financial statement are required to state categorically which of the various alternative policies is adopted. The Statement of Accounting Standard 1 (SAS 1) requires that every company shall disclose its accounting policies in relation to the following general issues:

- (a) Overall accounting policy (e.g. historical cost, general purchasing power, replacement value);
- (b) Consolidation policy; (for group entities)
- (c) Taxation;
- (d) Long term contracts;
- (e) Events subsequent to the balance sheet date;
- (f) Leases, hire purchase or instalment transactions and related interest;
- (g) Conversion or translation of foreign currencies including the disposition of exchange gains and losses; and
- (h) Franchises.

The presentation of accounting policies in financial statements varies from one enterprise to another. In order to provide an over-view of the accounting

policies of an enterprise, these accounting policies should be disclosed together, rather than as notes to individual items in the financial statements. However, many enterprises disclose in notes to their financial statements, the significant accounting policies which they have adopted in treating the following items:

Assets Related Items:

- (a) Debtors or receivables;
- (b) Stock and work-in-progress (inventories) and related cost of goods sold;
- (c) Depreciation;
- (d) Investments, subsidiary companies, associated companies, and other investments;
- (e) Research and development;
- (f) Patent and trademarks; and
- (g) Goodwill.

Liabilities and provisions:

- (a) Warranties;
- (b) Commitments and contingencies;
- (c) Pension costs and retirement plans; and
- (d) Severance and redundancy payments.

Profit and losses:

- (a) Methods of revenue recognition;
- (b) Maintenance, repairs and improvement expenditure;
- (c) Gains and losses on disposal of property;
- (d) Reserve accounting, statutory or otherwise, including direct charges and credits to surplus accounts; and
- (e) Establishment and building costs.

2.2 IMPLEMENTATION OF ACCOUNTING POLICIES IN ANNUAL REPORTS AND ACCOUNTS

Here we discuss a practical application of accounting policies adopted by real businesses as shown in their annual reports and accounts:

2.2.1 Excerpts from the Annual Report and Accounts of Lion Bank of Nigeria, Plc (Single Entity)

The following are the significant accounting policies adopted and consistently applied by the bank in the preparation of its financial statements:

(a) **Basis of accounting**

The accounts are prepared under the historical cost convention.

(b) Loans and Advances

Loans and advances are either performing or non-performing and are stated after deducting provisions against debts considered doubtful of recovery.

(c) Bad and doubtful debts

Provisions are made against loans and advances in accordance with the Prudential Guidelines issued by the Central Bank of Nigeria.

(d) Income

- (i) Interest is accrued on a daily basis on all performing advances. Interest accruing on non-performing accounts is not taken to the credit of profit and loss account until the debt is recovered.
- (ii) Credit-related fee income, where material, is amortized over the life of the credit. Otherwise, fees and commissions are recognized as earned upon the completion of the related services.

(e) Fixed Assets

Fixed assets are stated at cost less accumulated depreciation.

(f) Assets on Lease

Assets on lease are accounted for strictly in accordance with their legal form as fixed assets. The relevant assets are purchased in the name of the bank and subsequently leased to customers as operating leases.

(g) Depreciation

- (i) Depreciation charged on fixed assets is calculated on the straight-line basis to write off their costs over their estimated useful lives at the following annual rates:

Freehold buildings	2%
Leasehold buildings and improvements:	
50 years and over	2%
Below 50 years	over the term of the lease
Assets on lease	over the term of the lease
Motor Vehicles	25%
Furniture and Fittings	20%
Machinery and Equipment	20%
Computer Equipment	20%
- (ii) No depreciation is charged on assets until they are put into use.

(h) Exchange rates

- (i) Transactions in foreign currencies are translated to the naira at the rates of exchange ruling at the date of the transactions.
- (ii) Foreign currency balances are converted to the naira at the rate of exchange ruling at the balance sheet date and the resultant profit or loss on exchange is taken to the profit and loss account.

(i) Deferred taxation

Provision for deferred taxation is made using the liability method and calculated at the current rate of taxation on the differences between the net book values of qualifying fixed assets and their corresponding tax written down values in accordance with the Statement of Accounting Standard No. 19 (SAS 19) issued by the NASB in December 2000.

From the foregoing, it is clear that stating the policies becomes necessary as different methods of treatment exist. For instance, basis of accounting could be historical cost or current cost. Of these options the bank chooses to adopt the historical cost method. The bank has indicated its accounting policies in relation to such items as loans and advances, bad and doubtful debts, income, fixed assets, depreciation and deferred taxation. The statement of the policy provides a guide for the reader/user of the financial statements to have an adequate picture of certain assumptions underlying the treatment of items in the accounts.

2.2.2 Excerpts from the Annual Reports and Accounts of Group Entity (First Bank of Nigeria Plc)

The following are the significant accounting policies adopted by the Group in the preparation of its financial statements:

(a) Basis of Accounting

The accounts are prepared under the historical cost convention modified to include the revaluation of certain land and buildings (own premises only).

(b) Basis of Consolidation**(i) Subsidiaries**

The Group financial statements incorporate the financial statements of the Bank and four of its wholly owned subsidiaries, FBN Bank (UK) Limited, FBN Capital Limited, First Trustees Nigeria Limited and First Registrars Nigeria Limited, all made up to March 31, 2007. The other

subsidiaries whose results are considered immaterial have not been consolidated.

All intra-group transactions, balances, incomes and expenses are eliminated on consolidation.

(ii) **Investments in Associated Company**

Investments in associated company are carried on the balance sheet at cost. Profit and losses are eliminated to the extent of the Group's interest in the associated company.

(iii) **Foreign Operations**

The assets and liabilities of foreign entities are converted to Naira at the ruling exchange rates at the reporting date except for share capital and pre-acquisition reserves, which are translated at the historical rates. Incomes and expenses are translated to Naira using average rates.

(c) **Goodwill on Consolidation**

Goodwill represents the excess of the purchase consideration over the fair value of the Group's share of the separable net assets of the legacy banks acquired. Goodwill arising on consolidation of legacy banks is accounted for in line with the provision of schedule 2 Section 65 of the Companies and Allied Matters Act CAP C20 LFN 2004.

(d) **Cash and Short-Term Funds**

Cash and Short-Term funds comprise cash balances on hand, cash deposited with the Central Bank of Nigeria, cash deposited with other banks and financial institutions (local and foreign) other than the Central Bank of Nigeria. The Balance is stated less provisions for doubtful balances.

(e) **Bills Discounted**

Holdings in bills discounted (treasury bills) are stated at face value as it is the Bank's policy to hold these to maturity. Diminution in value of investments is noted in the financial statements.

(f) **Trading Securities**

Trading securities comprise of government bonds and other securities.

- (i) Trading securities held for fixed redemption date are stated at cost.

- (ii) Dealing securities are stated at the lower of cost and market value.
- (iii) Premiums and discounts arising on purchase are amortized on the yield to redemption.

(g) **Investments**

Investments are classified as short or long term investments. Those intended to be held for a period exceeding one year and which are either held to maturity or available for sale in response to needs for liquidity or changes in interest rates are classified as long term investments. Debt and equity securities held for a period not exceeding one year are classified as short-term investments.

- (i) Quoted investments other than dated securities are stated at the lower of cost and market value.
- (ii) Unquoted investments are stated at cost less provision for doubtful investments.
- (iii) Dated securities are stated at cost.
- (iv) Investments in subsidiaries are stated at cost.

(h) **Bad and Doubtful Accounts**

Loans and advances are stated after deducting provisions against debts considered doubtful of recovery. Loans are classified as performing and non-performing. They are considered non-performing when principal and interest repayment obligations are in arrears for three months or more. Specific provisions are made on non-performing accounts as follows:

Interest and/or principal outstanding for:	Classification	Provision
More than 90 days but less than 180 days	Sub-standard	10%
180 days but less than 360 days	Doubtful	50%
360 days and over	Lost	100%

A general provision of 1% is made on all performing balances in line with the Prudential Guidelines of the Central Bank of Nigeria.

(i) **Interest**

Interest on advances is accrued to the profit and loss account until such a time as reasonable doubt exists about its collectability. Interest accruing on non-performing accounts is not taken to the credit of the profit and loss account until the debt is recovered.

(j) Advances Under Finance Lease

Advances to customers under finance leases are stated net of unearned income. Lease finance is recognized in a manner which provides a constant yield on the outstanding net investment over the lease period.

(k) Fixed Assets

Fixed assets are stated at cost or valuation less accumulated depreciation.

(l) Depreciation

Depreciation is provided to write off the cost of fixed assets over their estimated useful lives on a straight line basis at the following annual rates:

Freehold buildings	-	2% from date of use
Leasehold buildings:		
50 years and over	-	2% from date of use.
Below 50 years	-	Over the term of the lease.
Assets on Lease	-	Over the term of the lease.
Motor Vehicles	-	25%
Computer equipment	-	33 $\frac{1}{3}$ %
Other fixed assets	-	20%

(m) Foreign currencies

Transactions in foreign currencies are translated to Naira at the rate of exchange ruling at the date of the transactions.

Foreign currency balances are converted to Naira at the rate of exchange ruling at the balance sheet date and the resultant profit/loss on conversion is taken to profit and loss account in respect of Bank-owned funds and the rest charged/credited to third parties. The Bank's equity investment in FBN Bank (UK) Limited is stated at transaction cost.

(n) Taxation

Income tax is provided on taxable profit at the current statutory rate. Provision for deferred taxation is made using the liability method and calculated at the current rate of taxation on the differences between the net book values of qualifying fixed assets and their corresponding tax written down values.

(o) Borrowings

Borrowings are recorded at the proceeds received, plus direct issue costs. The capitalized direct issuing costs are amortized over the tenor of the underlying instrument.

(p) **Dividend**

Proposed dividend for the year is recognized as a liability only when declared and approved by shareholders at the Annual General Meeting.

(q) **Retirement Benefits**

Arrangement for retirement benefits for members of staff is based on the provisions of the Nigerian Pension Act 2004, which is contributory. The matching contributions of 8.5% and 16.5% for staff and bank respectively are based on current salaries and eligible allowances and are charged to profit and loss account. Membership of the scheme is open to members of staff upon confirmation of employment with the Bank.

The Bank also maintains the defined benefit plan scheme based on 16.5% and 8.5% contributions on current salaries and eligible emoluments by the bank and staff respectively for employees who are not covered under the Nigeria Pensions Act 2004.

(r) **Off Balance Sheet Engagements**

Transactions that are not currently recognized as assets or liabilities in the balance sheet but which nonetheless give rise to credit risks, contingencies and commitments are reported off balance sheet. Such transactions include letters of credit, bonds, guarantees, indemnities, acceptances, trade related contingencies such as documentary credit, etc.

Outstanding and unexpired commitments at the year end in respect of these transactions are shown by way of note to the financial statements. Income on off balance sheet engagements is in form of commission which is recognized as and when transactions are executed.

(s) **Income Recognition**

(i) **Interest Income and Interest Expense**

Interest is accrued on daily balances on all assets and liabilities to which interest is applicable.

(ii) **Fees, Commissions and Other Incomes**

Fees and commissions, where material, are amortized over the life of the related service. Otherwise fees, commissions and other incomes are recognized as earned upon completion of the related service.

(iii) **Investment Income**

This is recognized on an accrual basis and credited to the profit and loss account.

(iv) Lease Finance Income

This is recognized on a basis that provides a constant yield on the outstanding principal over the lease term.

(v) Dividend Income

This is recognized on actual basis and credited to the profit and loss account.

(t) Provisions

Provision is recognized when the company has a present obligation whether legal or constructive as a result of a past event for which it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation in accordance with the Statement of Accounting Standard (SAS) 23.

The excerpt above is similar to the earlier one except that in the latter excerpt, certain assumptions which guided group entity were made. These include; the basis used in consolidating the accounts and the treatment of the goodwill arising on consolidation.

2.3 CHOICE OF ACCOUNTING POLICIES

Judgment is required in the choice of the accounting policies which are appropriate to the circumstances of an enterprise and are best suited to present the “true and fair view” of its results and financial position.

In the choice and application of the appropriate accounting policies, there are instances where some fundamental concepts contradict one another. It is however not possible to develop general rules for the exercise of judgment. The following principles have been evolved for use in particular circumstances:

(a) Substance Over Form

Although business transactions are often governed by legal principles, but where the legal principles contradict the financial reality, such transactions should be accounted for in accordance with their substance and financial reality and not merely with their legal form.

(b) Objectivity

This principle provides that the accountant preparing the financial statements should exercise independence of judgment supported by verifiable evidence in his choice of an accounting policy.

(c) Fairness

This principle requires that the choice of an accounting policy should be such that the reports prepared do not favor any user group or segment of society.

(d) Materiality

The principle holds that only items of material values are accorded their strict accounting treatment.

(e) Prudence

This principle demands exercising great care in the recognition of profit whilst all known losses are adequately provided for.

2.4 METHODS OF RECOGNIZING ASSETS AND LIABILITIES

Assets are resources controlled by the enterprise as a result of past events and from which future economic benefits are expected to flow to the enterprise. Liabilities on the other hand, represent obligations of the enterprise arising from past events, settlement of which is expected to result in an outflow of resources from the enterprise and embodying economic benefits.

In circumstances where legal principles contradict the financial realities of a transaction, the substance of the transaction should be accounted for while its legal principles are ignored. Accountants are often faced with this conflict in certain transactions such as:

Sale and Repurchase Agreement: These arrangements occur where an asset is sold by the seller to a buyer on terms that the seller repurchases the asset from the buyer at a future date. This transaction has two possible interpretations of either a secured loan or a sale and lease back. If the arrangements provide that the seller retains right to determine asset's use while the buyer only receives return (secured loan) the asset will only be recognized in the books of the seller. The transfer of title by way of purchase is ignored.

Where the transaction resembles a finance lease arrangement, that is, the ownership title passes to the buyer, the assets shall be recorded as that of the buyer.

2.5 SUMMARY AND CONCLUSIONS

This chapter discussed the general and specific policies that could be adopted by a reporting entity. The chapter also delved into guidelines for selecting relevant policies, methods of recognising assets and liabilities as well as the distinction between legal and commercial views of accounting. Excerpts from annual reports which highlight accounting policy implementation are given in the chapter.

Refer to Comprehensive Questions and Suggested Solutions in Appendix II, page 269.

2.6 REVISION QUESTIONS

2.6.1 MULTIPLE-CHOICE QUESTIONS

1. The Statement of Accounting Standard Number 1 requires every company to disclose its accounting policies in relation to all the following except:
 - A. Franchises
 - B. Taxation
 - C. Board of Directors
 - D. Long Term Contracts
 - E. Leases.
2. Goodwill on consolidation represents:
 - A. Excess of cost of acquisition over the value acquired.
 - B. Excess of Assets over Liabilities.
 - C. Excess of liabilities over assets.
 - D. Excess of tangible assets over intangible assets.
 - E. Excess of the purchase consideration over the fair value of assets acquired.
3. Which of the following is not an asset related item:
 - A. Stock and Work-In-Progress.
 - B. Research and Development.
 - C. Warranties.
 - D. Patent and Trademarks
 - E. Investments.
4. A commercial bank's cash and short-term funds comprise:
 - (i) cash balances on hand
 - (ii) cash deposited with the Central Bank of Nigeria
 - (iii) cash deposited with other banks and financial institutions.
 - A. (i) only
 - B. (i) and (ii) only
 - C. (ii) only
 - D. (i), (ii) and (iii)
 - E. (ii) and (iii) only.
5. A bank loan is regarded as lost if the interest and/or principal is outstanding for:
 - A. More than 30 days but less than 60 days.
 - B. More than 60 days but less than 90 days.
 - C. More than 90 days but less than 180 days.
 - D. More than 180 days but less than 360 days.
 - E. 360 days and above.

2.6.2 SHORT ANSWER QUESTIONS

1. In the preparation of consolidation schedule, goodwill represents the excess of purchase consideration over the.....
2. The excess of the cost of acquiring a controlling interest in a subsidiary over the value of interest acquired is the.....

3. The principle which stipulates that great care should be exercised in recognising profit is known as.....
4. The assumption that an enterprise will continue in operation for the foreseeable future is referred to as the..... concept.
5. The required provision on a sub-standard bank loan is..... percent.

Refer to Suggested Solutions in Appendix I, Page 263.

AMALGAMATION, ABSORPTION AND RECONSTRUCTION

3.0 LEARNING OBJECTIVES

After studying this chapter, it is expected that readers will understand:

- ◆ The meaning of business combination;
- ◆ The reason(s) why businesses combine;
- ◆ The major types of business combinations;
- ◆ Accounting entries for business combinations;
- ◆ When a company will embark on capital reduction scheme;
- ◆ The principles of implementing an already formulated capital reduction scheme;
- ◆ The differences between capital reduction and capital reconstruction scheme;
- ◆ Distinction between internal and external reconstruction schemes; and
- ◆ The formulation of an acceptable capital reduction scheme.

3.1 INTRODUCTION

The term “business combination” is used to describe an arrangement where two or more businesses owned and operated as separate entities come together to become a single entity under the same ownership. The implication of this is that the separate businesses will discontinue their ownership and come under a single ownership. Business combinations can be found in sole- proprietorship, partnership and companies’ business arrangements. Companies combine with a view to eliminating or reducing competition, to carry on business on a large scale or to control prices and markets.

Business combination can take two forms:

- (a) Amalgamation
- (b) Absorption

Sometimes companies are dissolved due to financial problems and after several adjustments they re-register to carry on normal businesses. This process is called reconstruction or reorganisation. This exercise is undertaken by those companies which either incur heavy losses for a long **time and were unable**

to write off such losses, or those having substantial fictitious assets such as goodwill, preliminary expenses, profit and loss account debit balances. Reconstruction can either be internal or external.

3.2 AMALGAMATION

This refers to a situation where companies that exist separately under different ownerships combine to form a new one. The major feature of this arrangement is that the two businesses that amalgamate will no longer exist, that is, they are liquidated. For example, company A may combine with company B to form company AB which is expected to be larger and more viable. Ideally suited to this method are similar businesses of the same sizes, operating on a relatively small scale.

Reasons/benefits of amalgamation include:

- (a) The desire to gain larger share of the market.
 - (b) The desire to attain synergy.
 - (c) The desire to establish a solid capital base.
 - (d) To provide efficient customer service.
 - (e) To acquire a base adequately for raw material sourcing in the case of a manufacturing firm.
 - (f) To be able to challenge a major competition.
 - (g) In order to meet legal and statutory requirement.
- When businesses amalgamate, two major accounting problems arise, viz:
- (i) Those concerned with closing the books of the discontinuing businesses which are being wound up;
 - (ii) Those concerned with the establishment of the new business.

3.3 CLOSING THE BOOKS OF THE DISCONTINUING COMPANIES

To close the books of the discontinuing companies, the following ledger accounts are necessary;

- (a) Realisation account.
- (b) New company account.
- (c) Sundry members account.
- (d) Each liability account, for example creditors, liquidation expenses payable/creditors for dissolution expenses, loan or debenture account.
- (e) Bank account.
- (f) Components of purchase consideration, for example ordinary shares issued, preference shares issued, debenture stock issued and cash paid.

3.4 REALISATION ACCOUNT

This is the account in which the profit or loss on the dissolution of a company is determined. It is usually prepared in a columnar form. The number of columns will depend on the number of companies amalgamating.

The following transactions or events are usually accounted for in the realisation account:

- (a) Debit all assets at book values to realisation account;
- (b) Determine the purchase consideration and credit it to the realisation account;
- (c) Amalgamation, dissolution or liquidation expenses should be debited to realisation account. This will in effect reduce the profit on realisation or increase the loss on realisation
- (d) Profit or loss on realisation is determined; that is, the balance on realiation account is transferred to the sundry members' account (ordinary).

3.5 NEW COMPANY ACCOUNT

This is the account where the purchase consideration and related transactions are treated. The purchase consideration, when agreed, is debited to this account (remember that the credit entry goes to realisation account) while transactions relating to the purchase consideration are credited to the account when settlement of the agreed purchase consideration is made. The account can therefore be regarded as a "self balancing" account.

3.5.1 Sundry Members Account (Ordinary Shares and Preference Shares)

The following accounting transactions/events are effected in the sundry members account:

- (a) Transfer the components of the shareholders' fund (for example, ordinary shares, preference shares, and reserves) to the account by debiting each of the components of the shareholders' fund and crediting sundry members' account;
- (b) The profit/loss on realisation is also transferred to this account; and
- (c) Each of the components of purchase consideration, when settlement is effected as agreed, including cash, are transferred to this account and the account will automatically balance.

This account is similar to the partners' account in the amalgamation of partnership.

It should be noted, however, that if there is more than one class of preference shares, the classes should be separated and different ledger accounts opened for each class. For example, if in the balance sheet there are 10% preference shares, 8% cumulative preference shares and 5% redeemable preference shares, these are three different classes of preference shares. Therefore, three different sundry members preference accounts must be opened to present each of them separately.

3.5.2 Liability Accounts

Balances on each liability account such as trade creditors and long term loans/debentures should be brought down in their respective ledger accounts. Each liability is either settled by the discontinuing business or taken over by the new business.

Where the liability is settled by the discontinuing business, the liability account is debited and cash/bank account credited. However, where the liability is taken over by the new business it becomes part of the purchase consideration and is treated as follows:

Dr.	Liability account
Cr.	New Company account

3.5.3 Discount Received from Creditors

Where the liability has been settled at less than the book value and this is regarded as full and final settlement. It means discount has been received from creditors. The accounting entries are:

Dr.	Liability account
Cr.	Realisation Account

ILLUSTRATION 3.1

The illustration below shows clearly how the discount received from creditors is treated.

The following balance sheets of two different companies were given as at 31 December 2004.

ABC LTD Balance Sheet as at 31/12/04

	N	m
Fixed Assets		
Motor Vehicles	40	
Plant and Equipment	60	
Furniture & Fittings	20	120
Current Assets		
Stock	12.0	
Debtors	26.8	
Cash & Bank	9.2	
	48	
Current liabilities (creditors)	(28)	
Net Current Assets		20
Net Assets		<u>140</u>

Financed by:

Capital & Reserves	
Ordinary share capital	100
Reserves	40
	<u>140</u>

XYZ LTD**Balance sheet as at 31/12/04**

Fixed Asset	m	m
Goodwill		20
Premises		20
Motor Vehicles		40
		<u>80</u>
Current Assets		
Stock	18	
Debtors	24	
Bank & Cash	8	
	50	
Current liabilities (creditors)	(40)	
Net Current Assets		10
Net Assets		<u>90</u>

Financed by:

Capital & Reserves	
Ordinary share capital	100
Unappropriated loss	(10)
	<u>90</u>

ABC Ltd decided to amalgamate with XYZ Ltd on 31 December 2004 to form a company known as ABAK Ltd under the following terms:

The assets and liabilities of ABC Ltd are to be taken over as follows:

	m
Motor Vehicles	80
Plant & Machinery	40
Furniture & Fittings	20
Stocks	8
Debtors	24

The cash of the firm was to be retained to pay in full 12,000,000 of the trade creditors and the balance of the creditors to be taken over by the new company. Amalgamation expense of 1,200,000 was incurred and paid by ABC Ltd.

Required:

Prepare

- (i) Creditors Account
- (ii) Cash Account.

SUGGESTED SOLUTION 3.1

In closing the books of ABC Ltd, the creditors and cash account will be as follows:

Creditors Account			
	m		m
Cash	8	Bal b/d	28
Realisation (Discount from creditors)	4		
ABAK Ltd	16		
	<u>28</u>		<u>28</u>

Cash Account			
	m		m
Bal b/d	9.2	Creditors for amalgamation expenses	1.2
		Creditors	8.0
	<u>9.2</u>		<u>9.2</u>

Notes

1. Amalgamation expense is a priority item and therefore should be settled before trade creditors. Hence the payment of 1.2 million. The balance of cash of 8 million was used to settle a debt of 12 million. It implies that a discount of 4 million was received from creditors.
2. Although the question did not specify the position of other creditors. It is assumed that the creditors that were not paid off by the discontinuing business are taken over by the new company.

3.5.4 Liabilities settled above the book value

Where a liability has been settled above its book value, the difference between the book value and the take over value is debited to realisation account. This implies that a loss was incurred in settling the liability. The accounting entries will be:

- Dr. Realisation account with the difference between the book value and the take-over value
- Cr. Liability account with the amount paid.

ILLUSTRATION 3.2

Assume the figures in illustration 3.1 except that the assets and liabilities of XYZ Ltd were taken over as follows:

	million
Goodwill	Nil
Premises	16
Motor vehicles	32
Stock	worthless
Debtors	12

All the trade creditors were taken over for 46m, the excess resulting from a dispute over undisclosed purchases. The amalgamation expense of 2.4m was fully borne by the new firm.

Required: Prepare the following accounts:

- (a) Creditors account
- (b) Amalgamation expense account.

SUGGESTED SOLUTION 3.2

In closing the books of XYZ Ltd, the creditors and cash account will be as follows:

Creditors Account			
	m		m
ABAK LTD	46	Bal b/d	40
	<u>—</u>	Realisation (loss)	6
	<u>46</u>		<u>46</u>

Creditors for Amalgamation Expenses			
	m		m
ABAK LTD	<u>2.4</u>	Realisation	<u>2.4</u>

Notes

The 6m on creditors account is the difference between the book value of creditors and the takeover value that is, the excess resulting from a dispute over undisclosed purchases.

3.6 PURCHASE CONSIDERATION

This is the aggregate amount, which the new company is to pay the owners (that is the stakeholders) of the discontinuing business and creditors.

The components of the purchase consideration in amalgamation of companies may comprise of some or all of the following:

- (i) Ordinary shares issued by the new company.
- (ii) Preference shares issued by the new company.
- (iii) Debenture stock issued by the new company.
- (iv) Cash given by the new company.
- (v) Liabilities of the old companies taken over by the new company.

Where liabilities are taken over, they form part of the purchase consideration. Such liabilities are debited to the liabilities account and credited to the new company's account.

3.6.1 Components of the purchase consideration account

Ledger accounts are opened for each of the components of purchase consideration treated in paragraph 3.6 above.

On settlement of the purchase consideration as agreed, the account of each of the components of the purchase consideration is debited while the new company's account is credited.

On distribution to the owners of discontinuing businesses, the sundry members account is debited and the account of each of the components of the purchase consideration is credited.

The accounting entries necessary to close the book of discontinuing businesses being liquidated are summarized below.

Dr. Realisation Account

Cr. Individual Asset's Account

S/No.	Events	Account to be Debited	Account to be Credited
1.	Book value of the asset taken over by the company at the date of cessation.	Realisation Account	Individual Asset Account
2.	Liabilities taken over by the new company at the date of cessation, (if part of purchase consideration).	Individual Liability Account	New Company Account
3.	Agreed purchase consideration (including liabilities taken over).	New Company's Account	Realisation Account
4.	Realisation expenses payable/creditors for realisation expenses.	Realisation Account	Realisation expenses payable account/creditors account for realisation expenses.
5.	Portion of the realisation expenses paid by the existing company being discontinued.	Liquidation expenses	Bank Account
6.	Portion of the realisation expenses to be paid by the new company.	Included in the purchase consideration recorded in (3) above. OR New Company's Account	Realisation Account
7.	Discount received from creditors.	Creditors account	Realisation Account
8.	Profit on realisation (this is to be derived)	Realisation account	Sundry shareholders and debenture holders account

9.	Loss on realisation (this is to be derived)	Sundry shareholders and debenture holders account	Realisation Account
10.	Transfer of balances on share capital, reserves and debentures Accounts.	Share capital reserves and debentures account.	Sundry shareholders and debenture holders account
11.	Settlement of the agreed purchase consideration by the new company.	Bank and/or shares and/or debentures in new company account.	New Company's Account
12.	Settlement of liabilities not taken over by the new company.	Creditors account	Bank account
13.	Distribution of balances.	Sundry shareholders and debenture holders account	Bank and/or shares and/or debentures in the New company account.
14.	Arrears of preference dividend included in the balance sheet as a liability.	Preference dividends in arrears.	Sundry members Preference Shares account
15.	Cumulative preference dividend in arrears but not included in the balance sheet and not to be forfeited.	Retained profit or any other revenue reserve account.	Sundry members preference account.
16.	Arrears of debenture interest (if any).	Retained profit or any other revenue account.	Debenture Stock Account
17.	Ordinary share dividend included in the balance sheet.	Proposed dividend account	Sundry members shares account.

3.7 ESTABLISHMENT OF THE NEW COMPANY

The accounting entries in the books of the new company can be divided into two:

- (a) The amalgamation journal
- (b) The balance sheet after amalgamation.

3.7.1 Amalgamation Journal

This is a composite journal which is prepared to reflect the assets and liabilities taken over as well as goodwill or capital reserve on amalgamation.

On the debit side of the journal are all tangible assets taken over at revaluation value or taken over value. However, if the take over values are not given, it is assumed that the assets are taken over at book values. The take over value will only be used when such assets are not revalued. If revalued, the revaluation value will be used instead of the takeover value.

On the credit side of the journal are all the components of purchase consideration (including liabilities taken over) as contained on the credit side of the new company account in the books of the discontinuing businesses.

The difference between the debit side and the credit side of the journal represents goodwill or capital reserve. If the balancing figure on the journal is an asset (i.e. debit balance) it is referred to as goodwill. If it is a claim over the assets (i.e. credit balance) it is referred to as capital reserve.

Proforma of the Amalgamation Journal

	Dr	Cr
Land & Building	X	
Plant & Machinery	X	
Furniture & Fittings	X	
Motor Vehicles	X	
Stocks	X	
Debtors	X	
Goodwill (balancing figure)	X	
Creditors		X
Bank overdraft		X
3% Debenture		X
Ordinary shares		X
Preference shares		X
	<u>X</u>	<u>X</u>

Being assets and liabilities taken over on amalgamation of A ltd and B ltd to form AB Ltd.

N.B

It is instructive to note that the values of individual assets mentioned above are a combined amount of the takeover values of all the companies that amalgamate. The amounts on the credit side of the journal are also combined figures of each item on the new company account as they appeared in the book of the discontinuing company.

All transactions after amalgamation in the book of the new company must be journalized by means of a simple journal. Such transactions may include fresh issue at or above the nominal value.

3.7.2 Issue of Shares

Where fresh issues of shares are made for cash, the accounting entries will be:

Dr - Bank/Cash account
 Cr - Ordinary share capital account with the nominal value
 Cr - Share premium account with the premium.

After this, the balance sheet of the new company can be prepared.

3.7.3 Balance Sheet of the New Company

The balance sheet of the new company, after amalgamation is prepared using the figures from the opening journal subject to adjustments for transactions after amalgamation as enumerated above.

ILLUSTRATION 3.3

The Moon Company Limited and the Rising Star Company Limited have agreed to amalgamate. A new company Sunshine Company Limited has been formed to take over the combined concerns on 31st January, 2009. The Balance sheet of the two companies as at 31st December, 2008 were as follows:

The Moon Company Limited			
Liabilities		Assets:	
Issued and paid up capital:		Buildings	50,000
100,000 ordinary shares		Machinery	20,000
of 1 each	100,000	Stock	26,000
15% Debentures	2,000	Debtors	12,000
Creditors	6,000	Cash	5,000
Unappropriated profit	5,000		
	<u>113,000</u>		<u>113,000</u>

The Rising Star Company Limited			
Liabilities:		Assets:	
Issued and paid up capital:		Buildings	30,000
5,000 ordinary shares		Machinery	25,000
of 10 each	50,000	Goodwill	5,000
Creditors	3,000	Stock	3,000
Bill payable	2,000	Debtors	2,000
General reserves	5,000		
Retained Earning	5,000		
	<u>65,000</u>		<u>65,000</u>

The new company (Sunshine) will take over the assets and liabilities as follows:

Moon

All assets at book value, except cash; buildings and machinery to be depreciated at the rate of 10%. Debentures will be redeemed by the Moon Company Limited

Rising Star

All assets at book value, except goodwill and stock. All liabilities, except creditors will be satisfied by paying in the form of stock-in-trade by the Rising Star Company.

The new company will pay purchase consideration as follows:

- (a) To Moon Company Limited:
 - (i) 7,000 ordinary shares of 10 each
 - (ii) 2,000 preference shares of 10 each
- (b) To Rising Star Company Limited:
 - (i) 5,000 ordinary shares of 10 each
 - (ii) 2,000 preference shares of 10 each

Required:

Prepare

- (a) Realisation Accounts of Moon and Rising Star Companies.
- (b) Shareholders' Accounts for Moon and Rising Star Companies.
- (c) Cash account of Moon Company.
- (d) Goodwill Account of Rising Star Company.
- (5) Balance Sheet of Sunshine Company Limited as at 31st January, 2009.

SUGGESTED SOLUTION 3.3**Workings**

The net assets and the purchase consideration of the two old companies have to be determined and compared for identification of goodwill or capital reserve.

Moon Company Limited

Assets		
Buildings	₦50,000 - ₦5,000 (depreciation)	45,000
Machinery	₦20,000 - ₦2000 (depreciation)	18,000
Stock		26,000
Debtors		12,000
		101,000
Less Creditors		6,000
Net Assets		95,000

Less purchase consideration (shares issued):

7,000 ordinary shares	10 = ₦70,000	
2,000 pref. share	10 = ₦20,000	90,000
Capital Reserve		<u>5,000</u>

Rising Star Company Limited

Assets:	₦
Buildings	30,000
Machinery	25,000
Debtors	2,000

57,000

Less bills payable 2,000

Net Assets 55,000

Less purchase consideration (shares issued):

5,000 ordinary shares	10 = ₦50,000	
2,000 pref. shares	10 = ₦20,000	70,000

Goodwill 15,000

ACCOUNTS FOR MOON COMPANY

Realisation Account

Buildings	50,000	Creditors	6,000
Machinery	20,000	Sunshine (P.C)	90,000
Stock	26,000	S/holders A/c (loss)	12,000
Debtors	12,000		<u>108,000</u>
	<u>108,000</u>		

* PC is purchase consideration

Sunshine Company

Realisation	<u>90,000</u>	Shareholders (shares)	<u>90,000</u>
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Shareholders Account

Realisation (loss)	12,000	Ordinary shares	100,000
Sunshine (shares)	90,000	Profit and loss	5,000
Cash	3,000		<u>105,000</u>
	<u>105,000</u>		

Cash Account

Opening balance	5,000	Debentures (15%)	2,000
		Shareholders	3,000
	<u>5,000</u>		<u>5,000</u>

ACCOUNTS FOR RISING STAR COMPANY**Realisation Account**

Building	30,000	Bills payable	2,000
Machinery	25,000	Sunshine (P.C)	70,000
Debtors	2,000		
Shareholders (profit)	15,000		
	<u>72,000</u>		<u>72,000</u>

Sunshine Company Account

Realisation	<u>70,000</u>	Shareholders	<u>70,000</u>
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**Balance Sheet of Sunshine Company
Limited as at 31 January, 2006.**

Fixed Assets:

Goodwill	(15,000 - 5,000)	10,000
Buildings	(₦ 45,000 + ₦ 3,000)	75,000
Machinery	(₦ 18,000 + ₦ 25,000)	43,000
		128,000

Current Assets:

Stock	26,000
Debtors	(₦ 12,000 + 2,000) 14,000
	40,000

Less Current Liabilities:

Creditor	6000
Bills payable	2000
	8000

Net Current Asset:	32,000
	160,000

Issued Share Capital:

12,000 ordinary shares at 10 per share	120,000
4,000 preference shares at 10 per share	40,000
	<u>160,000</u>

ILLUSTRATION 3.4

The following are the summarized balance sheets of two companies, Rose Ltd and Blacky Ltd as at 31 October 2008.

Rose Ltd

SHARE CAPITAL:		ASSETS	
Ordinary shares of ₦1 each	150,000	Freehold property (at cost)	45,000
Forfeited share capital	150	Plant & Machinery (at cost)	35,000
Reserve account	10,000	Goodwill	10,000
Profit & loss account	16,865	Stock	68,276
5% Debenture	35,000	Sundry Debtors	25,850
Sundry creditors	5,785	Balance at bank	33,674
	<u>217,800</u>		<u>217,800</u>

Blacky Ltd

ORDINARY SHARES		ASSETS	
of 1 each fully paid	39,000	Freehold property (at cost)	13,000
5% Debentures	7,000	Plant & machinery (at cost)	11,000
Sundry creditors	25,700	Goodwill	10,000
Bank overdraft	600	Stock	15,200
		Sundry debtors	9,500
		Profit & loss account	13,600
	<u>72,300</u>		<u>72,300</u>

The two companies decided to amalgamate as on 31st December, 2008 and a new company called Yellow Ltd was formed with an authorized capital of 250,000 in ordinary shares of ₦1 each. The following terms were agreed on:

Rose Ltd

- (i) The consideration was 6 shares of 1 each fully paid to Rose Ltd in exchange for every 5 shares in Yellow Ltd and 1,000 cash.
- (ii) The debenture holders were to be allotted such debentures in Yellow Ltd bearing interest at 3½ % per annum as would bring them in the same amount of interest.
- (iii) Yellow Ltd is to take over all assets and liabilities at their book values.
- (iv) The 2,500 expenses of dissolution is to be paid by Rose Ltd.

Blacky Ltd

- (i) The consideration was 1 share of 1 each, fully paid in Yellow Ltd in exchange for every 3 shares in Blacky Ltd and 500 in cash.
- (ii) The debenture holders were to be allotted such debentures in Yellow Ltd bearing interest at 3½% per annum as would bring them in the same amount of interest.

- (iii) Yellow Ltd to take over all the assets and liabilities (including the bank overdraft) at their book values.
- (iv) Cost of liquidation to be paid by Yellow Ltd 1,000.

The balance of the authorized share capital of Yellow Limited was issued by public offer through prospectus. The offer which was payable in full on application was fully subscribed and allotted.

You are required to:

- (a) Show the necessary ledger accounts to close the book of each company
- (b) The journal entries to open the book of Yellow Ltd
- (c) Prepare the balance sheet of Yellow Ltd after amalgamation.

SUGGESTED SOLUTION 3.4

Realisation Account

	Rose ₹	Blacky ₹		Rose ₹	Blacky ₹
Goodwill	10,000	10,000	Yellow Ltd (pc)	181,785	50,800
Freehold property	45,000	13,000	Sundry members		
Plants & Machinery	35,000	11,000	(Loss on	51,015	11,900
Stock	68,276	15,200	realisation)		
Sundry debtors	25,850	9,500			
5% Debenture	15,000	3,000			
Creditors for					
Dissolution expenses	2,500	1,000			
Bank	31,174	—			
	232,800	62,700		232,800	62,700

Sundry Members Account (Ordinary)

	Rose Ltd	Blacky Ltd		Rose Ltd	Blacky Ltd
Profit & Loss		13,600	Ordinary share capital	150,000	39,000
Account			Forfeited share capital	150	—
Ord share in	125,000	13,000	Reserves	10,000	—
Yellow	1,000	500	Profit & loss	16,865	—
Bank	51,015	11,900		177,015	39,000
Realisation Loss	177,015	39,000			

Yellow Ltd Account

	Rose Ltd	Blacky Ltd		Rose Ltd	Blacky Ltd
Realisation Account	181,785	50,800	Ordinary shares	125,000	13,000
			3½% Debenture	50,000	10,000
			Cash	1,000	500
			Sundry creditors	5,785	25,700
			Creditors for Dissolution expenses	—	1,000
	<u>181,785</u>	<u>50,800</u>		<u>181,785</u>	<u>50,800</u>

Bank Account

	Rose Ltd	Blacky Ltd		Rose Ltd	Blacky Ltd
Bal. b/d	33,674	—	Bal. b/d	—	600
Yellow Ltd.	1,000	500	Creditors for Dissolution expenses	2,500	—
Yellow Ltd.	—	600	Sundry member (ord.)	1,000	500
			Realisation	31,174	—
	<u>34,674</u>	<u>1,100</u>		<u>34,674</u>	<u>1,100</u>

5% Debenture Account

	Rose Ltd	Blacky Ltd		Rose Ltd	Blacky Ltd
3½ % Debenture Account	50,000	10,000	Bal. b/d	35,000	7,000
			Realisation Account	15,000	3,000
	<u>50,000</u>	<u>10,000</u>		<u>50,000</u>	<u>10,000</u>

3½ % Debenture in Yellow Ltd. Account

	Rose Ltd	Blacky Ltd		Rose Ltd	Blacky Ltd
Yellow Ltd.	<u>50,000</u>	<u>10,000</u>	5% Debenture	<u>50,000</u>	<u>10,000</u>

Sundry Creditors Account

	Rose Ltd	Blacky Ltd		Rose Ltd	Blacky Ltd
Yellow Ltd.	<u>5,785</u>	<u>25,700</u>	Bal. b/d	<u>5,785</u>	<u>25,700</u>

Ordinary Shares in Yellow Ltd Account

	Rose Ltd	Blacky Ltd		Rose Ltd	Blacky Ltd
Yellow Ltd.	<u>125,000</u>	<u>13,000</u>	Sundry members (ord.) account	<u>125,000</u>	<u>13,000</u>

N.B.: The amount of 15,000 and 3,000 on 5% Debenture account transferred to realisation account represents the surplus on issue of 3½ % debenture over the existing 5% Debenture.

Dissolution Expenses Account

	Rose Ltd	Blacky Ltd	-	Rose Ltd	Blacky Ltd
Bank	2,500	—	Realisation	2,500	1,000
Yellow Ltd.	—	1,000			
	<u>2,500</u>	<u>1,000</u>			<u>2,500</u>

Determination of Purchase Consideration

Rose Ltd.

- (a) Ordinary Shares
6 shares in Rose = 5 Shares in Yellow
1 share in Rose = $\frac{5}{6}$ in Yellow
150,000 shares in Rose = $\frac{5}{6} \times 150,000$
= 125,000 shares of 1 each
= 125,000
- (b) Cash = 1,000
- (c) 5% Debenture
Present interest is $\frac{5}{100} \times 35,000 = \text{N}1,750$
Future Interest is $3\frac{1}{2} \times \frac{100}{100} = 1,750$
 $X = 1,750 \times \frac{100}{3\frac{1}{2}} = 50,000$
- (d) Creditors taken over = 5,785

Blacky Ltd.

- (a) Ordinary Shares
- | | |
|-------------------------|----------------------------|
| 3 shares in Blacky | = 1 in Yellow |
| 1 share in Blacky | = 1/3 in Yellow |
| 39,000 shares in Blacky | = 1/3 x 39,000 |
| | = 13,000 shares of ₦1 each |
| | = <u>13,000</u> |

(b) Cash 500

(c) **5% Debenture**

Present Interest = $5/100 \times 7,000 = 350$

3 ½ % Debenture to be issued that will generate the same interest of 350 will be:

$$\begin{aligned} \frac{3\frac{1}{2}}{100} X &= 350 \\ 3\frac{1}{2} X &= \text{N}35,000 \\ X &= \text{N}35,000 \\ &\quad \times \frac{2}{7} \\ &= \text{N}10,000 \end{aligned}$$

(d) Creditors taken over

Sundry creditors - 25,700

Bank overdraft - 600

Creditors for dissolution expenses 1,000

SUMMARY OF PURCHASE CONSIDERATION

	Rose Ltd.	Blacky Ltd.
Ordinary share capital	125,000	13,000
3 ½ % Debenture	50,000	10,000
Cash	1,000	500
Creditors taken over	5,785	25,700
Creditors for Dissolution expenses	-	1,000
Bank overdraft		600
	<u>181,785</u>	<u>50,800</u>

Note

- (a) The purchase consideration, as calculated above, is debited to the new company account (Yellow Ltd) and credited to the realisation account.
- (b) The components of the purchase consideration are then credited to new company account and debited to each component of purchase consideration account when settlement is effected.
- (c) The bank amount of N31,174 in the realisation account represents the cash taken over by Yellow Ltd after all adjustments have been made on the accounts.

Books of Yellow Limited

Opening Journal

	Dr	Cr
Freehold property (45,000 + 13,000)	58,000	
Plant & Machinery (35,000 + 11,000)	46,000	
Stocks (68,276 + 15,200)	83,476	
Debtors (25,850 + 9,500)	35,350	
Bank (Bank taken over as reflected in the realisation account)	31,174	
138,000 ordinary shares of 1 each (125,000 + 13,000)		138,000
Bank overdraft (1000+ 500+ 600)		2,100
3 ½ % Debenture		60,000
Sundry creditors (including creditors for dissolution expenses)		32,485
Capital reserve (Balancing figure)		21,415

Being assets and liabilities on amalgamation of Rose Ltd and Blacky Ltd.

Note

All figures on the credit side of the Journal are as on the credit side of the New Company account (Yellow Ltd.) and as in the books of the discontinuing businesses.

Other Journals

	Dr	Cr
Bank	112,000	
Ordinary share capital		112,000

Being proceeds from issue of 112,000 ordinary shares of 1 each.

Bank Account

Vendor	31,174	Bal. c/d	143,174
Ordinary shares	112,000		
	<u>143,174</u>		<u>143,174</u>
Bal. b/d	143,174		

Ordinary Shares Account

Bal. c/d	250,000	Vendor	138,000
	<u>250,000</u>	Bank	112,000
			<u>250,000</u>
		Bal. b/d	<u>250,000</u>

Yellow Ltd.			
Balance Sheet as at 31/12/08 (after amalgamation)			
Fixed Assets:			
Freehold property			58,000
Plant and Machinery			46,000
			104,000
Current Assets:			
Stocks		83,476	
Sundry debtors		35,350	
Bank		143,174	
		262,000	
Creditors amount falling due within one year			
Sundry creditors	32,485		
Bank overdraft	2,100	(34,585)	
Net current assets			227,415
Total assets less current liabilities			331,415
Creditors amount falling due after more than 1 year			
3 ½ % Debenture			(60,000)
Net assets			<u>271,415</u>
Financed by:			
Capital & Reserves		Authorized	Issued & fully paid
Ordinary shares of 1 each		250,000	250,000
Capital reserves			21,415
Shareholders funds			<u>271,415</u>

3.8 ABSORPTION, TAKE OVER OR PURCHASE OF BUSINESS

3.8.1 Absorption involves a situation where a company takes over another company.

The company that is being taken over (that is, absorbed company) will lose its identity (that is, wind up) while the assets and liabilities of the absorbing company will increase after the absorption. For example, A Ltd can purchase or take over B Ltd to form a bigger A Ltd.

This means that unlike amalgamation in which all the amalgamating businesses lose their identities, only one (that is, the absorbed company) loses its identity in the case of absorption. The amalgamation method is employed where relatively small scale businesses are concerned. Where large, complex businesses are involved, a holding company is usually established to acquire all, or majority of voting shares of those companies which then continue in existence but as subsidiaries of the holding company. The acquisition of controlling interest can also arise without the establishment of a holding company for the purpose. This occurs when an existing dominant company acquires a controlling interest in one or more other companies.

When one company takes over another company, two major matters arise. These are:

- (a) Closing the books of the discontinuing business which is being wound up.
- (b) Updating the records of the continuing business.

3.8.2 Closing the Books of the Discontinuing Company

To close the book of the discontinuing company, the following ledger accounts are necessary:

- (i) Realisation account
- (ii) Absorbing company's account
- (iii) Sundry members account
- (iv) Each liability account
- (v) Bank account
- (vi) Account for each component of purchase consideration.

The operation of each of the ledger accounts mentioned above is similar to that of amalgamation except that all entries that are passed into the new company's account in amalgamation go to absorbing company's account.

In essence, profit or loss on realisation is determined in the realisation account and transferred to sundry members ordinary shares account.

All liabilities are either paid off by the absorbed company or taken over by the absorbing company.

Each component of purchase consideration is transferred to sundry members ordinary or preference shares account.

All adjustments are made to bank account before the balance is transferred to realisation account (i.e. bank/cash taken over by absorbing company).

It should be noted that where bank balance is not taken over, the balance should be debited to sundry members account.

3.8.3 Accounting Entries in the Book of Absorbing or Continuing Business

The continuing business has been in existence before it took over the discontinuing business. Therefore, its assets and liabilities will increase in proportion to the assets and liabilities taken over.

The balances on its assets, liabilities and shareholders fund must be brought down in their respective ledger accounts. The records to incorporate the activities of the business taken over will be divided into two as follows:

- (a) The absorbing journal
- (b) Recording from the absorption journal to the existing relevant ledger account.

3.8.3.1 The Absorption Journal

This is a composite journal which is prepared to reflect the assets and liabilities taken over and determine the goodwill or capital reserve that arises (if any).

On the debit side of the journal are all tangible assets taken over at revaluation value, or takeover value if such assets are not revalued.

On the credit side of the journal are all purchase considerations (including liabilities taken over) as stated on the credit side of the absorbing company's account in the book of the discontinuing business.

The difference between the debit and the credit sides of the journal represent goodwill or capital reserve.

In essence, the journal is not different from the amalgamation journal except that in amalgamation, amounts on the journals are combined amounts of the companies involved in the amalgamation, while in absorption, it is only the amounts of the dissolved (absorbed) company.

The format of the two journals are similar (Please refer to amalgamation journal).

3.8.3.2 Recording items from the absorption journal to the ledger account

The ledger accounts opened for assets and claims over assets are scrutinized.

Items in the absorbing journal and other journals are then transferred to the relevant ledger accounts with each of them having the narration 'Vendor'. Assets from the journal will be posted to the debit side of the relevant asset account while liabilities and claims over assets from the journal will be posted to the credit side of each relevant ledger account.

After this, the ledger accounts are balanced and the balance sheet for the continuing business can be prepared.

ILLUSTRATION 3.5

The Middle Belt Chemical Company Limited sold its business to the Northern Chemical Company Limited as on 31st December, 2008. Its balance sheet on that date was as given below

Balance Sheet as at 31st December, 2008

Liabilities		Assets	
Issued and paid up capital:		Buildings	233,000
2,000 ord. shares of 100 each	200,000	Goodwill	5,000
10% Debentures	100,000	Stock	35,000
Creditors	30,000	Bill Receivable	4,500
Reserve Fund	50,000	Debtors	27,500
P & L Account	20,000	Cash	50,000
	<u>400,000</u>		<u>400,000</u>

The Northern Chemical Company agreed as follows:

- (i) To take over the assets at 90% of the book when values (excluding cash and goodwill).
- (ii) To pay 75,000 for goodwill
- (iii) Purchase consideration was to be discharged by the allotment to Middle Belt Chemical Company Limited 1500 shares of 100 each at a premium of 10 per share.
- (iv) Cost of liquidation of 3000 to be paid by Middle Belt Chemical Company.

Required: Show ledger accounts in the books of Middle Belt Company Limited and journal entries in the books of Northern Chemical Company.

SUGGESTED SOLUTION 3.5:

The purchase consideration will be determined as follows:

Assets:

Goodwill		75,000
Buildings (233,000 - 10% of 233,000) or	233,000 x 90%	209,700
Stock (35,000 - 10% of 35,000) or	35,000 x 90%	31,500
Bill Receivable (4,500 - 10% of 4,500) or	4500 x 90%	4,050
Debtors (27,500 - 10% of 27,500) or	27,500 x 90%	24,750
Liabilities (Debentures)		(100,000)
Purchase consideration		<u>245,000</u>

Realisation Account

Goodwill	50,000	Debentures	100,000
Buildings	233,000	Northern Chemical Company Ltd (PC)	245,000
Stock	35,000	Shareholders (Loss)	8,000
Debtors	27,500		
Bill Receivable	4,500		
Cash (Liquidation cost)	3,000		
	<u>353,000</u>		<u>353,000</u>

Northern Chemical Company Limited Account

Realisation Account	245,000	Shareholders Account	165,000
	<u>245,000</u>	Cash Account	80,000
			<u>245,000</u>

Note: The shares allottable to shareholders of Middle Belt Company were arrived at follows:

1,500 shares of 100 each	150,000
Share premium 1,500 x 10	15,000
	165,000
Cash	80,000
Purchase consideration	<u>245,000</u>

Cash Account

Balance b/d	50,000	Creditors	30,000
Northern Chemical Company	80,000	Shareholders	97,000
	<u>130,000</u>	Realisation exp.	3,000
			<u>130,000</u>

Middle Belt Company Shareholders Account

Realisation A/C (Loss)	8,000	Share Capital	200,000
Shares(of N.C.C)	165,000	Reserve Fund	50,000
Cash (balance transferred)	97,000	P & L Account	20,000
	<u>270,000</u>		<u>270,000</u>

B. Journal Entries in the books of Northern Chemical Company Limited

	DR	CR
Purchase Consideration Middle Belt Chemical To record the agreed purchase consideration	245,000	245,000
Goodwill Buildings Stock Bill Receivable Debtors Debentures Purchase consideration To record the take over of assets and liabilities	75,000 209,700 31,500 4,050 24,750	100,000 245,000
Middle belt Company Share Capital Share Premium Cash To record the settlement of purchase consideration.	245,000	150,000 15,000 80,000

Notes:

It should be noted that all undistributed profits and reserve fund should be distributed amongst the shareholders of the selling company and should not be brought into the new company's book. However, employees fund like provident fund, Superannuation fund, Gratuities, etc. are to be brought to the new company's books as it is expected that the new company will absorb the employees of the selling company.

ILLUSTRATION 3.6

Messrs. Oyeyipo & Chukwu, who are friends, are also majority shareholders and managing directors of their respective electrical businesses of Oyeyipo & Sons Limited, and Chukwu & Sons Limited. For the purposes of access to more

funds and rationalization, it was agreed that Oyeyipo & Sons Limited should absorb the business of Chukwu & Sons Limited.

The balance sheets of the two companies prior to absorption on 30 April 2008 were as follows:

	Oyeyipo & Sons Ltd	Chukwu & Sons Ltd		Oyeyipo & Sons Ltd	Chukwu & Sons Ltd
Share capital					
Authorized of 50k each	1,200,000	200,000	Goodwill		60,000
Issues:			Fixed Asset	980,000	150,000
Redeemable pref. Shares	40,000	—			
Ordinary shares	800,000	100,000	Current Asset	310,000	240,000
Share premium	100,000				
Revenue					
Reserve	180,000	300,000			
Current Liabilities	170,000	50,000			
	<u>1,290,000</u>	<u>450,000</u>		<u>1,290,000</u>	<u>450,000</u>

The redemption, at 5% premium, of redeemable preference shares took place on 1 May 2008. In order to partially finance the redemption, 80,000 ordinary shares at a premium of 5 kobo were issued to existing shareholders and paid in full on that date.

Chukwu & Sons Limited was liquidated on 1 May, 2008 when all its assets, except certain items of stocks valued at 40,000, were purchased from the liquidator by Oyeyipo and Sons Limited. The company was also to assume all the liabilities of Chukwu & Sons Limited, and

- (i) issue 260,000 of its ordinary shares of 50k each at a premium of 8 kobo per share and;
- (ii) pay 300,000 in cash.

The purchase consideration was effected on 2 May 2008 and share issue expenses amounted to 60,800.

You are required to:

- (a) Prepare the balance Sheet of Oyeyipo & Sons Limited after the absorption had been effected.
- (b) Show your workings for calculations of:
 - (i) Current Assets;
 - (ii) Share premium; and
 - (iii) Revenue Reserve.

SUGGESTED SOLUTION 3.6

(a) **OYEYIPO & SONS LTD**
Balance Sheet as at 1 May 2008 (After Absorption)

Fixed Assets		1,130,000
Deferred charges		
Goodwill		150,800
Current Assets	151,200	
Current Liabilities	(220,000)	
Net Current Liabilities		(68,800)
Net Assets		<u>1,212,000</u>
Financed by		
Capital and Reserves		
Authorized		
2,400,000 ordinary shares of 50k each		1,200,000
Issued and fully paid		
1,940,000 ordinary shares of 50k each		970,000
Share premium account		62,000
Revenue reserve		180,000
		<u>1,212,000</u>

(b) (i) **Current Assets**

Bal b/d	310,000	Redemption of Red. Pref shares	42,000
Vendor	200,000	Share issue expenses	60,800
Ordinary shares (Bank)	40,000	Vendor	300,000
Share premium (Bank)	4,000	Bal c/d	151,200
	<u>554,000</u>		<u>554,000</u>
Bal b/d	151,200		

N.B

- (a) All items that affect cash and bank are reflected in the current assets accounts.
- (b) Share issue expenses were posted to the share premium account because it is one of the statutory uses of share premium account.

(ii) **Share Premium Account**

Bank (Share issue expenses)	60,800	Bal b/d	100,000
Bank	2,000	Vendor	20,800
Bal c/d	62,000	Bank	4,000
	<u>124,800</u>		<u>124,800</u>
		Bal b/d	62,000

(iii) Revenue Reserve Account

Bal c/d	<u>180,000</u>	Bal b/d	<u>180,000</u>
		Bal b/d	<u>180,000</u>

N.B

Only revenue reserve of Oyeyipo & Sons Ltd is shown as that of Chukwu & Sons Ltd had been regarded and treated as pre acquisition reserve.

(iv) Fixed Assets

Bal b/d	980,000	Bal c/d	1,130,000
Vendor	150,000		
	<u>1,130,000</u>		<u>1,130,000</u>
Bal b/d	<u>1,130,000</u>		

(v) Ordinary Share Capital Account

Bal c/d	970,000	Bal b/d	800,000
		Vendor	130,000
		Bank	40,000
	<u>970,000</u>		<u>970,000</u>
		Bal b/d	<u>970,000</u>

(vi) Current Liabilities Account

Bal c/d	220,000	Bal b/d	170,000
		Vendor	50,000
	<u>220,000</u>		<u>220,000</u>
		Bal b/d	<u>220,000</u>

LEDGERS TO CLOSE THE BOOKS OF CHUKWU & SONS LTD**Realisation Account**

Goodwill	60,000	Oyeyipo & Sons (Pc)	500,800
Fixed Assets	150,000		
Current Assets	240,000		
Sundry Members Account	50,800		
	<u>500,800</u>		<u>500,800</u>

PC = Purchase Consideration

Oyeyipo & Sons Ltd

Realisation (Pc)	500,800	Ordinary shares	150,800
		Cash	300,000
		Current Liabilities	50,000
	<u>500,800</u>		<u>500,800</u>

Sundry Members Account (Ordinary)

Ordinary shares in Oyeyipo	150,800	Ordinary shares	100,000
Cash	300,000	Revenue reserve	300,000
		Realisation	50,800
	<u>450,800</u>		<u>450,800</u>

Current Liabilities

Oyeyipo & Sons	<u>50,000</u>	Bal b/d	<u>50,000</u>
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Ordinary Shares in Oyeyipo & Sons Ltd

Oyeyipo & Sons Ltd	<u>150,800</u>	Sundry member A/c	<u>150,800</u>
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IN THE BOOK OF OYEYIPO & SONS**OPENING JOURNAL**

	DR	CR
Fixed Assets	150,000	
Current Assets ₦ (240,000-40,000)	200,000	
Goodwill (Balancing figure)	150,800	
Current Liabilities		50,000
Ordinary Shares		130,000
Share premium		20,800
Bank		300,000
	<u>500,800</u>	<u>500,800</u>
Being assets and liabilities taken over on absorption of Chukwu & Sons Limited by Oyeyipo & Sons limited.		

Journals To Reflect Transactions Occurring After Absorption

		DR	CR
1.	Preference Share Capital Account	40,000	
	Share Premium Account	2,000	
	Redemption of Redeemable Preference Share Account		42,000
		<u>42,000</u>	<u>42,000</u>
Being transfer of redeemable Preference Shares and premium payable to Redemption of Redeemable Preference Shares account.			

2.	Bank Account	44,000	
	Ordinary Share Capital Account		40,000
	Share Premium Account		4,000
	Being proceeds of issue of 800,000 Ordinary shares at a premium of 5k per share.		
3.	Redemption of Redeemable Preference Shares Account	42,000	
	Bank Account		42,000
	Being redemption of redeemable preference shares at a premium of 5% per share		
4.	Share Issue Expense Account	60,800	
	Bank Account		60,800
	Being payment of share issue expenses.		
5.	Share Premium Account	60,800	
	Share Issue Expense Account		60,800
	Being share issue expenses written off to premium account.		

Determination of Purchase Consideration

260,000 ordinary shares of 50k each at 58k per share	150,800
Cash	300,000
Current Liabilities taken over	50,000
	<u>500,800</u>

3.9 RECONSTRUCTION

The ideal goal that every company strives to achieve is a balanced capital structure. A balanced capital structure is one in which the long term funds (share capital plus long term liabilities) adequately cover investment in long

term assets and leave a surplus which substantially covers current assets. A balanced capital structure also implies that the gearing ratio should be optimal. When a company is faced by problems arising from imbalance in capital structure, it may have to carry out a capital reconstruction to redress the problem. Capital reconstruction refers to the re-organisation of capital and/or re-arrangement of the rights of shareholders as between themselves in order to revive an ailing company or transfer its operation to another company. Indicators of imbalance capital structure include overcapitalization, overtrading, unhealthy working capital ratio, excessive amount of reserve and capital not represented by available assets.

A capital reduction is a scheme approved by the court in which the nominal or par value of a company's paid up share capital is reduced.

3.9.1 The General Rule

The general rule, going by section 105 of CAMA, 1990, is that a company is not permitted to reduce its share capital.

3.9.2 Exceptions

A company, however, may reduce its issued share capital on fulfillment of the following conditions;

- (a) It must be authorised by its articles;
- (b) It must be by a special resolution passed at a general meeting;
- (c) The resolution must specify the amount of reduction; and
- (d) The capital reduction must be approved by the court.

The purpose of requiring court's approval is to ensure the protection of creditors whose interest may be jeopardized should the company embark on the capital reduction scheme. They are, therefore, entitled to object to the scheme.

Specifically, Section 107(4) requires the company to apply to the court for an order confirming the reduction, after passing a special resolution, while section 107(2) provides that every creditor of the company who is entitled to any debt or claim admissible in proof against the company shall be entitled to object to the scheme if;

- (a) The proposed reduction of share capital involves a diminution of liability in respect of unpaid share capital; and
- (b) It involves the payment to a shareholder of any paid up share capital or any other form of reduction.

Section 107(4) empowers the court to settle the list of creditors entitled to object to the scheme.

All these provisions are to ensure that the creditors are protected and do not suffer any loss as a result of the capital reduction scheme unless they allow it by refusing to come forward and object when their interest is not protected.

3.9.3 Capital Reduction - The issued share capital of a company could be reduced by:

- (a) Extinguishing or reducing the liabilities on a company's share not represented by available assets.
- (b) Extinguishing or reducing the liabilities on a company's share in excess of the company's need.
- (c) Extinguishing or reducing the liabilities on a company's share not fully paid up.

In practice and in most examination questions, capital reduction will take the form described in (a) above. In this case, substantial losses have been accumulated and there are no immediate prospects of improvement. Therefore, remedial measures have to be taken by way of capital reduction, which will ultimately ensure that fresh funds are injected into the business, providing an impetus to set the company into motion once again.

3.9.4 Capital Reconstruction

Capital reduction should not be construed to be the same as Capital Reconstruction. The latter is wider and embraces the former. A company in severe financial difficulties which needs to reach a compromise with its creditors, may embark on capital reconstruction. Whereas, in capital reduction scheme, only the existing shareholders (ordinary and preference) are involved, in capital reconstruction external creditors are involved.

There are basically two types of capital reconstruction. These are:

3.9.4.1 Internal Capital Reconstruction:

This can be by way of re-capitalization or capital reduction. It is a means of solving the capital problem of a company without involving another company. It is a scheme of capital reduction, involving existing creditors, in which the company's financial structure is altered, but not requiring the formation of a new company to take over all or part of the enterprise facing difficulties. For example, debenture holders may be issued ordinary shares in place of their debentures or take over assets at agreed valuations in part satisfaction of their debt,

Creditors should agree to any changes in their rights, since the whole objective of the scheme is to ensure that all parties to it are better off - when compared to immediate liquidation.

3.9.4.2 External Capital Reduction

In external reconstruction, an entirely new company will be formed for this purpose to take over all or part of the enterprise

facing difficulties. The new company will absorb the ailing enterprise which appears to have been liquidated and taken over. Accounting entries passed in this case will be similar to those involved in `absorption', under business combination.

In this study pack, the term `Capital Reduction' is used to include Capital Reduction proper and Internal Capital Reconstruction.

Generally, capital reduction may involve:

- (a) Implementing an already formulated scheme; and
- (b) Formulating a capital reduction scheme.

3.9.4.3 Implementing An Already Formulated Scheme

An already formulated capital reduction scheme may be proposed by creditors or shareholders, agreed by all interest groups and approved by the court. They are not required to propose a scheme that will be acceptable by all, in terms of reducing the capital. What is required is simply to pass the necessary accounting entries to give effect to the proposed scheme which has already been agreed. Since the scheme has already been formulated, it is necessary to familiarize with the relevant terms.

3.9.4.4 Principles of Implementing an already Formulated Scheme

In implementing an already formulated scheme, the following principles should be borne in mind;

- (a) Any liability waived or cancelled constitutes a gain or profit to capital reduction. The accounting entries are:

DR	-	Liability
CR	-	Capital reduction

`Liability' in this context is not limited to current and long term liabilities, but is defined to include share capital (ordinary and preference shares).

It should be noted that in capital reduction, the liability expected to be waived or cancelled is restricted to ordinary and preference shares, whereas in capital reconstruction, creditors would be involved.
- (b) Where a liability which is not represented in the balance sheet is waived or cancelled, it does not constitute a gain or capital reduction and should, therefore, be ignored. In that case, no accounting entry will be passed.

You may be asked what is meant by "liability not represented in the balance sheet." A typical example is contingent liability. Most questions on capital reduction

supply information on the arrears of preference dividend as a note, but will not show the dividend in the balance sheet. A liability not represented in the balance sheet needs to be recognized first and thereafter eliminated on waiver. Consequently, it has no effect.

- (c) Where a liability that is not represented in the balance sheet is settled, it will constitute a loss to capital reduction. The accounting entries are:

DR	-	Capital Reduction
CR	-	Bank/Cash, Shares, Loan Stock or Debenture.

- (d) Any revaluation surplus or deficit arising from revaluation of asset or investment should be taken to capital reduction. For revaluation surplus, accounting entries will be:

DR	-	Asset / Investment
CR	-	Capital Reduction

For revaluation deficit, accounting entries will be:

DR	-	Capital Reduction
CR	-	Asset / Investment

- (e) Similarly, profit or loss arising from the disposal of asset or investment should be taken to capital reduction. Accounting entries will be:

For profit on disposal:

DR	-	Disposal Account
CR	-	Capital Reduction

For loss on disposal:

DR	-	Capital Reduction Account
CR	-	Disposal Account

- (f) Any accumulated loss shown in the balance sheet should be written off. In this case, the accounting entries would be:

DR	-	Capital Reduction Account
CR	-	Profit and Loss Account

- (g) Ordinarily, a well-formulated scheme should have no balance in the capital reduction account. However, should there be any, it is expected to be a credit balance (in which case interest group has been over tasked) and should be closed off to Capital Reserve Account. The accounting entries would be:

DR	-	Capital Reduction
CR	-	Capital Reserve

A debit balance in the capital reduction account means that the scheme has not been well formulated, as it has not been able to wipe out accumulated loss. This could be written off against capital reserve if it exists; otherwise it should be carried forward as such to be written off subsequently to trading profits.

Note that the term capital reduction is used loosely. Some examination questions may ask for capital reduction and reorganisation account while others may be on capital reduction and reconstruction account. All one needs to do is to substitute capital reduction account. Accounting entries will remain as shown above.

Having laid the foundation, the mechanics of formulating a capital reconstruction scheme may now be considered as follows:

ILLUSTRATION 3.7

Peepee Construction Company Plc is in financial difficulty. The following is the Trial Balance of the company as at 30 June, 2008.

	DR	CR
Land	580,000	
Building (Net)	136,230	
Ordinary shares of 1 each		500,000
5% cum-preference shares at 1 each		350,000
8% Debenture (2013)		400,000
Equipment (Net)	53,770	
Goodwill	200,000	
Investment in shares (quoted)	135,000	
Stock and work in progress	501,235	
Debtors	253,460	
Profit/Loss Account	199,105	
Interest payable on debenture		64,000
Trade creditors		481,235
Loan from Directors		80,000
Bank draft		183,565
	<u>2,058,800</u>	<u>2,058,800</u>

Authorized capital is 1,000,000 ordinary shares of 1.00 each and 500,000 5% cumulative preference shares of 1.00 each.

During the meeting of the shareholders and directors it was decided to carry out a scheme of internal reconstruction.

The following scheme was agreed:

- (i) Each ordinary share is to be reduced to a share of 25k.

- (ii) The existing 5% cumulative preference shares are to be exchanged for new issue of 175,000 8% cum preference shares of 1.00 each and 700,000 ordinary shares of 25k each.
- (iii) Ordinary shareholders accepted a reduction in the nominal value of the shares of 1.00 for 25k, with subscription to a new issue on the basis of 1 to 1 at a price of 30k per share.
- (iv) 30,000 of Directors loan is to be cancelled. The balance is to be settled by issue of 50,000 ordinary shares of 25k each.
- (v) Goodwill and loss in the profit and loss account are to be written off.
- (vi) Investments in shares are to be sold at market price of 300,000.
- (vii) Bank overdraft to be repaid, 100,000 is to be paid to trade creditors and the balance payable instalmentally.
- (viii) 20% of debtors is to be written off.
- (ix) Assets are revalued as follows:

Land	1,450,000
Building	400,000
Equipment	50,000
Stock and Work-in-Progress	250,000

Required:

- (a) Show the necessary journal entries to effect the reconstruction scheme.
- (b) Prepare the balance sheet after the reconstruction, showing all workings.

SUGGESTED SOLUTION 3.7**(a) PEEPEE CONSTRUCTION COMPANY PLC****Journal Entries**

	Debit	Credit
5% cum preference shares	350,000	
8% cum preference shares		175,000
Ord. Shares (700,000 x 25k)		175,000
Being exchange of 5% cum pref.		
Ordinary shares	500,000	
New ordinary shares		125,000
Capital reconstruction		375,000
Amount written off ordinary share capital		
Bank (500,000 x 30k)	150,000	
Ordinary shares		125,000
Share premium		25,000
Issue of 1 for 1 right at 30k each		

	Debit	Credit
	₦	₦
Director's Loan	80,000	
Capital reconstruction		30,000
Ord shares (50,000 @ 25k each)		12,500
Share premium		37,500
Write off and issue of shares to settle director's loan		
Capital reconstruction	399,105	
Goodwill		200,000
P & L account		199,105
Goodwill and loss written off		
Bank	300,000	
Investment		135,000
Capital reconstruction		165,000
Sale of investment at market price		
Bank overdraft	183,565	
Trade creditors	100,000	
Bank		283,565
Payment of overdraft and part payment of trade creditors		
Capital reconstruction	50,692	
Debtors		50,692
20% written off debtors account		
Land	870,000	
Building	263,770	
Stock & WIP		251,235
Equipment		3,770
Capital reconstruction		878,765
Revaluation of assets		

(b) PEEPEE CONSTRUCTION COMPANY PLC
BALANCE SHEET AFTER RECONSTRUCTION

Fixed Assets:

Land	1,450,000
Building	400,000
Equipment	50,000
	1,900,000

Current Assets

Stock & WIP	250,000
Debtors (less 50,692)	202,768
Bank	166,435
	619,203

Current liabilities

Trade Creditors	381,235	
Interest on debenture	64,000	
	445,235	
Net current asset		173,968
Total assets less Current Liabilities		2,073,968
8% Debenture		(400,000)
Net Assets:		1,673,968
Capital and reserves:		
Ordinary shares of 25k		437,500
Share premium		62,500
8% of cum preference		175,000
Capital reserve (W1)		998,968
		<u>1,673,968</u>

Workings

(W1)

Capital Reduction Account

Goodwill (written off)	200,000	Ordinary shares	375,000
Profit and loss account	199,105	Investment	165,000
Debtors	50,692	Land	870,000
Equipment	3,770	Buildings	263,770
Stock	251,235	Directors loan	30,000
Capital reserve	998,968		
	<u>1,703,770</u>		<u>1,703,770</u>

3.9.4.5 Principles of Formulating a Capital Reconstruction Scheme

Capital reduction is worth considering if the company has recovery prospects. The following principles should be borne in mind:

- (a) 'Hit' ordinary shareholders hard. They should be made to suffer more loss to be written off through the scheme than any other group. This is because they are the prime beneficiaries of the company's future prosperity to be achieved through the scheme.
- (b) In a capital reduction scheme, preference shareholders should have a share, if the loss to be written off exceeds what can be borne by the ordinary shareholders. However, the overriding principle should be what the position would look like in the immediate liquidation. If in an immediate liquidation. Preference shares cannot be paid in full, meaning that they will suffer some loss of

capital, they will be prepared to accept a lesser loss of capital in a reduction scheme. They should be compensated by issue of ordinary shares so that they could recoup their losses if the company's fortune improves.

- (c) Arrears of cumulative preference share dividend should be dealt with on merit. If cancellation is proposed in the scheme, compensation in form of issue of shares, debenture or loan stock for the whole or part of the arrears should be suggested.
- (d) The proposed capital reduction scheme should be such that secured creditors who have the right to appoint a receiver or call for immediate liquidation (for example debenture holders and loan stockholders) make contribution which would leave them worse off than they would have been in an immediate liquidation.
- (e) Consider the avenues for injecting fresh funds into the business. One of the reasons for embarking on capital reduction scheme is to write off accumulated loss. This alone is not sufficient to set the company into motion a second time, since it does not provide working capital for the company's operation. Therefore, there is need to consider how to inject funds into the business.
- (f) Consider replacing preference shares with loan stock for possible tax gains. This is because interest on loan stock is allowed for tax purposes, whereas preference dividend is not allowed.

3.9.4.6 Steps to be adopted in formulating a Capital Reconstruction Scheme

In trying to formulate a capital reduction scheme, the following steps are to be taken:

- (a) Determine the realizable value of assets and the total amount of loss recoupable through the scheme. In determining this, hidden losses and profits are taken into consideration. Hidden losses exist where fictitious assets that cannot realize anything are represented in the balance sheet. Examples include goodwill, trademark, patents and deferred expenses capitalized, or assets shown in the balance sheet whose book values exceed their realizable values. Conversely, there will be hidden profits where the book value of assets is less than the

realizable value. Where the realizable value of an asset is not given in an examination question, it is assumed that the asset will realize its book value; in that case, there will be neither profit nor loss.

- (b) Determine the extent that the realizable value of assets will go in repaying the company's debts in order of priority, assuming that the company is going on liquidation. In liquidation, repayment is made in order of priority, as follows:
 - ◆ Priority costs
 - ◆ Priority debts.
 - ◆ Secured creditors
 - ◆ Unsecured creditors.
 - ◆ Preference shares, and
 - ◆ Ordinary shares.
- (c) From step (b) above, determine the maximum amount of loss that each interest group can bear in liquidation and hence, the amount of reduction possible in the proposed capital reduction scheme. What is being considered in steps (b) and (c) above is the right of creditors and shareholders. The principle here is that they must be protected by the same scheme more than their position in an immediate liquidation. For example, if from step (b) it is ascertained that in an immediate liquidation, secured and unsecured creditors will be paid in full, then they should not be made to suffer any loss in the scheme that would not be acceptable to them. The scheme will be restricted to both ordinary and preference shares and is, therefore, capital reduction. On the other hand, if they will not be paid in full, they may be persuaded to accept a reduction lesser than what it will be in an immediate liquidation. It is in this case that they will be enticed with future prospects by allotting ordinary shares to them. If they accept, then it is capital reconstruction.
- (d) Formulate the scheme, taking into consideration all the principles of formulating an acceptable capital reduction scheme and the peculiar circumstances of the company in question. One may have to refer back to the principles of formulating capital reduction scheme, in dealing with the assignment.
- (e) Summarise the proposed reduction scheme.
- (f) If required, prepare a revised balance sheet after implementing your proposed scheme.

ILLUSTRATION 3.8

Carrygo Limited has been operating in the scrap metal industry for many years. The company is under pressure from its bankers and other creditors and the directors wish to consider re-organisations.

The summarized balance sheet of Carrygo Ltd as at 30th September, 2008 is as follows:

	'000	'000	'000
Capital and Reserves			
Share Capital:			
Ordinary shares of 1 each			1,500
7% pref. shares of 1 each			500
			2,000
Profit and loss balance			(352)
			1,648
Represented by:			
Fixed Assets: Patent, Research and Development	500		
Land and Buildings	700		
Plant and Machinery	100		
			1,300
Current Assets			
Stock	1,200		
Debtors	830		
Investment at cost (Market Value 14,000)	150		
Cash in hand	10		
	2,190		
Creditors falling due within 1 year			
Bank overdraft & short term loan	1,140		
Trade and other creditors	148		
Directors' Loans	140		
Debenture interest	14		
	1,442		
Net current assets			748
			2,048
Creditors due after more than 1 year			
7% Debenture secured on land and Building			(400)
			<u>1,648</u>

The following additional information is given;

- Assets whose values have been impaired are to be written down or written off as appropriate.
- The estimated cost of the re-organisation scheme is 50,000.
- Of the trade and other creditors, 15,000 relates to arrears of 2 weeks wages, 25,000 to Value Added Tax and 12,000 to Scrap Metal Dealers Association, the balance being trade creditors.
- Accrual for expenses in September of 60, 000 have not been included.

- (e) If the re-organisation took place, an estimated 90,000 would be required for new processing equipment.
- (f) The bank will require part payment of its overdraft and short term loans before agreeing to the scheme. Preliminary negotiation suggests that a 40% reduction would be accepted.
- (g) Preference dividends are 3 years in arrears
- (h) The value of certain assets on a going-concern basis are stated below:
 - (i) Patents are worth 140,000
 - (ii) The value of land and building is estimated to be 900,000.
 - (iii) Plant and Machinery is worth only 10,000
 - (iv) Stock is worth 800,000
 - (v) Debtors include an estimated 40,000 bad debts
 - (vi) A floating charge is held by the bank
- (i) There is a general willingness on the part of the shareholders and directors to forego part of their capital and their loans and to subscribe further equity capital whilst ensuring that trade creditors are paid in full.
- (j) The debenture holders are to subscribe for 200,000 more debenture to be secured on land and building.
- (k) Ordinary Shareholders and Preference Shareholders are to make sacrifice of 60% and 50% of their interests respectively and to subscribe for further shares as follows:
 - (i) Ordinary Shareholders (1 for 2) at the existing price of 0.4
 - (ii) Preference Shareholders (1 for 2) at the existing price of 0.5
- (l) 15,000 of the arrears of wages for two (2) weeks is to remain unpaid in the current year.
- (m) The Directors' loan is to be reduced by 30%

Required:

Prepare for consideration of the Directors of Carrygo Limited:

- ◆ Your estimated state of affairs, assuming a liquidation with assets realized on a forced sale basis, making such assumptions as you consider appropriate.
- ◆ Your suggested scheme of re-organisation; and
- ◆ The balance Sheet following your scheme.

SUGGESTED SOLUTION 3.8**Carrygo Ltd**

- ◆ **Step 1.** The total losses to be written-off

Re-organisation cost	50,000
Accrual for expenses	60,000
Patent (500,000-140,000)	360,000
Plant & Mach. (100,000-10,000)	90,000
Stock (1,200,000-800,000)	400,000

Bad debt	40,000
Profit and Loss Account	352,000
	<u>1,352,000</u>

◆ **Step 2. Source of Credit**

Revaluation surplus on Land & Building: (900,000-700,000)	200,000
1,500,000 Ordinary Share Capital (60%)	900,000
500,000 Preference Share Capital (50%)	250,000
Directors' loan (30%)	42,000
	<u>1,392,000</u>

◆ **Step 3. Determination of minimum cash required**

New plant and Machinery	90,000
Re-organisation cost	50,000
Bank overdraft (40% of 1,140,000)	456,000
Creditors 148,000	
Less Accruals 15,000	133,000
Less cash in hand	(10,000)
Minimum cash required	<u>719,000</u>

◆ **Step 4. Source of Cash**

Ordinary Share (capital 1 for 2 @ 0.4 (1,500,000 x 0.5 x 0.40)	300,000
Preference share capital 500,000 x 1 x 0.5	250,000
Debenture holders (50%)	200,000
	<u>750,000</u>

Capital Reduction Account

Reorganisation Cost	50,000	Ordinary Share	900,000
Patents	360,000	Preference Shares	250,000
Plant and Machinery	90,000	Land and Buildings	200,000
Stock	400,000	Directors' Loan	42,000
Bad Debt	400,000		
Accrued Expenses	60,000		
Profit and Loss	352,000		
Capital Reserve	40,000		
	<u>1,392,000</u>		<u>1,392,000</u>

Patent Account

Balance b/d	500,000	Capital reduction	360,000
		Balance c/d	140,000
	<u>500,000</u>		<u>500,000</u>

Land and Buildings Account

Balance b/d	700,000	Balance c/d	900,000
Capital reduction	200,000		
	<u>900,000</u>		<u>900,000</u>

Plant and Machinery Account

Balance b/d	100,000	Capital reduction	90,000
	<u>100,000</u>	Balance c/d	10,000
			<u>100,000</u>

Stock Account

Balance b/d	1,200,000	Capital reduction	400,000
	<u>1,200,000</u>	Balance c/d	800,000
			<u>1,200,000</u>

Debtors Account

Balance b/d	830,000	Capital reduction	40,000
	<u>830,000</u>	Balance c/d	790,000
			<u>830,000</u>

Carrygo Company Limited
Balance Sheet as at 30th September, 2008

Fixed Assets:

Land and Buildings	900,000
Plant and Machinery (10,000+ 90,000)	100,000
	<u>1,000,000</u>

Intangible Assets:

Patent	140,000
	<u>1,140,000</u>

Current Assets:

Stock	800,000
Debtors	790,000
Bank	31,000
Investment	150,000
Current Liabilities	<u>1,771,000</u>
Accruals (60,000+ 15,000)	75,000
Directors Loan	98,000
Debenture interest	14,000
Bank overdraft	684,000
Net current assets	871,000
Total assets less current liabilities	<u>900,000</u>
	<u>2,040,000</u>

Creditors amount falling due after more than one year;	(600,000)
7% Debenture (secured on Land and Building)	1,440,000
Net Assets	
Financed by:	
Ordinary share capital	900,000
Preference share capital	500,000
	1,400,000
Reserves:	40,000
Capital Reserve	<u>1,440,000</u>

3.10 SUMMARY AND CONCLUSIONS

This chapter discussed business combinations and reasons why separate businesses may decide to come together by way of amalgamation or absorption. The accounting procedure for business combination and steps involved in closing the books of the discontinuing business were given in details.

Refer to Comprehensive Questions and Suggested Solutions in Appendix II, page 269.

3.11 REVISION QUESTIONS

3.11.1 MULTIPLE CHOICE QUESTIONS

- The balancing figure in the capital reduction and capital re-construction accounts is transferred to as:
 - Revenue reserves
 - Capital redemption reserves
 - Capital reserves
 - Revaluation reserves
 - Unappropriated reserves
- The purchase consideration agreed during business combinations is settled by
 - issue of debentures
 - issue of bonus shares
 - issue of ordinary shares
 - cash
 - i and ii
 - i and iv
 - i, ii and iv
 - i, iii, and iv
 - i, ii, iii and iv
- Given that the agreed purchase consideration for the acquisition of 60% holding in a company is ₦3.6 million to be satisfied by issue of ordinary shares of ₦0.50 per share at a premium of ₦0.30 per share, calculate the number of ordinary shares to be issued.
 - 18 million
 - 12 million
 - 7.2 million
 - 4.5 million
 - 2.88 million

4. Where the liability of a business being absorbed is taken over by the acquiring company the double entry is.
- A. Dr. Liability account
Cr. Acquiring Company Account
 - B. Dr. Liability Account
Cr. Liability Account
 - C. Dr. Realisation Account
Cr. Liability Account
 - D. Dr. Bank Account
Cr. Liability Account
 - E. Dr. Liability Account
Cr. Bank Account
5. Which of the following is not a form of business combination?
- A. Sole trader acquires another sole trader.
 - B. Partnership acquires sole trader.
 - C. Partnership converts to limited liability company.
 - D. Partnership buys another partnership.
 - E. Two or more sole traders form a partnership.

3.11.2 SHORT ANSWER QUESTIONS

1. On the completion of a scheme of capital reduction the capital reconstruction account is expected to show abalance.

Use the following information to answer questions 2 - 4

Big-Head Plc. absorbed Small Mind Ltd. at an agreed purchase price which is to be settled by the issuance of ordinary shares with ₦25million and Debentures worth ₦12.5million. The balance is to be paid in cash. Big head is to take over all the assets of Small-Mind Ltd. except the bank balance. Extracts from the books of Small-Mind Ltd. are detailed below:

Assets	Book value ₦'000	Takeover value ₦'000
Fixed Assets	29,030	34,775
Other Current Assets	10,970	10,225
Bank Balance	1,345	--

Small Mind Ltd. incurred realisation expenses of ₦1.26 million. Big-Head Plc is expected to have a negative goodwill of ₦2.5 million after absorption.

- 2. What is the value of the purchase consideration?
- 3. What is the profit or loss that accrued to Small-Mind Limited on the take-over?
- 4. How much of the purchase consideration will be settled in cash?
- 5. In amalgamation all the assets of the discontinuing companies are transferred to the realisation account at _____ value.

Refer to Suggested Solutions in Appendix I, Page 263.

ANALYSIS AND INTERPRETATION OF FINANCIAL STATEMENTS

4.0 LEARNING OBJECTIVES:

After studying this chapter, readers will be able to appreciate the following:

- ◆ The application of IFRS, GAAP and other accounting and disclosure requirements to financial statements' preparation and publication;
- ◆ The computation of significant accounting ratios from published financial statements;
- ◆ The Interpretation of significant ratios;
- ◆ Application of ratio analysis to group financial statements;
- ◆ The choice of accounting treatments adopted in the preparation and presentation of financial statements;
- ◆ The conduct of both vertical and horizontal analysis, trend analysis as well as inter-firm analysis using financial statements; and
- ◆ The usefulness and limitations of ratio analysis.

4.1 INTRODUCTION

The information to be disclosed in financial statements for the purpose of guiding informed decision making could be qualitative and quantitative in nature. The information should be subjected to critical analysis and interpretation using ratios and other relevant indicators for a good understanding of the contents of the financial statements.

The whole content of a company's annual reports, rather than just some aspects of the financial statements, should attract the attention of stakeholders to the reporting entity. Therefore, the ability to understand the implications of all the items in the financial statements of a reporting entity and how to ruthlessly analyze and interpret the statements should be obtained by students at this level. The ability to compute accounting ratios is, however, a fundamental requirement.

It is also pertinent to note that the application of ratio analysis to group financial statements is additional requirement at this level. Students are, therefore, expected to have a good knowledge of the contents of consolidated financial statements of companies that have subsidiary (and sometimes sub-subsidiary) companies.

4.2 CONTENTS OF A COMPANY'S ANNUAL REPORTS AND ACCOUNTS

As provided in section 334 of CAMA 2004 (as amended), the financial statements of a company should contain the following items:

- (a) Statements of accounting policies.
- (b) The balance sheet as at the last day of the financial year.
- (c) A profit and loss account/income statement or in the case of nonprofit organisation, an income and expenditure account for the year.
- (d) Notes to the accounts.
- (e) The Auditor's report.
- (f) Directors' report.
- (g) Statement of Cash Flow.
- (h) Value Added Statement for the year,
- (i) Five year financial summary, and
- (j) In the case of a holding company, the group financial statements.

Section 334(3) stipulates that the financial statements of a private company need not include the matters stated in paragraphs (a), (g), (h) (and (i) above. It should, however, be noted that this is the minimum requirement, and private companies should be encouraged to include those items in their financial statements.

Financial statements are the accounting reports in respect of economic activities of an enterprise, prepared periodically and usually at the end of every financial year. These statements form an integral part of the company's annual report and accounts, and they are components specified not only in CAMA, but also in the Statement of Accounting Standard (SAS) No. 2, issued in November 1984 by the Nigerian Accounting Standards Board (NASB). This SAS provides that all accounting information that will assist users to assess the financial liquidity, profitability and commercial viability of a reporting entity should be disclosed and presented in a logical, clear and understandable manner.

This reporting requirement is also emphasised by the International Financial Reporting Standard (IFRS) 5 in relation to information to be disclosed in financial statements of a company. The Generally Accepted Accounting Principles (GAAPs) also describes all the accounting conventions, postulates, rules, and procedures necessary to define accepted accounting practice to be adopted by reporting entities at any given time and in any given situation. Over the years, GAAPs have been developed in various countries. For instance, the pace of development of UK and US GAAPs has always supported the developmental process of accounting principles and practices of developing countries, like Nigeria. At the international scene, International Accounting Standards have been harmonized and worked upon to the extent that, with effect from January 2005, all the listed European Union (EU) companies must prepare their consolidated financial statements in accordance with International Accounting Standard. Many countries in the developing world (Nigerian inclusive) have also adopted IAS where there are no local alternatives.

SAS No. 2 provides that the financial statements of a reporting enterprise should state the following:

- (a) the name of the enterprise,
- (b) the period of time covered,
- (c) a brief description of its activities,
- (d) its legal form, and
- (e) its relationship with significant local and overseas suppliers, including the immediate and ultimate parent, associated or affiliated companies.

Furthermore, the financial statements are required to include the following:

- (a) Statement of accounting policies
- (b) Balance sheet
- (c) Profit and loss account or income statement
- (d) Notes on the accounts
- (e) Cash flow statement
- (f) Value added statement, and
- (g) Five –year financial summary

An in-depth examination of the annual report and accounts of various companies (especially public limited liability companies) will show clearly that in addition to the items listed above, the following may also be found in such reports:

- (a) Results at a glance
- (b) Notice of Annual General Meeting
- (c) Chairman’s Statement
- (d) Report of the Directors
- (e) Report of the Audit Committee
- (f) Performance charts (such as Bar charts, Pie charts, etc.)
- (g) Statement of Unclaimed Dividend Warrants
- (h) Proxy Form(or proxy card); and
- (i) Admission Form(or Admission card)

It should be noted that whereas ratios are usually calculated from the financial variables obtainable from the balance sheet and profit and loss account, the task of interpreting financial statements cannot be adequately discharged without reference to information available from the remaining components of the Annual Reports and Accounts.

4.3 DISCLOSURE REQUIREMENTS OF CONSOLIDATED FINANCIAL STATEMENTS

Consolidated financial statements are the financial statements of a group presented as those of a single enterprise. According to Section 337 of Companies and Allied Matters Act (CAMA) 2004 (as amended), Schedule 2 part IV, paragraph 60, “The group account laid before an Annual General Meeting of a holding company shall be consolidated accounts comprising:

- (a) Consolidated Balance Sheet, dealing with the state of affairs (financial position) of the reporting company and all its subsidiaries that have been consolidated in the group accounts.
- (b) A consolidated profit and loss account, dealing with the profit and loss of the company and those of the subsidiaries".
This means that Consolidated Balance Sheet and Consolidated Profit and Loss Account shall combine the information contained in the separate balance sheets and profit and loss accounts of the holding company and of the subsidiaries, but with such adjustments (if any) as the directors of the holding company might think necessary.

The contents of group accounts, therefore, are:

- (a) Holding company's balance sheet
- (b) Holding company's profit and loss account, unless advantage is taken of section 335(10) of CAMA which is about disclosure of facts in a note to the consolidated accounts.
- (c) Consolidated Balance Sheet, and
- (d) Either Consolidated profit and loss account, or Holding company's profit and loss account framed as a consolidated profit and loss account and/or a statement of the holding company's share of the profit of the subsidiaries not consolidated.

4.4 PURPOSE OF ANALYSIS AND INTERPRETATION OF FINANCIAL STATEMENTS

Analysis of financial statements entails a careful identification of key financial variables in the opening and closing balance sheets and income statements of a firm with a view to establishing meaningful relationships between the variables so identified. The relationships are usually established through accounting or financial ratios.

Interpretation, on the the other hand, involves **giving meaning** to the various ratios with a view to ascertaining the financial strengths, weaknesses, opportunities and threats of the firm. This is for the purpose of assessing the financial position and commercial soundness of the reporting entity to which those variables relate. It is believed that, all things being equal, accounting ratios should have resemblance from period to period, hence a major variance between one period and another, would attract attention and comments.

The financial strength or weakness of a reporting entity could be in respect of its operation, financial position and/or prospect. Most often financial statements are interpreted for the purpose of assessing the operations of a business. This is done either on a short term basis, which is for one year, or on a long term basis, which goes beyond one year. In the former, the analysis will take the form of explanation of and comment on past year's result and the financial position of the reporting entity at the end of the current year, making such deductions as are possible in relation to the trend of the past one or two years.

The following are some of the matters that will usually be the subject of comparison and comment:

- (a) Adequacy of the working capital
- (b) Adequacy of the provisions for losses in assets value e.g. depreciation, bad and doubtful debt, etc..
- (c) Adequacy of long term capital
- (d) Consistency of accounting methods
- (e) The relative proportion of fixed and liquid assets
- (f) The general overall picture of the latest balance sheet; and
- (g) Impact of inter-company transactions in the case of group accounts.

4.4.1 Purpose of the analysis

The specific purpose of financial statements analysis is dictated by the needs of the group of users for whom the analysis is carried out. Thus, various groups of financial statements users are often more concerned with different needs that include:

- (a) Investors are mainly concerned about the firm's earnings and therefore concentrate on the present and future profitability as well as the firm's financial structure as it relates to the earnings ability and risk of the firms.
- (b) Trade creditors are mainly interested in the firm's ability to meet its current obligation when due. They focus their attention on the firm's liquidity position or short term solvency.
- (c) Long term creditors, for example banks and debenture holders, need to look at the firm's long term solvency and survival. Hence they consider the firm's profitability over time, liquidity from time to time, and capital structure. They also analyse the firm's projected financial statements.
- (d) Management is interested in every aspect of the firm, which includes profitability, liquidity, solvency, financial structure and activities.
- (e) Other users, for example researchers, will have interest in every aspect of the firm based on their research interest.

4.4.2 Purpose of the interpretation

With respect to the interpretation and analysis on long term basis, an attempt is made at explaining the broad trends of the operation of the reporting entity over several years without giving undue regard to yearly variations, except where considered absolutely necessary. Some of the inferences that may be drawn from the analysis of a firm's financial statements on a long term basis are in the areas of considering the implication of having a particular type of movement in selected income statement and balance sheet figures. Examples are:

- (a) A progressively increasing amount of fixed assets without a corresponding increasing net profit; a fair inference is that the assets are not profitably employed either because of under utilization of such assets or because selling prices have not been appropriately adjusted to cover the enhanced cost of such assets.
- (b) Where short term liabilities, like bank overdraft or bank loan, do not decrease or actually increases – a fair inference is that the firm's position has not been sufficiently attractive to support the issue of shares or debentures to fund the firm's operations.

4.5 TOOLS OF ANALYSIS AND INTERPRETATION OF FINANCIAL STATEMENTS

Analysts and interpreters of financial statements will usually employ a combination of the following items:

- (a) Ratios
- (b) Cash Flow Statement
- (c) Value Added Statement
- (d) Profit and Loss Account
- (e) Balance Sheet
- (f) Notes to the Accounts

In making use of the above, the following approaches may be employed:

- (i) Comparison of absolute/raw figures as shown in the financial statements, for example figures may indicate that sales have increased by 250,000, fixed assets by 300,000, etc.
- (ii) Ratio Analysis: This is the most widely used tool in the analysis and interpretation of financial statements.
- (iii) The Cash Flow Statement will assist in revealing the true liquidity position of an enterprise. This is because the statement provides an insight into the ability of an enterprise to generate cash and cash equivalents as well as the pattern of utilization.
- (iv) Value Added Statement, on the other hand, helps in measuring the efficiency of the enterprise in terms of value added per employee or per naira.

4.6 PROCESS OF INTERPRETATION OF FINANCIAL STATEMENTS

The process of interpretation of financial statement entails the following:

- (a) Calculating the ratios considered to be appropriate and relevant for the purpose of the analysis.
- (b) Comparison of the ratios with similar ratios which could be the firm's own past ratios, target ratios (projected ratios), industry or competitor's ratios.
- (c) Trend analysis or time series analysis of the ratios so calculated.
- (d) Vertical and horizontal analysis of financial statements.
- (e) Inter-firm analysis.

- (f) Preparation of a written report on the analysis and interpretation of the financial statements of a chosen reporting entity, drawing reasonable conclusions based on the purpose of the exercise and the appreciation of steps (a) to (e) above.

An analyst will find any other information about a firm in the Chairman's Statement and Directors' Report or even in the financial press relating to the company or the industry in which the company operates.

4.7 CLASSIFICATION OF RATIOS

Financial ratios can be classified into various groups according to the purpose for which they are intended to be used. While some will assist in measuring the firm's profitability, others are useful in assessing the liquidity and solvency of the firm. Yet, others aid in appraising the financial structure of the firm.

Adequate knowledge of the types of ratios will guide readers in the choice of ratios to use in answering questions on relevant topics or supporting view points. It is important to note that it is only when the question calls for the use of ratios that such should be calculated and used. In some cases, even when the use of ratios is called for, the readers would be at liberty on the choice of ratios. For instance, if the question merely states that you are required to give "a report on the financial performance of the company with appropriate comparative ratios," the ratios to be calculated should be those that closely linked the issue at stake. The ratios that are frequently used to test financial performance of the reporting entity are profit margin (gross and net), return on capital employed, current and liquid ratios, and turnover ratios.

For the purpose of analysis, financial ratios can be classified into the following groups:

- (a) Profitability Ratios
- (b) Liquidity and Efficiency Ratios
- (c) Investment Ratios
- (d) Turnover or Activity Ratios
- (e) Financial Structure or Leverage Ratios

4.7.1 Profitability Ratios

These ratios measure the overall performance and effectiveness of companies. Profit is the difference between income and expenses over a period of time (usually one year). Profit is the ultimate objective of a company and a company will have no future if it fails to make sufficient profit.

The profitability of a firm can be expressed in relation to the capital employed or its total revenue, that is, sales or gross earnings. Ratios that are used to test profitability or the overall performance of a reporting entity include the following:

- (a) **Return on Capital Employed (ROCE):** This is the ratio of net profit to capital employed. It is also known as the return on investment (ROI) ratio or the primary ratio, as it is the measure of the primary aim of the business, that is, return on the funds invested in the business. If the return is low, the firm must seek ways of improving upon its profit level or seek alternative use of its funds. Furthermore, its decrease from one year to the other is a sign of unfavorable result to the business and, so, management must adopt appropriate strategies to improve on the ratio by minimizing costs/expenses, maximizing sales/turnover and reducing outright acquisition of too many fixed assets. The general form of this ratio is given by:

$$\frac{\text{Net Profit after Tax}}{\text{Net Assets}} \times 100\%$$

OR

$$\frac{\text{Net Profit after Tax}}{\text{Capital Employed}} \times 100\%$$

ROCE can also be referred to as return on average net assets (ROANA)/ROA, return on total assets (ROTA), and return on equity (ROE). These are calculated as follows:

$$(i) \quad \text{ROA/ROANA} = \frac{\text{Net profit after tax}}{\text{Average Net Assets}} \times 100\%$$

$$(ii) \quad \text{ROTA} = \frac{\text{Net profit after tax}}{\text{Total Assets}} \times 100\%$$

$$(iii) \quad \text{ROE} = \frac{\text{Profit after interest and preference dividends}}{\text{Ordinary Share Capital} + \text{Reserves}} \times 100\%$$

This ratio (ROCE) can be calculated in several ways, depending upon the interpretation given to the denominator, that is, capital employed. It could be total capital or the equity shareholders' capital. Some of its variants are:

$$(i) \quad \frac{\text{Net profit before loan interest and taxation}}{\text{Shareholders' fund} + \text{Loan Capital}} \times 100\%$$

$$(ii) \quad \frac{\text{Net profit after tax}}{\text{Shareholders' fund}} \times 100\%$$

$$(iii) \quad \frac{\text{Net profit before tax}}{\text{Shareholders' fund}} \times 100\%$$

$$(iv) \quad \frac{\text{Net Profit after tax and Preference Dividends}}{\text{Shareholders fund}} \times 100\%$$

The first variant attempts to measure the return on capital employed while the second variant is a measurement of the return on only the funds belonging to the shareholders, that is, a situation where only ordinary shareholders exist. However, in cases where there are ordinary and preference shareholders, the third variant will be used. The fourth variant is measuring the return after tax on the funds belonging to the shareholders in a situation where there are only ordinary shareholders.

- (b) **Return on Sales (ROS):** This ratio serves as a measure of the profitability of sales. It is either the gross profit percentage or net profit percentage depending upon the need of the analyst. The gross profit percentage could be used in order to detect errors or frauds affecting items in the trading account or to detect any deviation from a fixed gross profit margin. The net profit percentage is a good measure of a company's net profit/loss result in relation to various periods or even in relation to other firms in the same industry. These ratios include:

$$\frac{\text{Gross profit}}{\text{Sales}} \times 100\%$$

$$\frac{\text{Net profit}}{\text{Sales}} \times 100\%$$

The return on sales ratio, especially the net profit margin is one of the two ratios jointly referred to as 'the secondary ratios.' The other one is the ratio of sales to capital employed, that is, the capital turnover ratio. The **two ratios** form the **components** of the **primary ratio** since their products will result in the primary ratios shown below:

$$\frac{\text{Net profit}}{\text{Sales}} \times \frac{\text{Sales}}{\text{Capital Employed}} = \frac{\text{Net profit}}{\text{Capital Employed}}$$

Any dissatisfaction with the primary ratio can be analysed by looking at the secondary ratios more clearly.

4.7.2 Liquidity and Efficiency Ratios

Liquidity refers to the ability of a firm to meet its current obligations when they fall due. Hence, liquidity ratios have a lot to do with the size and relationship of current assets to current liabilities. The standard measures of liquidity are obtained from the current ratio and the liquid ratio. These ratios are shown below:

(a) Current Or Working Capital Ratio:

$$\frac{\text{Current Assets}}{\text{Current Liabilities}} \times 100\%$$

Current ratio is a measure of a company's short term solvency. It indicates the available current assets in naira for every one naira of current liabilities. A ratio of greater than one indicates that the company has more current assets than current liabilities.

As a conventional rule, a current ratio of 2:1 is considered optimally satisfactory. Current ratio represents a margin of safety for the creditors. The higher the current ratio, the greater the margin of safety, that is, the larger the amount of current assets in relation to current liabilities, the more the company's ability to meet its current obligations as they fall due.

(b) Quick asset ratio or Acid test ratios:

$$\frac{\text{Current Asset Less Stock}}{\text{Current Liabilities}} \times 100\%$$

Generally, a quick asset ratio of 1:1 is considered to be optimally satisfactory to the current financial condition.

Although quick ratio is a more penetrating test of liquidity than current ratio, yet both need to be used continuously together.

It is also important to note that current and quick ratios of a company that is trading on cash basis will be very low compared to the ratios of manufacturing organisations who operate with liquidity ratios closer to the standard ratios.

The trend, rather than the absolute value of the ratios, is more important. One can easily ascertain whether the liquidity of a company is improving or deteriorating if one looks at the trend of the ratios.

(c) Cash Ratio:

$$\frac{\text{Cash plus Cash equivalents}}{\text{Current Liabilities}} \times 100\%$$

Cash is the most liquid asset in the financial statements of a company. A company may have a small cash ratio.

This may not be worrisome provided that it has a reserve of borrowing power.

(d) Debtors' Collection Period

$$\frac{\text{Average Debtors}}{\text{Credit Sales}} \times 100\%$$

$$\text{Where average debtors} = \frac{\text{Opening Debtors} + \text{Closing Debtors}}{2}$$

However, a rough estimate of the average length of time it takes a company's debtors to pay is expressed as:

$$\frac{\text{Debtors}}{\text{Sales}} \times 365 \text{ days}$$

The average collection period measures the quality of debtors since it indicates the speed of collection. The shorter the collection period, the better the quality of the debtors to a firm. An excessively long collection period implies a very inefficient collection performance. However, this should not be taken as a hard and fast rule for the purpose of interpretation as other factors may need to be considered before taking a financial decision. The collection period, therefore, helps in determining the following:

- (i) The collectability of debts, and, thus, the efficiency of collection efforts, and
- (ii) The company's comparative strength and advantage relative to its credit policy and performance vis-à-vis the competitors' credit policies and performance. Debtors' collection may not necessarily be expressed in terms of length of time but also in terms of velocity to pay. Debtors' collection expressed in terms of velocity (i.e. rate of collection) is called Debtors' Turnover.

$$\text{Debtors' Turnover} = \frac{\text{Credit Sales}}{\text{Average Debtors}}$$

OR

$$\frac{\text{Sales}}{\text{Debtors}}$$

Debtors' turnover indicates the number of times debtors are turned over each year. Generally, the higher the value of debtors' turnover, the more efficient is the management of credits.

It must be noted that debtors' collection period or debtors' turnover measures the quality of debtors in an aggregative way.

- (e) Creditors' Payment Period

$$\frac{\text{Average Creditors Credit Purchase}}{\text{Credit Purchase}} \times 365 \text{ days}$$

$$\text{Average Creditors} = \frac{\text{Opening} + \text{Closing Creditors}}{2}$$

However, where the average creditors' figure is not available, the payment period could simply be calculated as:

$$\frac{\text{Creditors}}{\text{Purchases}}$$

Creditors' payment period or creditors' turnover measures the velocity of payment to creditors.

4.7.3 Investment Ratios

The ability of a business to survive depends on its capability to attract additional equity capital when required. Major factors in the assessment of this capacity are the relationships between the earnings available for ordinary shareholders and the other attributes of the ordinary shares. These factors are measured in the following ratios which serve as market test for the shares:

- (a) **Earnings per share (EPS):** This is of considerable importance in estimating the value of a share. It is arrived at as follows:

$$\frac{\text{Net Income}}{\text{Number of Ordinary Shares}}$$

Note:

Net Income is the same as net profit after tax and preference dividend.

- (b) **Price/Earnings (P/E) Ratio:**

This is the comparison of the market price of an ordinary share with the earnings per share. It is calculated thus:

$$\frac{\text{Market Price Per Share}}{\text{Earnings Per Share}}$$

This ratio indicates the number of years within which the investors' capital outlay will, at the present level of earnings, be recouped either in the form of dividend received or capital growth or by virtue of retained earnings. Note, however, that this is subject to fluctuations in the market price and the incidence of taxation on dividends.

(c) Earnings Yield

This is the reciprocal of the price earnings ratio. It gives the capitalisation rate, which is the rate at which the stock market is apparently capitalizing the value of the current earnings. It is calculated thus:

$$\frac{\text{Earnings Per Share}}{\text{Market Price Per Share}}$$

(d) Dividend per Share

This is that part of earnings per share which is received by the share holders as dividend. It is computed thus:

$$\frac{\text{Ordinary share dividend}}{\text{No. of ordinary shares}}$$

(e) Dividend Yield

This is also known as the yield ratio. It is based on dividend declared during the year in respect of any type of share. It is calculated thus:

$$\frac{\text{Annual Dividend Per Share}}{\text{Market Price Per Share}}$$

The dividend yield indicates how the capital employed is being efficiently utilized in comparison with the past years or with alternative investments or returns from other companies in the same industry.

(f) Dividend Cover

This indicates the relationship between earnings and dividend per share. It indicates how many times dividend per share is covered by earnings per share. A higher dividend cover indicates that only a small portion of the earnings has been distributed as dividends while a substantial portion has been ploughed back into the business. A lower dividend cover will indicate the reverse situation. It is calculated thus:

$$\frac{\text{Earnings Per Share}}{\text{Dividend Per Share}}$$

4.7.4 Turnover (or Activity) Ratios

These ratios are used to test the skill with which management takes care of and utilizes the assets under its control. The ratios are otherwise known as “assets management ratios”. These ratios are usually expressed in terms of days or number of times.

4.7.4.1 Stock Turnover Ratio

This is computed as follows:

$$(a) \quad \text{Average Turnover Period} = \frac{\text{Average Stock}}{\text{Cost of Sales}} \times 365 \text{ days}$$

OR

$$(b) \quad \text{Number of times stock is turned over} = \frac{\text{Cost of Sales}}{\text{Average Stock}} = \text{No. of times per annum}$$

The (a) variant, expressed in days, is an indication of the number of days stock is kept in the store or warehouse before being sold and therefore replaced. The second variant gives the number of times stock is turned over in the year. It is an indication of the speed with which stock moves through the business. In a manufacturing concern, stock turnover ratio can be calculated for each type of stock namely, raw materials, work-in-progress and finished goods so as to assist in the calculation of the operating cycle. It must be noted that this ratio should be interpreted in the light of the type of business being carried on. For instance, a higher stock turnover ratio (in terms of number of times) will normally be expected for perishable goods than for non-perishable goods.

4.7.4.2 Debtors' Turnover Ratio

This expresses the average period for which credit is allowed. It is calculated thus:

$$(a) \quad \frac{\text{Average Debtors}}{\text{Credit Sales}} \times 365 \text{ days}$$

OR

$$(b) \quad \text{Number of times debtors figure is turned over} = \frac{\text{Credit Sales}}{\text{Average Debtors}} = \text{Number of times per annum}$$

OR

$$\frac{\text{Sales}}{\text{Trade Debtors}} = \text{Number of times per annum}$$

The third formula indicates that when credit and cash sales are not clearly distinguished, total sales figure could be used. Furthermore, when the opening balance of trade debtors is not available, the closing balance alone could be used in the

calculation of this ratio. This ratio is sometimes simply referred to as Debtors' ratio and it is a measure of the collection period. Changes in this ratio indicate changes in the company's ability to collect its debts or in its credit policy.

4.7.4.3 Creditor's Days (Payment) Ratio

This is the ratio of creditors to credit purchases and it is calculated as follows:

$$\frac{\text{Trade Creditors}}{\text{Credit Purchases}} \times 365 \text{ days}$$

The ratio shows how quickly creditors are paid. The lower the ratio, the better for the creditors who only have to wait for a short period to get paid for the goods supplied or services rendered.

4.7.4.4 Capital Turnover Ratio

This is the ratio earlier on referred to under profitability ratios as one of the secondary ratios. It is also known as asset turnover ratio. It is computed by:

$$\frac{\text{Sales}}{\text{Capital Employed}} \times 100\%$$

Again, as in the case of the primary ratio, this ratio can be calculated in several ways, depending upon the interpretation given to the denominator.

4.7.5 Financial Structure (Leverage) Ratios

These are the ratios used to test the solvency of the company, that is, the ability of the company to meet the interest costs and repayment schedules associated with its long-term obligations. Some of the ratios in this group are:

4.7.5.1 Capital Gearing Ratio

This indicates the relationship between the ordinary share capital of a company and fixed interest capital (that is, debentures, preference share capital, and other bank loans). This ratio is defined in two different ways thus:

$$\frac{\text{Loan Capital}}{\text{Equity Capital}}$$

OR

$$\frac{\text{Local Capital}}{\text{Total Capital}}$$

If the proportion of fixed interest capital of ordinary share capital is high, the company's capital structure is said to be highly geared, that is, there is a great burden of interest payment on the company's resources. Whereas, if the proportion of fixed interest capital to ordinary share capital is low, the company's capital structure is said to be lowly geared, that is, there is not much burden of interest payment on the company's resources. Where, however, the classes of capital are of an equal proportion, there is a neutral gear.

4.7.5.2 Proprietary Ratio

This is the ratio of shareholders' funds to total assets. This ratio provides a measure of the adequacy of security to pay all liabilities. It serves as a test of long term financial stability and cushion for creditors. It is calculated as:

$$\frac{\text{Shareholder's Funds}}{\text{Total Assets}} \times 100\%$$

The higher this percentage, the better the security for the creditors in case of liquidation

4.8 COMPARATIVE ANALYSIS OF FINANCIAL STATEMENTS

Comparative analysis could be done in various ways including vertical and horizontal analysis, trend analysis and inter-firm analysis. Comparison can be between firms or between periods.

4.8.1 Vertical and Horizontal Analysis

Vertical analysis of financial statements involves expressing opinion on the various items in the financial statements, that is, income statement or balance sheet as a percentage and in relation to a common base within the particular statement. Hence, it is seen as analysis of proportional changes. In the case of the income statement, the sales figure is regarded as the common base made equivalent to 100% while all other items are calculated as percentage of sales. This is also referred to as common-size profit and loss account. As regards the balance sheet, the total assets or total capital figure is regarded as the common base of 100% while other balance sheet items are expressed as percentages of total assets or total capital. This is illustrated below:

ILLUSTRATION 4.1**Comparative Profit and Loss Account (Vertical Analysis)**

	2008	2009
Turnover	100.00	100.00
Less: Cost of Sales	(71.53)	(67.96)
Gross Profit	28.47	32.04
Less: Distrib. And Admin. Expenses	(19.61)	(16.98)
	8.86	15.06
Add: Other Operating Income	1.10	0.98
Earnings before interest and tax	9.96	16.04
Less: Interest	(5.62)	(8.31)
Profit before Tax	4.34	7.73
Taxation	(0.33)	(0.24)
Profit After Tax	<u>4.01</u>	<u>7.49</u>

Horizontal analysis is the simplest method of analysing financial statements. It involves the comparison of the current year with the previous year, noting any significant changes, that require further explanation. The change in each of the items of the income statement and balance sheet is analysed in aggregate form and also as percentages of the previous year's figures, and shown in separate columns. This is illustrated below:

ILLUSTRATION 4.2**Comparative profit and loss account (Horizontal Analysis)**

	2008	2009	Change	% Change
	'm	'm	'm	
Turnover	11,421	11,987	+ 566	+ 4.96%
Cost of Sales	(8,169)	(8,147)	- 22	- 0.27%
Gross Profit	3,252	3,840	+ 588	18.08%
Distribution and Admin. Exp.	(2,240)	(2,036)	- 204	- 9.11%
	1012	1,804	+ 792	78.26%
Other Operating Income	126	107	- 19	-15.08%
Operating Profit	1,138	1,911	+ 773	+ 67.93%
Interest and Other Charges	(642)	(996)	+ 354	x + 55.14%
Profit before Tax	496	915	+ 419	x + 84.48%
Taxation	(38)	(29)	+ 9	x - 23.68%
Profit after Tax	<u>458</u>	<u>886</u>	<u>428</u>	<u>93.45%</u>

4.8.2 Trend Analysis

Analysis of financial statements can be enhanced further by the use of trend analysis. This can be in respect of the absolute figures of key items of the balance sheet and income statement (such as the type shown in the five year financial summary) or of the relevant ratios calculated. A trend analysis or time series is a display of key figures for a period of years, usually between five and ten years, for the purpose of showing the direction of changes in these figures. This is with a view to allowing the analyst to appreciate the overall strength or weakness of the firm.

The trend analysis of key ratios can be prepared for examination purposes to the extent that information is available for such computations. It is also possible to have trend percentages for profit and loss account and balance sheet items. This involves assigning 100% to the items of the base year and calculating percentage changes in each of the items of the other years in relation to the base year.

Trend analysis can be used as a basis for future forecasting in respect of a firm addition to usings it for interpretation of financial statements. It becomes essential to ensure that the underlying information used for the analysis is free of all sorts of biases. Its measurement should be on a consistent basis.

There is, therefore, the need to look out for the possible effects of changes in accounting policies during the year(s) under review and the impact of inflation on the trend. The latter is particularly important in respect of sales because it is only when the sales figure have been adjusted by a suitable index of general prices that the true trend of growth in sales can be deduced.

It should be noted that CAMA 2004 (as amended) provides that each company should include in its financial statements:

- (a) Five-Year financial summary(Section 334(2)); and
- (b) Corresponding figures for the immediately preceding year (Schedule 2, Section 9(1)).

The above two requirements are examples of provisions made by the law and many accounting standards to encourage trend analysis. They are equally required for group accounts.

4.8.3 Inter-Firm Analysis

After the in-depth analysis of the financial statements of a firm (vertical and horizontal as well as the trend), it becomes necessary to know the position of the firm among the various firms in its industry. This necessitates an inter-firm analysis, which involves comparing the firm's ratios with those of its competitors or with the industry average.

In undertaking inter-firm analysis, one would need to take note of some factors which may render the analysis invalid. They include:

- (a) Use of different accounting dates by the various companies;
- (b) Application of different accounting policies especially as they relate to asset valuation;
- (c) Differences in the size of companies, which result in differences in the relative advantages that the bigger firms may have over the smaller ones;
- (d) Differences in the management structure and technical expertise of the companies; and
- (e) Differences in product range and sales mix among companies within the same industry.

4.9 USEFULNESS AND LIMITATIONS OF RATIO ANALYSIS

4.9.1 Usefulness

Ratio analysis serves as a useful guide which provides indicators of a firm's past performances and near-present financial position in order to give the user a basis for predicting future performance and financial position. A carefully prepared trend analysis of accounting ratios can assist in the construction of a pattern of the firm's behavior and financial position, which in turn can help in predicting the firm's future performance. However, ratios should be used in conjunction with other information relevant to the interpretation of the financial statements of any particular organisation. The overall usefulness of ratio analysis depends very much upon the ability of the analyst to use the result of the ratios calculated along with all other relevant information, bearing in mind the nature of trade (or business) carried on and the type of circumstance surrounding each case. The various user groups of accounting information use ratios to determine the operating and financial efficiency as well as growth potentials of the firm in which they are interested. Ratio analysis can help to determine:

- (a) The efficiency with which the firm is using its assets in generating revenue, for example, sales;
- (b) The extent to which the firm is using its long-term solvency to borrow funds;
- (c) The ability of the firm to meet its current obligations as and when they fall due; and
- (d) The overall operating efficiency and performance of the firm.

4.9.2 Limitations

In spite of the usefulness of ratio analysis, there are certain limitations to its use and it is important that analysts always pay attention to these limitations. Some of these limitations are:

- (a) Comparisons of ratios can be misleading unless they are calculated from uniform data using uniform accounting policies;
- (b) Ratios calculated from financial statements prepared on historical cost basis cannot give a true picture of year-to-year trends because of the impact of inflation;
- (c) Financial statements do not give a complete picture of the activities of a firm, as only items that can be measured in money terms are included. For instance, the strength or weakness of management is omitted. Thus, the ratios calculated from these statements are also defective in this regard;
- (d) For purposes of overall assessment of the financial strength or weakness of a firm, the fact that there is no ideal ratio makes the task difficult. For instance, a current ratio of less than 2 could be dangerous for many firms but quite acceptable for some others;
- (e) The factors influencing the performance of a firm in one year may change in another year and thus render horizontal analysis misleading; and
- (f) The balance sheet prepared at different points in time are static in nature, and therefore cannot give much information about the pre and post balance sheet events.

4.10 IDENTIFYING CHOICES OF ACCOUNTING TREATMENTS ADOPTED IN FINANCIAL STATEMENTS

To effectively compare the financial accounting information of different companies, there must be consistency in their accounting treatments. SAS 1 also requires an enterprise to select and apply appropriate accounting treatments which comply with accounting standards to ensure that the financial statements provide information that is relevant and reliable.

Accounting treatments are the specific accounting methods, bases and concepts chosen by an enterprise in the preparation and presentation of its financial statements. To select a suitable accounting policy, the factors to be considered include:

- (a) Fairness
- (b) Materiality
- (c) Substance over form
- (d) Objectivity
- (e) Prudence

When a particular treatment, which complies with a particular standard is adopted to show a faithful representation of events, such compliance must be disclosed. When an organisation decides that compliance with a particular policy or standard will not give a true and fair view of events, such treatment may be departed from and the financial statements must disclose:

- (a) That the financial statements show a true and fair view;

- (b) That standards are complied with except for the departure from a standard in order to achieve a fair presentation;
- (c) The standard departed from and explanation of the circumstances; and
- (d) The financial impact of the departure.

4.11 SUMMARY AND CONCLUSIONS

This chapter has discussed analysis and interpretation of financial statements with particular and detailed reference to the requirements of the International Financial Reporting Standards and the Generally Accepted Accounting Practices. The use and classification of financial ratios have been fully discussed while sufficient attention has also been devoted to Trend Analysis, Inter-firm Analysis and Limitations of ratios in Interpreting Financial Statements.

Refer to Comprehensive Questions and Suggested Solutions in Appendix II, page 269.

4.12 REVISION QUESTIONS

4.12.1 MULTIPLE-CHOICE QUESTIONS

1. A company's ability to meet its obligations as at when due will be shown by:
 - A. Value Added Statement.
 - B. Income Statement.
 - C. Shareholders' Fund.
 - D. Cash Flow Statement.
 - E. Value of all fixed assets
2. Which of the following, according to SAS 2, does not need to be stated in the financial statements of a reporting enterprise?
 - A. Enterprise's legal form.
 - B. Business of the enterprise.
 - C. Intention to cease being a going concern
 - D. Relationship with local and overseas suppliers.
 - E. Name and location of the enterprise.
3. in selecting a suitable accounting policy all the following factors should be considered except:
 - A. Fairness.
 - B. Substance over form.
 - C. Materiality.
 - D. Prudence.
 - E. Sensitivity.
4. Inter-firm analysis could be rendered invalid by
 - A. The use of different accounting dates by the various companies.
 - B. Application of different accounting policies.
 - C. Operating in different market segments.
 - D. The differences in the management structures and technical expertise.
 - E. The product range and sales mix variations among the companies

5. Which of the following is NOT an Investment Ratio?
- A. Quick Asset Ratio.
 - B. Dividend Cover.
 - C. Earnings Yield.
 - D. Dividend Per Share.
 - E. Earnings Per Share.

4.12.2 SHORT ANSWER QUESTIONS

1. The financial statements of a group of companies are otherwise called.....
2. Interpretation of financial statements involves..... to the various ratios so as to ascertain a firm's financial strengths, weaknesses, opportunities and threats.
3. State the group of ratios which measure the overall performance and effectiveness of a company.
4. Cash ratio is given by the formula.....
5. The formula for Earnings Yield is.....

Refer to Suggested Solutions in Appendix I, Page 263.

ACCOUNTING STANDARDS

5.0 LEARNING OBJECTIVES

After studying this chapter, the reader will be able to understand:

- ◆ The responsibility of the Nigerian Accounting Standards Board (NASB);
- ◆ The International Accounting Standards Board (IASB) and the;
- ◆ International Federation of Accountants (IFAC);
- ◆ The various Accounting Standards issued by NASB, IASB and IFAC; and
- ◆ The compliance requirements of the standards.

5.1 INTRODUCTION

The Nigerian Accounting Standard Board (NASB) is the government agency shouldered with the responsibility of issuing Statements of Accounting Standards (SAS) on various accounting topics. The Board was established in September 1982, at the instance and sponsorship of the Institute of Chartered Accountants of Nigeria (ICAN), having realized the necessity of setting local accounting standards that would take into account the customs, laws, level of economic development and other peculiarities of the country. The first SAS issued by the Board was on Disclosure of Accounting Policies, in 1982. The Board was made a parastatal of government, under the supervision of the Federal Ministry of Commerce, in May 1992. It was made an autonomous body in 2003, with the enactment of Act No.22 of the National Assembly, the NASB Act 2003. The composition of the institutions/organisations represented on the Board was enlarged from eight in 1984 to fourteen in 2003 and from thirteen council members to eighteen council members.

At the international level, there are International Accounting Standards (IASs) issued by the International Accounting Standards Board (IASB) of the International Federation of Accountants (IFAC), as well as the International Financial Reporting Standards (IFRSs) issued also by the IFAC. Many IASs and IFRSs have been issued to ensure uniformity in the application of various accounting principles and to guide preparers and users of financial statements. With SASs in place, preparers of financial statements in Nigeria are to de-emphasize compliance with the provisions of a similar International Accounting Standard (IAS). In other words, if there is any conflict between the

provisions of an SAS on an accounting topic and those of an IAS, the conflict is to be resolved in favor of the SAS. The provisions of an IAS on an accounting topic are fully applicable in Nigeria, where an SAS is not issued on the topic.

Students of Financial Accounting/Reporting at the academic and professional levels must demonstrate adequate proficiency in the provisions of all the local and international accounting standards issued by the standards setting bodies for them to be accepted as good accounting graduates or as good professional accountants. They are, therefore, expected to have adequate knowledge of all the SASs, IASs and IFRSs, IPSASs (International Public Sector Accounting Standards) that have been issued so far.

This Chapter highlights some major provisions made in some of the Statements of Accounting Standards issued by the Nigerian Accounting Standards Board and similar provisions made in relevant IASs and IFRSs. The aim is to encourage readers to work towards acquiring a thorough knowledge of the financial statements areas covered in those SASs, IASs and IFRSs with a solid understanding of the subject matter. The chapter is also aimed at ensuring that readers acquire sufficient understanding of the application areas for those accounting standards so that they can exercise reasonable professional judgment in the subject matter.

5.2 MAJOR ISSUES ADDRESSED IN SELECTED ACCOUNTING STANDARDS

5.2.1 Statement of Cash flows

Relevant Standards are:

- (a) *Statement of Accounting Standard 18: Statements of Cash Flows*
- (b) *International Accounting Standard 7: Cash Flow Statements*

These standards address the following important issues:

- (a) A statement of cash flow provides information about cash receipts and cash payments of an enterprise over a given period. It indicates the pattern of cash generation and utilization. It reveals how cash is generated from operations or through new capital raised and how payments are made for taxes, dividends, new investments and debts. It is designed to shed light on an enterprise's financial strength. Just as these provisions are made in SAS 18 for Nigerian enterprises to comply, they are also made in IAS 7, requiring every enterprise, anywhere in the world, to publish a statement which shows its cash inflows and cash outflows over a given period.
- (b) Both SAS 18 and IAS 7 stressed the fact that the information provided in a statement of cash flows, if used with related disclosure and other information in the financial statements, will, over a period, assist users to:

- (i) assess the impact of its current transactions – operating, investing and financing activities - on its performance and financial position;
 - (ii) assess the ability of the enterprise to meet its debt obligations, pay dividends and meet other claims;
 - (iii) assess the ability of the enterprise to finance ongoing operations and growth from internal sources and determine the amount of external financing required;
 - (iv) reconcile profit/loss and cash flow; and
 - (v) assess the ability of the enterprise to generate positive net future cash flows.
- (c) Both standards (SAS 18 and IAS 7) emphasize that a Statement of Source and Application of Funds is based on movements in working capital components. Working capital encompasses cash, cash equivalents and other assets which are convertible into cash within an accounting year, such as debtors and stocks. The main reason why the Statement of Cash Flows is now regarded as a preferred parameter for evaluating corporate liquidity is that the Statement of Source and Application of Funds based on movements in working capital can obscure movements relevant to the viability and liquidity of an enterprise. For example, a potentially disastrous decrease in cash available can be masked by an increase in stock or debtors. Enterprises may, therefore, run out of cash while reporting increases in working capital.
- (d) Going through the two accounting standards, readers would learn about the precise definitions of cash, cash equivalent, operating activities, investing activities, financing activities, etc. The two standards accord cash and its management the attention and seriousness they deserve in accounting sense!

5.2.2 Construction Contracts

Relevant Standards are:

- (a) Statement of Accounting Standard 5: Construction Contracts.
- (b) International Accounting Standard 11: Construction Contracts.

These standards address the following matters:

- (a) The main issues involved in accounting for Construction Contracts, especially by the contractor, are the timing, measurement and recognition of revenue and the asset created during construction.
- (b) Costs on a Construction Contract may start to accumulate even before the contract is won. It is, therefore, necessary to determine the accounting treatment that should be accorded to such costs as soon as there is a convincing evidence that the contract will be won.

- (c) The treatment of these costs may have a significant effect on the reported result of an accounting period and on the assets and liabilities of the reporting enterprise. Unless a correct treatment of such costs is adopted, it may lead to a wrong appraisal of the profitability of the construction contract.
- (d) The period for the execution of a Construction Contract depends on the nature, type and size of the contract. Some contracts run for only a short period of time, as a result of which it may be more prudent to recognize the profit on such a contract only on completion, hence the use of the completed contract method of recognizing revenue is recommended by both SAS 5 and IAS 11. Some other contracts, however, may extend over two or more accounting periods of the enterprises, in which case, a meaningful basis has to be adopted for the determination of the proportion of profit that has been earned as at each accounting date and the value that needs to be reported in the financial statement as work- in-progress in the books of the contractor. Hence, percentage of completion method of revenue recognition is recommended by both accounting standards.
- (e) Most of the provisions of both SAS 5 and IAS 11 apply to the Contractor.
- (f) The two Statements do not cover:
 - (i) Contracts that deal with the research into and the development of new products;
 - (ii) Service Contracts that fall under job order costing;
 - (iii) Property development projects including those often referred to in Nigeria as Contractor Financed Projects; and
 - (iv) The treatment of Construction Contracts in the books of the Employer (Contractee) because the value of any Construction Contract can be easily determined by the Employer through the analysis of cash outlays and the liabilities accrued on the contract.
- (g) These standards are clearly about accounting in the construction industry, emphasizing on revenue and income recognition for periodic financial statements preparation in the industry.

5.2.3 Accounting for Government Grants and Government Assistance

Relevant standards and interpretations are:

International Accounting Standard 20: Accounting for government grants and disclosure of government assistance.

There is no SAS yet on the issues addressed by IAS 20!

- (a) Governments sometimes transfer economic resources (such as cash and long term assets) to business entities in return for past or future compliance with certain government conditions. IAS 20 prescribes the approach to be adopted in accounting for these benefits and how they should be presented in the financial statements of the benefiting entities. IAS 20 also deals with the accounting treatment of government assistance with no specific value.
- (b) IAS 20 does not, however, cover accounting for capital grants in the books of an enterprise, government assistance in terms of tax holidays and treatment of government grant or assistance where government is part owner of the business entity.
- (c) According to IAS 20, grants related to assets are government grants whose primary condition is that an entity qualifying for them should purchase, construct or otherwise acquire non-current assets. Subsidiary conditions may also be attached restricting the type or location of the assets or the periods during which they are to be acquired or held.
- (d) Government grants relating to income are government grants other than those related to assets.
- (e) IAS 20 identifies two methods that could be used to account for government grants, namely capital approach and income approach. Using the capital approach, you are to credit the grant directly to shareholders interest, while using the income approach; you are to credit the grant to income statement over one or more period.
- (f) Presenting the argument in support of the two approaches, IAS 20 provides the following in favor of the two:
 - (i) Capital approach:
 - ◆ Government grants are a financing device and should therefore be recognized in the balance sheet. In the income statement, they would simply offset the expenses they are financing.
 - ◆ Grants are not earnings; they are incentives without related cost, so it would be wrong to take them to the income statement.
 - (ii) Income approach:
 - ◆ Grants are not contributions from shareholders. Therefore, they should not be credited directly to shareholders interests.

- ◆ Grants are not given or received for nothing. They are earned by compliance with conditions and by meeting obligations. The grants should, therefore, be matched with the cost of meeting those obligations.
- ◆ Grants are an extension of fiscal policies and so as income taxes are charged against income, so grants should be credited to income.
- ◆ The requirement of IAS 20 is that grants should not be credited directly to shareholder's fund. They should be recognized as income over the period required matching them with the cost of the obligations they are expected to meet. In other words, government grants should be accounted for using the income approach.
- ◆ Grants should be credited to the income statement on a systematic basis in such a manner as to match the grants with the costs they are expected to compensate. For instance, grants for the acquisition or construction of a depreciable asset should be recognized in the income statement in proportion to the depreciation of the asset.
- ◆ Government may transfer a non-monetary asset such as a motor vehicle, a piece of land or equipment, to an entity as a grant. The entity should determine the asset's fair value and use it as the basis for accounting for both the asset and the grant. As with cash grants, non-cash grants should be accounted for using the income approach.
- ◆ Government offers various kinds of assistance to enterprises to support their business activities. The condition for the receipt of such assistance may not be related to the operating activities of the entity. For instance, government may offer assistance to enterprises to start their businesses, or continue to operate in rural areas. Such assistance should be regarded as government grant within the scope of IAS 20, and so should not be credited directly to equity.
- ◆ IAS 20 provisions are very suitable in the periods of economic meltdown, when governments are designing a number of bailout policies to assist businesses to continue to exist or to bounce back. There is, therefore, an urgent need for a similar SAS in Nigeria!

5.2.4 Borrowing Costs

Relevant standards are:

International Accounting Standard 23: Borrowing Costs.

There is no SAS yet on the issues addressed by IAS 23!

- (a) The construction of a tangible fixed asset may be financed by loans. The finance cost (borrowing cost) related to such borrowings may be capitalised or charged to the income statement when incurred. IAS 23 addresses the accounting treatment of borrowing costs, especially borrowings used in the construction of qualifying assets.
- (b) Under IAS 23, borrowing costs are interest and other costs incurred by an enterprise in connection with acquisition of loans. Examples are:
 - (i) Interest on bank overdraft;
 - (ii) Interest on short term and long term loans;
 - (iii) Amortisation of discounts or premiums relating to borrowings;
 - (iv) Finance charges in respect of finance leases; and
 - (v) Exchange differences arising from foreign currency loans to the extent that they constitute adjustments to interest costs.
- (c) There is considerable debate on whether borrowing costs should be capitalized or not. There are arguments for and arguments against capitalization. Some of these arguments are presented in the standard (i.e. IAS 23).
- (d) The benchmark treatment for borrowing costs is that they should not be capitalized. They should be charged to the profit and loss account in the period in which they are incurred. However, IAS 23 permits capitalization as an allowed alternative. Borrowing cost may only be capitalized if they are directly attributable to the acquisition, construction or production of a qualifying asset.
- (e) IAS 23 is purely about accounting treatment of the costs of borrowing money for execution of various projects, and since capital is always scarce for executing projects necessary for achieving set objectives of an enterprise, money must be borrowed from all available sources and the cost to be incurred should be accounted for properly.
- (f) In Nigeria, where businesses are expected to be utilizing all available avenue for sourcing funds to execute projects that would allow room for expansion and diversification, NASB should start

the process of issuing SAS similar to IAS 23 so that borrowers could be properly guided as to how to account for the costs of borrowing, rather than treating all the categories of the costs as mere interests on borrowing!

5.2.5 Related Party Disclosures

Relevant standards are:

International Accounting Standard 24: Related Party Disclosures.

There is no SAS yet on the issues addressed by IAS 24!

- (a) Business transactions are usually effected on an arm's length basis. This basis cannot be sustained when transactions are carried out between related parties. A related party relationship can, therefore, affect the financial position and results of an entity. IAS 24 addresses this problem by requiring disclosures which will draw to the possibility that the reported financial position and result may have been affected by the presence of related party relationships.
- (b) A related party transaction is a transfer of resources or obligation between related parties, regardless of whether or not a price is charged.
- (c) Close members of the family of an individual are those family members who may be expected to influence, or be influenced by, that individual in their dealings with the entity. They may include: i) the individual's domestic partner and children; or ii) children of the individual's domestic partner; and dependants of the individual or the individual's domestic partner.
- (d) The most common related party relationship is where one entity is a subsidiary or an associate of another entity.
- (e) In considering whether or not a related party relationship exists between two parties, one must look at the substance of the relationship, not merely the legal form. IAS 24 gives examples of certain relationships that do not necessarily result in related parties.
 - (i) Two entities that have a director (or key management personnel) in common. This relationship will not necessarily give rise to related parties unless the director is able to influence the two entities in their mutual transactions.
 - (ii) Two venturers, simply because they share joint control over a joint venture.

- (iii) Certain persons and entities, simply because of their role in their dealings with the enterprise. Examples are:
 - ◆ trade unions;
 - ◆ utility companies;
 - ◆ government departments and agencies;
 - ◆ customers, suppliers, franchisers, distributors; and general agents with whom the entity transacts a significant volume of business, simply by reason of the economic dependence.
- (f) According to IAS 24, the following transactions should be disclosed if they occur between related parties:
 - (i) Purchases and sales of goods (finished and unfinished).
 - (ii) Purchases or sales of property and other assets.
 - (iii) Rendering of services.
 - (iv) Leases
 - (v) Transfers of research and development
 - (vi) Transfers under license arrangement
 - (vii) Provision of guarantees and collateral security
 - (viii) Settlement of liabilities on behalf of the entity.

5.2.6 Consolidated and Separate Financial Statements

Relevant Standards are:

- (a) *Statement of Accounting Standard 27: Consolidated and Separate Financial Statements.*
- (b) *International Accounting Standard 27: Consolidated and Separate Financial Statements.*

These standards address the following matters:

- (a) Both IAS 27 and SAS 27 provide that there is the need for the parent company to combine its financial position and earnings reports with those of its various subsidiaries into an overall report as if they were a single economic entity.
- (b) The main objective of the two Statements is to reduce alternative methods in accounting for subsidiaries in consolidated financial statements and in accounting for investments in the separate financial statements of a parent, venture or investor.
- (c) The two Statements apply in the preparation and presentation of consolidated financial statements for a group of entities under the control of a parent; they also apply in accounting for investments in subsidiaries, jointly controlled entities and associates when an entity elects, or is required by local regulations, to present separate financial statements.

- (d) The two Statements do not deal with methods of accounting for business combinations and their effects on consolidation, including goodwill arising on a business combination.

5.2.7 Investments in Associates

Relevant Standards are:

- (a) *Statement of Accounting Standard 28: Investments in Associates*
- (b) *International Accounting Standard 28: Investments in Associates*

These standards address the following matters:

- (a) An investor may have a significant influence in an entity that is neither a subsidiary nor a joint venture, so that it does not appear in the consolidated financial statements under the provisions of the SAS 27/IAS 27: *In Consolidated and Separate Financial Statements* it is important that the user be made aware of the nature and implications of this investment. These Standards, therefore, provide the basis for accounting for ownership interests in associates.
- (b) In IAS 27 and SAS 27, we have considered an investment situation which enables the investor to exercise control over the financial and operating policies of the investee. Control is presumed to exist when an investor owns more than 50% of the voting power of an investee. Under the CAMA 1990 (as amended) the mere ownership of more than 50% in normal value of the equity share capital of a company by another company, results in a parent-subsidiary relationship.
- (c) Another type of intercompany investment involves the acquisition of a substantial (but not controlling) proportion of the shares of another company. Because of the substantial nature of the investment, the investor is usually able to exercise a significant influence in the decision making process of the investee. In this investment situation the investee is an associate of the investor.
- (d) The two Standards set out the criteria to establish significant influence and provide specific requirements on accounting for associates in the consolidated financial statements under the equity method and the disclosures required. Generally, significant influence is considered as one entity having the power to participate in the financial and operating policies of another entity but without having control or joint control over these policies.
- (e) The Standards shall be applied by all entities in accounting for investments in associates, except investments in associates held

by venture capital organisations, mutual funds, unit trusts and similar entities when those investments are classified as held for trading and accounted for at fair value.

- (f) Furthermore, the Standards provide exemptions from application of the equity method similar to those provided for certain parents not to prepare consolidated financial statements. These exemptions include when the investor is also a parent exempted in accordance with paragraph 41 of SAS 27 – *On Consolidated and Separate Financial Statements*, and when the investor, though not such parent in accordance with paragraph 42 of SAS 27 – *On Consolidated and Separate Financial Statements*.

5.2.8 Interests in Joint Ventures

Relevant Standards are:

- (a) *Statement of Accounting Standard 29: Interests in Joint Ventures*
- (b) *International Accounting Standard 31: Financial Reporting of Interests in Joint Ventures.*

These standards address the following matters:

- (a) Joint Venture is a contractual arrangement whereby two or more parties pool their resources together for a given economic objective. This form of business undertaking is different from Partnership in that it is not permanent and it is usually for a particular objective. Joint Venture is formed mainly in order to take advantage of the resource possessed by the respective parties in the Joint Venture. One party may possess technological know-how; others may have the financial resources, manpower, physical infrastructure, etc.
- (b) The method and pattern of accounting and reporting for Joint Venture activities have often posed challenges to conventional methods of accounting. For instance, in some Joint Ventures, the respective venturers keep records of their transactions in their books, while no separate records are kept for the joint venture. In other cases, records of transactions are kept both in the books of the individual venturers and in the books of the Joint Venture.
- (c) These Standards (SAS 29 and IAS 31) establish guidelines as to the scope of accounting for interests in Joint Ventures, the alternative methods that might be adopted and the limited circumstances under which interests in Joint Ventures might be accounted for at cost, less any provision for impairment.

- (d) These Standards shall be applied in accounting for interests in Joint Ventures and the reporting of joint assets, liabilities and income and expenses in the financial statements of venturers and investors, regardless of the structures or forms under which the Joint Venture activities take place. However, they do not apply to venturers interests in jointly controlled entities held for trading purposes, by:
 - (i) Venture capital organisations, or
 - (ii) Mutual funds, unit trusts and similar entities including investment-linked insurance funds that are recognized at cost, less any provision for impairment.
- (e) A venture with an interest in a jointly controlled entity is exempted from proportionate consolidation and equity method when it meets the following conditions:
 - (i) There is evidence that the interest is acquired and held exclusively with a view to its disposal within twelve months from acquisition and that management is actively seeking a buyer;
 - (ii) The venture is a wholly-owned subsidiary, or is a partially-owned subsidiary of another entity and its owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the venture not applying proportionate consolidation or the equity method;
 - (iii) The venturer's debt or equity instruments are not traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets);
 - (iv) The venture did not file, nor is it in the process of filing, its financial statements with the Securities and Exchange Commission or other regulatory organisations, for the purpose of issuing any class of instruments in a public market; and
 - (v) The ultimate or any intermediate parent of the venture produces consolidated financial statements available for public use that comply with Statements of Accounting Standard (SAS) or International Accounting Standard (IAS).

5.2.9 Financial Instruments Presentation

Relevant standards are:

IAS 32 Financial Instruments: Representation.

IAS 39 Financial Instruments: Recognition and Measurement.

IFRS 7 Financial Instruments: Disclosures.

There is no SAS yet on the issues addressed by the three Standards above!

- (a) In Nigeria, as in any other country, the use of financial instruments is rapidly expanding, but, unfortunately, there is no local accounting standard yet to take care of their treatments. The use of financial instruments, however, contributes to the risk profile of an entity. The accounting standards on financial instruments listed above were therefore developed to meet the following needs;
 - (i) To assist financial statements users understand the significance of financial instruments' to an entity's financial position and performance; and the nature and extent of risk arising from financial instruments.
 - (ii) To guide the recognition and measurement of financial assets and financial liabilities.
- (b) According to the three Standards listed above, financial instrument refers to any contract that gives rise to a financial asset for one entity and a financial liability to another entity.

Financial asset refers to any asset that is:

- (i) cash;
- (ii) an equity instrument of another entity; and
- (iii) a contractual right:
 - ◆ to receive cash or another financial asset from another entity;
 - ◆ to exchange financial asset or financial liabilities with another entity; or a contract that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments.

For this purpose the entity's own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the entity's own equity instruments.

- (c) Financial liability refers to a liability that is:
 - (i) a contractual obligation:
 - ◆ to deliver cash or another financial asset to another entity; or
 - ◆ to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavorable to the entity.
 - (ii) a contract that will or may be settled in the entity's own equity instrument and is:

- ◆ a non-derivative for which the entity is or may be obliged to deliver a variable number of the entity's own equity instruments.
- ◆ a derivative that will be or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own instruments.

For this purpose the entity's instruments do not include instruments that are themselves contracts for the future receipt or delivery of the entity's own equity instruments.

- (i) Equity instrument refers to any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities.
- (ii) A derivative is a financial instrument or contract within the scope of IAS 39 with all the following characteristics: Its value changes in response to the changes in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rate, credit rating or credit index, or other variable, provided that in the case of a non-financial variable the variable is not specific to a party to the contract.
- (d) It requires no initial net investment or an initial net investment that is smaller than would be required for other types of contract that would be expected to have a similar response to changes in market factors.
- (e) It is settled at a future date.

5.2.10 Impairment of Assets

Relevant standards are:

International Accounting Standard 36: Impairment of Assets

There is no SAS yet on the issues addressed by IAS 36!

- (a) When an asset is significantly impaired, its carrying value will probably exceed the recoverable value except where the carrying value is adjusted for the effect of the impairment. Prudence, however, requires that assets are carried at no more than their recoverable value. IAS 36 prescribes the procedure an entity should apply to ensure that its assets are not carried at more than their recoverable amount. The standard guides the accounting for impairment of all assets except inventories, deferred tax assets, financial assets, investment property measured at fair value, biological assets related to agricultural

activity, non-current assets classified as held-for-sale, deferred acquisition costs under an insurance contract, assets arising from employee benefits, and assets arising from construction contracts.

- (b) IAS 36 requires an entity to carry out a review of its assets at each balance sheet date to determine whether or not there is any indication that an asset may be impaired. If such indication exists, the entity is required to estimate the recoverable amount of the asset. "Asset" in this context includes individual assets and cash-generating units (CGUs).
- (c) Indications of impairment of assets may be obtained from two sources: internal sources and external sources.
 - (i) External sources of information include:
 - ◆ significant unexpected decline in the market value of an asset;
 - ◆ significant adverse changes that have taken place, in the technological, market, economic or legal environment in which the entity operates;
 - ◆ increase in market rates or market rate of return on investments that are likely to decrease the assets recoverable amount materially; and
 - ◆ the carrying amount of the net assets of the entity being more than its market capitalization.
 - (ii) Internal sources of information include:
 - ◆ evidence of obsolescence or physical damage of an asset;
 - ◆ significant reduction concerning the extent to which an asset is used or is expected to be used;
 - ◆ evidence that the economic performance of an asset is, or will be, worse than expected.
- (d) Whether or not there is any indication of impairment, an entity is required to:
 - (i) test an intangible asset with an indefinite useful life on an annual basis;
 - (ii) test goodwill acquired in a business combination for impairment annually.
- (e) IAS 36 defines recoverable amount of an asset or a cash-generating unit (CGU) as the *higher of*:
 - (i) the asset's or CGU's fair value less cost of selling;
 - (ii) its value in use.

If either of these amounts is greater than the asset's carrying value, the asset is not impaired and it is not necessary to estimate the recoverable amount.

- (f) IAS 36 sets out the requirement for recognizing and measuring the impairment loss of
 - (i) an individual asset
 - (ii) a cash generating unit, and
 - (iii) goodwill.
- (g) According to IAS 36, if the carrying amount of an asset is greater than the recoverable amount of the asset, then the asset is impaired. The impairment loss is the excess of the carrying amount over the recoverable amount. The asset should be reduced to its recoverable amount and the impairment loss should be charged as an expense in the income statement.
- (h) However, the impairment loss of a revalued asset should be treated as a revaluation decrease in accordance with the relevant IAS. What this means is that the impairment loss on a revalued asset should be taken to the revaluation reserve to the extent of the revaluation surplus on that asset. If the impairment loss is greater than the revaluation surplus, the excess should be charged to the profit and loss account. When the asset is written down, depreciation of the impaired asset should be calculated to write off the impaired value over the asset's remaining life.

5.2.11 Intangible Assets

Relevant Standards are:

- (a) *Statement of Accounting Standard 22: Research and Development Costs*
- (b) *International Accounting Standard 38: Intangible Assets*

These standards address the following matters:

- (a) According to the two Standards, Research and Development are activities directly related to long-range planning. The effectiveness of research and development expenditure may be assessed only in relation to the attainment of goals specified in the long-range plan. The spending of millions of Naira on research and development which invariably leads to all kinds of new products and services is important for the survival of most businesses. The world's level of development is the product of research and development. Usually, there is a long lead time between costs incurred and benefits received.
- (b) The importance of research and development to any business cannot be over emphasized as many industries' survival and growth depend to a great extent on it. The measurement and treatment of the associated costs also affect the entity significantly. Some entities treat all research and development costs as expense

in the year incurred; other entities in the same business treat the cost as intangible assets to be amortized over future years. These divergent practices, no doubt, prevent the financial statements of different entities from being readily comparable.

- (c) The entities that are adopting the practice of writing off the cost of research and development rely on the provisions of Section 8(2) of schedule 2 to the Companies and Allied Matters Act, 1990 which stipulates that research and development costs shall not be treated as assets in any entities' balance sheet. However, those opposed to this practice opine that research and development costs are so significant that writing them off in one accounting year will distort the information content of the financial statements of the entity. They further argue that it will be a disincentive to investors who are really interested in the development of the economy.
- (d) A review of the financial statements of some entities reveals that only a few entities carry the cost of research and development activities as asset in their financial statements whilst others do not. This, no doubt, creates problems of uniformity and comparability in financial reporting. Therefore, these Statements are expected to provide an acceptable and uniform accounting practice for reporting research and development costs.
- (e) The two Standards, especially IAS 38, also made adequate provisions on the accounting treatments of intangible assets such as goodwill, website costs, brand, etc.

5.2.12 Investment Property

Relevant Standards are:

- (a) *Statement of Accounting Standard 13: Accounting for Investments*
- (b) *International Accounting Standard 40: Investment Property*

These standards address the following matters:

- (a) Organisations, in the course of their business operations, apply all or some of their resources in acquiring assets to be held for capital appreciation, income generation, or other purposes such as securing trading advantages.
- (b) Many financial statements published in Nigeria do not disclose adequate information about the investment held by the reporting enterprises. These statements, therefore, seek to provide a guide for the accounting treatment of investment transactions and their

disclosure in the financial statements. Such investments do not enable the investor to exercise significant influence or control over the financial and operating decisions of the investee companies.

- (c) These statements do not cover:
 - (i) Stocks/inventory;
 - (ii) Property, plant and equipment; accounting for leases;
 - (iii) Investment in pension benefit plans and Life Insurance Enterprises;
 - (iv) Investment in subsidiaries and associates;
 - (v) Investment in Joint Ventures;
 - (vi) Goodwill, patents, trademarks and similar assets;
- (d) The statements focus on three main forms of investments, namely; short-term investments (current investments); long-term investments, and investment properties.

5.2.13 Business Combinations

Relevant Standards are:

- (a) *Statement of Accounting Standard 26: Business Combinations*
- (b) *International Financial Reporting Standard 3: Business Combinations.*

These standards address the following matters:

- (a) A business combination is the bringing together of separate entities or businesses into one reporting entity. The result of nearly all business combinations is that one entity, the acquirer, obtains control of one or more other businesses, the acquirees.
- (b) The two Standards include the following salient features:
 - (i) they require all business combinations within their scope to be accounted for by applying the acquisition method;
 - (ii) they require an acquirer to be identified for every business combination within their scope. The acquirer is the combining entity that obtains control of the other combining entities or businesses;
 - (iii) they require an acquirer to measure the cost of a business combination as the aggregate of: the values, at the date of exchange, of assets given, liabilities incurred or assumed, and equity instruments issued by the acquirer, in exchange for control of the acquire;
 - (iv) they require an acquirer to recognize separately, at the acquisition date, the acquiree's identifiable assets, liabilities and contingent liabilities that satisfy the following recognition criteria at that date, regardless of

whether or not they had been previously recognized in the acquiree's financial statements:

- ◆ In the case of an asset other than an intangible asset, it is probable that any associated future economic benefits will flow to the acquirer, and its value can be measured reliably;
 - ◆ In the case of a liability other than a contingent liability, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and its value can be measured reliably;
 - ◆ In the case of an intangible asset or a contingent liability, its value can be measured reliably.
- (v) they require the identifiable assets, liabilities and contingent liabilities that satisfy the above recognition criteria to be measured initially by the acquirer at their fair values at the acquisition date irrespective of the extent of any non-controlling interest;
- (vi) they require goodwill acquired in a business combination to be recognized by the acquirer as an asset from the acquisition date, initially measured as the excess of the cost of the business combination over the acquirer's interest in the net value of the acquiree's identifiable assets, liabilities and contingent liabilities.
- (vii) they require disclosure of information that enables users of an entity's financial statements to evaluate the nature and financial effect of:
- ◆ Business combinations that were effected during the period;
 - ◆ Business combinations that were effected after the balance sheet date but before the financial statements are authorized for issue; and
 - ◆ Some business combinations that enable users of an entity's financial statements to evaluate changes in the carrying amount of goodwill during the period.
- (d) The two Standards include specific requirements clarifying that the value of an intangible asset acquired in a business combination can normally be measured with sufficient reliability to qualify for recognition separately from goodwill. If an intangible asset acquired in a business combination has a finite useful life, there is a presumption that its value can be measured reliably.

- (e) The two Standards require the acquiree's identifiable assets, liabilities and contingent liabilities recognized as part of allocating the cost of the combination to be measured initially by the acquirer at their fair values at the acquisition date. Therefore, any non-controlling interest in the acquiree is stated at the non-controlling proportion of the net fair values of those items.
- (f) The two Standards require goodwill acquired by business combination to be measured after initial recognition at cost less any accumulated impairment losses. Therefore, goodwill is not amortized but instead it must be tested for impairment annually or more frequently if events or changes in circumstances indicate that it might be impaired.

5.2.14 Non-Current Assets Held for Sale and Discontinued Operations

Relevant Standards are:

International Financial Reporting Standard 5: Non-Current Assets Held for Sale and Discontinued Operations

There is no SAS yet on the issues addressed by IFRS 5!

- (a) An entity may put up one or more of its current assets for sale. It may decide to sell one or more of its cash generating units, or a part of a single cash generating unit. How should an entity account for an asset held for sale? How should discontinued operations be presented in the financial statements of an entity? These are the issues addressed by IFRS 5. In other words, IFRS specifies the accounting treatment of assets held for sale and the presentation of discontinued operations.
- (b) IFRS 5 requires an entity to classify a non-current asset (or a disposal group) as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use.
- (c) The following conditions must be met before a non-current asset is so classified:
 - (i) the asset must be available for sale in its present condition.
 - (ii) Its sale must be highly probable within one year from the date of classification.
 - (iii) Management must be committed to a plan to sell the asset.
 - (iv) The asset must be actively marketed for sale at a price that is reasonable in relation to its current fair value.

- (v) Actions required to complete the plan should indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn.
- (d) A discontinued operation is a component of an entity that either has been disposed of or is classified as held for sale; and
 - (i) represents a separate major line of business or geographical area of operations;
 - (ii) is part of a single coordinated plan to dispose of a separate major line of business or geographical area of operation; or
 - (iii) is a subsidiary acquired exclusively with a view to resale.
- (e) IFRS 5 requires an entity to disclose a single amount on the face of the income statement comprising the total of;
 - (i) the post-tax profit or loss of discontinued operations, and
 - (ii) the post-tax gain or loss recognized on the measurement of fair value less cost of selling or on the disposal of the asset.
- (f) An analysis of the single amount in (e) into:
 - (i) the revenue, expenses and pre-tax profit or loss of discontinued operation;
 - (ii) the related tax
 - (iii) the gain or loss recognized in the measurement of fair value less cost of selling or on the disposal of the discontinued operation;
- (g) The net cash flows attributable to the activities of the discontinued operations.

5.2.15 Operating Segments

Relevant Standards are:

- (a) *Statement of Accounting Standard 24: Segment Reporting*
- (b) *International Financial Reporting Standard 8: Operating Segments*
- (a) Activities of many organisations cut across different classes of business and geographical boundaries. It is expected that their financial reports should give reasonable information about the classes and geographical boundaries of their businesses, where such businesses are significantly affected by the different classes or geographical boundaries.
- (b) Financial statements are a means of communicating information on the resources, obligations, and performances of a reporting

entity. Therefore, the information contained therein should enable users to understand the risks and conditions which have affected or may affect the performance and financial position of the entity.

- (c) The current format of reporting as stipulated by the Companies and Allied Matters Act, 1990, does not provide for adequate information for effective analysis and comparison of entities whose operations cut across different classes of business and geographical boundaries.
- (d) The primary objectives of SAS 24 and IFRS 8, therefore, are to:
 - (i) require classification by segments in terms of business and location;
 - (ii) determine what constitutes material segments; and
 - (iii) specify formats for the presentation of financial statements by segments.
- (e) These Standards apply to all companies whose securities are publicly traded carrying on different classes or operating in different geographical areas. All other entities who choose to disclose segmental information in their financial statements should comply with the provisions of these standards.

5.3 SUMMARY AND CONCLUSIONS

Accounting standards all over the world are set with a view to ensuring uniformity in the way enterprises prepare and present their financial statements for the use of various interested parties. The unified financial statements would allow for comparative analysis on the performance of competing business organisations. The standardization, therefore, has the primary objective of ensuring objective comparison of the performance of enterprises before investment and other decisions are taken by users.

This chapter gives highlights of nine out of the thirty Statements of Accounting Standards (SAS) issued so far by the Nigerian Accounting Standards Board (NASB), twelve out of the forty-one International Accounting Standards (IAS) issued so far by the International Accounting Standards Board, and three out of the seven International Financial Reporting Standards (IFRS) issued by the IASB. This is done with a view to showing the efforts so far made to ensure good marriage between theory and practice in the field of Accounting, and to ensure standardization in the treatment of various accounting issues when it comes to the preparation of financial statements/reports. Each of the Standards contains some background information on the theoretical or conceptual aspects of the Accounting topic addressed, including definitional issues, before outlining how the issues are to be practicalized by relevant enterprises in Nigeria and beyond to ensure standardization and uniformity in application.

Accounting students should take it as a challenge to master the contents of all the SASs, IASs, IFRSs and IPSASs with a view to obtaining sustainable knowledge of financial accounting, specifically, and accounting, generally.

Refer to Comprehensive Questions and Suggested Solutions in Appendix II, page 269.

5.4 REVISION QUESTIONS

5.4.1 MULTIPLE-CHOICE QUESTIONS

1. One of the following Accounting Standards aims at ensuring uniformity in preparing and presenting financial statements in respect of construction contracts:
 - A. Statement of Accounting Standard No.3
 - B. Statement of Accounting Standard No.5
 - C. Statement of Accounting Standard No.4
 - D. Statement of Accounting Standard No.10
 - E. Statement of Accounting Standard No.6

2. Information provided in a Statement of Cash Flows will assist users in the following, except:
 - A. Assessing the impact of its current transactions on its financial position.
 - B. Assessing enterprise's ability to meet its debt obligations.
 - C. Estimating capital expenditure requirements.
 - D. Evaluating enterprises ability to finance ongoing operations.
 - E. Assessing the ability of the enterprise to generate positive net future cash flows.

3. According to International Accounting Standard Number 23, the following are borrowing costs except:
 - A. Interest on short term and long term business.
 - B. Finance charges in respect of finance lease.
 - C. Interest on bank overdraft.
 - D. Amortisation of discount or premium relating to borrowing.
 - E. Installation expenses incurred on an equipment procured from borrowed fund.

4. Which of the following Accounting Standards deals with Research and Development Costs?
 - A. SAS 28
 - B. SAS 24
 - C. SAS 2
 - D. SAS 22
 - E. SAS 16

5. Matters relating to Business Combinations are the subject of
 - A. SAS 26
 - B. SAS 30
 - C. SAS 29
 - D. SAS 4
 - E. SAS 18

5.4.2 SHORT ANSWER QUESTIONS

1. State ONE of the approaches used in accounting for government grants.
2. Statement of Accounting Standard Number 24 deals with _____
3. Interests in Joint Ventures are the subject matter of SAS No. _____
4. Both IAS 32, and IAS 39 as well as IFRS 7 deal with _____
5. Both SAS 27 and IAS 27 prescribe guidelines for _____

Refer to Suggested Solutions in Appendix I, Page 263.

ETHICAL FRAMEWORK, CONCEPTS AND VALUE

6.0 LEARNING OBJECTIVES

After studying this chapter, readers will be able to:

- ◆ Explain the nature of ethics and its framework for professional accountants;
- ◆ Describe rules-based and principles - based approaches or concepts in ethical consideration;
- ◆ Explain the foundation of the accounting profession;
- ◆ Explore commonly used theories and principles; and
- ◆ Describe ethics and culture.

6.1 MEANING AND NATURE OF ETHICS

Introduction

“We are discussing no small matter, but how we ought to live.” – Socrates, in Plato’s Republic.

Socrates clearly recognises the importance of ethics in human existence and relationship and hence advises us to pay critical attention to it. It is therefore imperative for us to do a conceptual clarification of the concept with the aim identifying first what ethics is not and differentiate it from morality.

6.1.1 What Ethics is not

(a) Ethics is not the same as feelings

To some people ethics is not grounded on reason but on how we feel about an issue. This is because we always have strong feeling about ethical issues. On the other hand it seems that we all are naturally drawn to try to convince others of our ethical standpoints through argument. It is therefore not strange to think that ethics is a matter of feelings rather than reason.

Feelings however have important place in our ethical thinking to the extent that we care about others and provide an important

clue to our ethical choices. This actually helps in making sense of any ethical reasons. So, emotions certainly can inform our ethical judgments and can motivate us to act out of deep concern for others, but they cannot be all there is to ethical judgment.

The main point here is that *good* ethical judgments are *considered* judgments, rather than unexamined biases or emotional intuitions. It is important to feel strongly about our ethical convictions, but feelings alone are not enough – we must think carefully about our ethical judgments in order to ensure that they are justified and consistent.

(b) Ethics is not merely a religion

Though most religions present ethical standards, not everyone is religious, yet ethics applies to everyone. Most religions do advocate high standards but sometimes do not address all the types of problems we face.

Unlike religion, ethics appeals to reasons rather than authority to justify its principles. A religious person might believe it is wrong to steal because “Thou shalt not steal” is one of the Ten Commandments of the Bible. But using ethics as our base, we can justify our conclusion that we should not steal because it is morally wrong to harm another person and, when we deprive a person of what is rightfully theirs, we harm them.

(c) Ethics is not merely being legal

A good system of law does incorporate ethical standards, but laws can deviate from what is ethical, the two domains are therefore different. Laws can be totally unethical especially in a totalitarian regime. Law can be an instrument of operation, oppression and exploitation, designed to serve the interest of the few. For example the South African laws which until 1994 enforced a cruel racial apartheid in that country.

On the other hand, there are things we should (ethically speaking) do, for example, give to charities, even though they are not legally required.

(d) Ethics is not merely adhering to culturally accepted norms

While some cultures are quite ethical, others are corrupt or blind to certain ethical concerns. It is not a satisfactory ethical standard to say “When in Rome, do as the Romans” though it is advisable to be sensitive to cultural norms when entering another environment.

(e) Ethics is not science

Though social and natural science can provide important information to help us make better ethical choices. Science alone does not tell us what we ought to do. It may provide information for what humans are like. But ethics provides reasons for how humans ought to act. And just because something is scientifically or technologically possible does not make it ethical.

(f) Ethics is not the same as values

Values imply the conscious prioritising of different behavioral alternatives or standard that are perceived possible, worthwhile or esteemed for the individual, an institution or nation value is more personal than factual.

(g) Ethics is not the same as morality

Morality refers to the beliefs and practices about good and evil by means of which we guide our behavior. Morality refers to principles or standards of human conduct. For some people ethics is a code of conduct and yet for other it is a form of etiquette or rules guiding human beings in their private and public life. Technically, ethics is not morality.

6.1.2 What then is Ethics someone may be asking?

Ethics is the general term for attempts to state or determine what is good, both for the individual and for the society as a whole. The Chambers Dictionary (2003) defines ethics as “the science of morals; that branch of philosophy which is concerned with human character and conduct; a system of morals or rules of behaviour; and a treatise on morals.”

Solomon (1994) also describes the aim of ethics as “first of all, the quest for, and the understanding of, the good life, living well, a life worth living. It is largely a matter of perspective: putting every activity and goal in its place, knowing what is worth doing and what is not worth doing, knowing what is worth wanting and having and knowing what is not worth wanting and having. It is also, within business itself, keeping in mind what is ultimately important and essential and what is not, what serves our overall career goals and what does not, what is part of business and what is forbidden to business, even when increased profit – the most obvious measure of business success – is at stake.”

Ethics, just as Medicine and Military techniques or Strategy, explores how human beings should act in all earthly situations, not only for the achievement of stated objectives. The aims being pursued should bring

about flourishing and successful life. In all that a person **does**, there are good reasons to take other people's interests into consideration, otherwise, they will retaliate. A guiding principle appears to be that one should be fair and seek to uphold the common good of the community to which one belongs, in the spirit of duty of care to one's neighbours.

Also called moral philosophy, it involves systematizing, defending and recommending concepts of right and wrong behaviour. As a branch of philosophy, is a systematic attempt to understand the nature and foundations of morality and its effect on our conduct. It is a systematic study of the principles of good behaviour. Ethics is the reflective consideration and evaluation of our moral beliefs and practices. It is considered a *normative* science, because it is concerned with norms of human conduct, as distinguished from the *formal* sciences, such as mathematics and logic, and the *empirical* sciences, such as chemistry and physics.

Finally it considers the question of *justification*, such as, what are the foundations of morality? How do we know them to be true, or good, or right? It also involves questions of *motivation*, such as why should we obey the demands of morality? Or, what motivates us to behave ethically? It is concerned with norms and standards of conduct. Its primary focus is with what *ought* to be the case rather than merely what *is* the case. Thus, ethics is *normative*: it is concerned with how we ought to act and what we ought to try to bring about

6.2 THE NATURE OF ETHICS AND ITS FRAMEWORK FOR PROFESSIONAL ACCOUNTANTS

Ethics, as a branch of philosophy, tries to address moral issues. Accounting ethics is a subspecies or sub-set of business ethics. All disciplines or professions have their moral codes, rules of conduct and standards of behaviour. In view of the moral obligation of social responsibilities of companies, major organisations now demand business ethics consultants and indeed set up ethics committees in the quest for "acting decently while pursuing economic objectives."

However, W. Michael Hoffman puts the moral dilemma of companies in this way, "clearly, the ethical thing to do is not always in the best interests of the firm." If a company has its way, it will rather declare small figure of profit, so as to remit minimal or no tax and pay mere pittance to employees. How are the professionals, indeed accountants, manage moral conflicts which confront them time and again? How are they to retain their integrity? In trying to answer the questions raised, one consolation is available. Pursuing ethics in accounting is likely to bring about clearer and logical reasoning, leading to acting intelligently. Complete rationality demands that a thoroughbred professional

should evaluate scientifically not just the adequacy and flawlessness of the means but also the value of the ends.

ILLUSTRATION 6-1

Mr. Dokus is a fellow member of The Institute of Chartered Accountants of Nigeria. He has been a consultant on auditing and taxation to his client for many years, for which reasonable fees were received. The accountant has, however, been secretly giving information on the financial transactions of his client to the relevant tax authority. The Inland Revenue Service subsequently indicted the client for tax evasion. The client cleared the arrears of the tax owed and the penalty. He later sued Mr. Dokus for failure as an accountant to respect his privacy and give him loyalty. His Attorney submitted before the High Court of Justice that “a client has a right to feel he is getting undivided loyalty and confidentiality from his accountant.” The defence counsel countered this point by saying that “loyalty and confidentiality to a client end when they are in conflict with the law.” The client lost the case. What is your view on this matter?

SUGGESTED SOLUTION 6-1

The position of Mr. Dokus, the chartered accountant, is only legally acceptable. He has to preserve the confidentiality of information acquired in the course of his duties. The professional accountant should not use the information to his/her personal advantage. Mr. Dokus, the accountant, should not have disclosed any such information to third parties without the authority from his client unless there was a legal or professional right or duty to disclose. Legally, the client to Mr. Dokus went to court with soiled hands. Whoever goes to equity, should go with clean hands. The principle of law which the court invoked to pronounce ‘guilty’ on Mr. Dokus is “Ex turpi causa oritur non actio.” This legal maxim means “out of illegality nothing legal shall come out.”

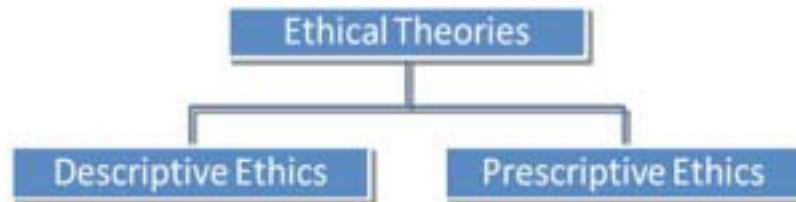
Although, the client lost the case to the law, in ethics, he won. Mr. Dokus infringed the Code of Professional Conduct of Members issued by The Institute of Chartered Accountants of Nigeria and strengthened by the International Federation of Accountants. If he was in doubt as to what to do, Mr. Dokus should have sought and obtained guidance from ICAN, his professional body.

6.3 COMMONLY USED PRINCIPLES AND THEORIES

The philosophical dimension to ethics evokes various views and postulations from experts. The different schools of thought use terminologies or principles to ventilate fervently their positions. The various classifications of ethical theories would be discussed below.

6.3.1 Broad Classifications

A broad classification of ethical theories differentiates the social scientists approach from the philosophers' approach.



(a) **Descriptive Ethics**

This is also known as comparative ethics. It is the study of people's beliefs about morality. It is a form of empirical research into the attitudes of individuals or groups of people. The aim is to discover people's beliefs about such things as values, which actions are right or wrong, and which characteristics of moral agents are virtuous. Simply put, it is a factual description and explanation of moral behaviour and beliefs. This the social scientist approaches.

(b) **Prescriptive or Normative Ethics**

Normative ethics bridges the gap between meta-ethics and applied ethics. It is the attempt to arrive at practical moral standards that tell us right from wrong, and how to live moral lives.

The formulation of prescriptions and proscriptions about what we ought and ought not to do. It is a study of ethical theories that prescribes how people ought to act. How should people act?

6.3.2 Traditional Classifications

In analytic philosophy, ethics is traditionally divided into three fields: Meta-ethics, normative ethics and applied ethics.



(a) **Meta-Ethics**

The study of the origin and meaning of ethical concepts. Unlike normative ethics, it does not attempt to evaluate specific choices as being better, worse, good, bad or evil.

(b) **Metaphysical Issues in Meta-ethics**

Metaphysics is the study of the nature of existence and its course in different forms – physical and non-physical. The metaphysical components of meta ethics involves discovering specifically whether moral values are eternal truths that exist in a spirit-like realm or physical – that is human conventions.

(c) **Ethical Objectivism**

Holds that moral values are independent of one's perception or conception – in the sense that they exist in a spirit-like realm beyond subjective conventions. Moral values are absolute or eternal, not changing. They are universal – applying to all rational creatures. Plato and Kant hold this view.

(d) **Ethical Relativism**

It follows in the sceptical philosophical tradition (Sextus Empiricus) and denies the objective status of moral values. Sceptics do not reject moral values themselves, but denied that values exist as spirit-like objects.

Ethical relativism claims that when two cultures or any two people hold different moral views of an action, both can be right. Thus any action can be right for one person, yet wrong for another.

For the relativists, there is no universal standard or moral truth. The moral truism of a proposition or action is culture dependent, figure dependent and individual dependent.

(e) **Psychological Issues in Metaethics**

This section examines the psychological basis of our moral judgments and conducts. Here we try to understand what motivates morality. Why be moral.

(f) **Ethical Egoism and Altruism**

17th Century British Philosophers hold that many, if not all of our actions are prompted by selfish desires. This is the theory in ethics which holds that an action is morally right if the consequences of that action are more favourable than unfavourable only to the agent performing the action. Ethical Altruism holds that an action is right only if it is more favourable to others except the agent.

(g) **Emotion and Reason**

There is a dispute concerning the role of emotion and reason in motivating moral actions. For instance, does a statement such as, “abortion is morally wrong,” a rational assessment or an expression of emotion? On the one side of the dispute, 18th century British philosopher David Hume argued that moral assessments involve our emotions, and not our reason. We can amass all the reasons we want, but that alone will not constitute a moral assessment. We need a distinctly emotional reaction in order to make a moral pronouncement. Reason might be of service in giving us the relevant data, but, in Hume’s words, “reason is, and ought to be, the slave of the passions.”

Inspired by Hume’s anti-rationalist views, some 20th century philosophers, and most notably A.J. Ayer similarly denied that moral assessments are factual descriptions. For example, although the statement “it is good to donate to charity” may on the surface look as though it is a factual description about charity, it is not. Instead, a moral utterance like this involves two things. First, I (the speaker) am expressing my personal feelings of approval about charitable donations and I am in essence saying “Hooray for charity!” This is called the *emotive* element insofar as I am expressing my emotions about some specific behaviour.

Second, I (the speaker) am trying to get you to donate to charity and am essentially giving the command, “Donate to charity!” This is called the *prescriptive* element in the sense that I am prescribing some specific behaviour.

From Hume’s day forward, more rationally-minded philosophers have opposed these emotive theories of ethics and instead argued that moral assessments are indeed acts of reason. 18th century German philosopher Immanuel Kant is a case in point. Although emotional factors often do influence our conduct, he argued, we should nevertheless resist that kind of sway. Instead, true moral action is motivated only by reason when it is free from emotions and desires.

A recent rationalist approach, offered by Kurt Baier, was proposed in direct opposition to the emotivist and prescriptivist theories of Ayer and others. Baier focuses more broadly on the reasoning and argumentation process that takes place when making moral choices. All of our moral choices are, or at least can be, backed by some reason or justification. If I claim that it is wrong to steal someone’s car, then I should be able to justify my claim with some kind of argument. For example, I could argue that stealing Smith’s car is wrong since this would upset her, violate her ownership rights, or put the thief at risk of getting caught. According to Baier, then, proper moral decision making involves giving the best reasons in support of one course of action versus another.

6.3.3 Normative Ethics

Normative ethics involves arriving at moral standards that regulate right and wrong conduct. It is the search for an ideal litmus test of proper behaviour. It is the sub-division of ethics which investigates the principles upon which certain things and actions are said to be good or bad, right or wrong. It is that aspect of ethical thinking that seeks for principles or reasons upon which moral positions can be justified. It deals with norms, standards or principles of human behaviour. Normative ethical theories can be subdivided in: Teleologism, Deontologism and Ontologism.

6.3.4 Applied Ethics

Applied ethics is a field of ethics that deals with ethical questions specific to a professional, disciplinary, or practical field. It is the normative practice of ethics in particular disciplines, professions or organisations. It is a branch of ethics which consists of the analysis of specific, controversial moral issues such as abortion, animal rights or euthanasia. According To Brenda Almond, applied ethics is “the philosophical examination, from a moral standpoint, of particular issues in private and public life that are matters of moral judgment”.

Applied ethics applies normative ethics to specific controversial issues. Many of these ethical problems bear directly on public policy. For example, the following would be questions of applied ethics: “Is getting an abortion ever moral?”; “Is euthanasia ever moral?”; “What are the ethical underpinnings of affirmative action policies?”; “Do animals have rights?”

Applied ethics has been sub divided into: bioethics, business ethics, environmental ethics, government ethics, military ethics, police ethics, legal ethics and sexual ethics.

It is thus a term used to describe attempts to use philosophical methods to identify the morally correct course of action in various fields of human life. Bioethics, for example, is concerned with identifying the correct approach to matters such as euthanasia, or the allocation of scarce health resources, or the use of human embryos in research. Environmental ethics is concerned with questions such as the duties of humans towards landscapes or species. Business ethics concerns questions such as the limits on managers in the pursuit of profit, or the duty of ‘whistleblowers’ to the general public as opposed to their employers. As such, it is a study which is supposed to involve practitioners as much as professional philosophers.

6.3.5 Normative Ethical Theories



(a) Normative Ethics

One branch of normative ethics is **theory of conduct**; this is the study of right and wrong, of obligation and permissions, of duty, of what is above and beyond the call of duty, and of what is so wrong as to be evil. Theories of conduct propose standards of morality, or moral codes or rules. For example, the following

would be the sort of rules that a theory of conduct would discuss (though different theories will differ on the merit of each of these particular rules): “Do unto others as you would have them do unto you”; “The right action is the action that produces the greatest happiness for the greatest number”; “Stealing is wrong.”

Normative ethics involves arriving at moral standards that regulate right and wrong conduct. It is the search for an ideal litmus test of proper behaviour. It is the sub-division of ethics which investigates the principles upon which certain things and actions are said to be good or bad, right or wrong. It is that aspect of ethical thinking that seeks for principles or reasons upon which moral positions can be justified. It deals with norms, standards or principles of human behaviour.

- (b) **Teleological** theories determine the ethics of an act by looking at the probable outcome or consequences of the decision (the ends). It judges the rightness or wrongness of an action based on its consequences. Actions are therefore not good in themselves; their moral values are totally based on the effects that follow upon them. Actions have no intrinsic value but merely serve as means to attain that which has value. In considering the consequences of an action, the good effect should be weighed against the bad effects on all the people affected by it. If the good effects outweigh the bad effects, then it tends to be a good action, but if the bad outweighs the good, then it tends to be a bad action, hence not morally right.

- (c) **Ethical Egoism**

Ethical egoism expresses ‘the view that human conduct should be based exclusively on self-interest.’ Ethical egoists believe that morality requires nothing more of us other than we maximise our own good. An action therefore is right if it maximises one’s own personal good. Similarly other definitions go thus: “each and every man ought to look out for himself alone... everyone ought to concern himself with his own welfare alone.” According to John Hospers, one’s sole duty is to promote his own interests, exclusively,¹ and for Bernard Williams “everyone ought exclusively to pursue his own interest.”

- (d) **Utilitarianism**

Utilitarianism was formulated by the British philosopher Jeremy Bentham toward the end of the 18th century and later expounded by the British philosopher James Mill and his son, John Stuart Mill. Utilitarianism, otherwise known as the ‘greatest happiness

principle', is an ethical theory that holds that an action is right if it produces, or if it tends to produce, the greatest amount of good for the greatest number of people affected by the action. Otherwise the action is wrong.

According to Bentham actions were right if they tended to produce the greatest happiness for the greatest number of people.

- (e) **The deontological** theories determine the ethics of an act by looking to the process of the decision (the means). The deontological tradition holds that what makes an action right is not the sum of its consequences, but the fact that it conforms to the moral law. This concept addresses the issue of obligation or duty. Under this basis, an action or decision is justified for the fact, in itself, that it is good.

(f) **Kantianism (Ethics of Duty)**

The German philosopher, Immanuel Kant (1728-1804) is a major contributor to Ethics of duty. He thought that morality and the question of rightness and wrongness of actions was not dependent on a particular situation or on the consequences of the action. Rather, morality was simply a question of certain eternal, abstract and unchangeable principles that humans should apply to all ethical problems. Hence his moral philosophy is deontological.

To be moral, therefore, one must consciously act according to rules previously calculated by 'reason' to be right or just, and the incentive for observing those rules must be respected for duty alone.

Kant, consequently, articulated what could be seen as a guide to what ought to be our commitment to duty by developing a theoretical framework through which these principles could be derived. This he called the 'categorical imperative'. By this he meant that this theoretical framework should be applied to every moral issue regardless of who is involved, who profits and who is harmed by the principles once applied in specific situations.

The 'categorical Imperative' consists mainly of three parts, but we shall dwell on the first two formulations. The first formulation states,

Act only according to that maxim by which you can at the same time will that it should become a universal law.

De George explains this formulation to mean that, for any action to be morally right, it must be capable of being consistently universalisable. By implication, if any action is moral for me, it

must be moral for anyone else; everyone should be able to follow the same underlying principle. For instance, there can be no exception to the principle that murder is immoral or that lying is immoral. We are therefore commanded to do what is morally right, which must be such that, in doing it, none of us interferes with or prevents others from doing it. As De George observes, “in many instances people who act immorally trade on the fact that not everyone does what they do”.

The second formulation otherwise referred to as the principle of humanity goes thus:

Act so that you treat humanity, whether is your own person or in that of another, always as an end and never as a means only.

Kant’s emphasis here is on the rational nature of humans as free, intelligent and self directing beings. This nature of rationality is the basis for his/her value as an end in itself. Because of this, “a rational being is worthwhile, has dignity and is worthy of respect. Hence each person should be treated by every person as an end, with respect and dignity...”

This formulation forbids us to ‘use’ people and manipulate them merely as means to our own ends. According to Kant, it is a different statement of the supreme moral law contained in the first formulation. Hence, it commands and forbids the same actions as the first formulation. The formula of the end-in-itself, according to Kant, generates both negative and positive duties. In the negative sense, we treat persons as ends when we do not interfere with their pursuit of their (legitimate) ends. In the positive sense we treat persons as ends when we endeavour to help them realize their (legitimate) ends. It entails making other people’s ends one’s ends, and requires that we do those acts which are necessary to further the permissible ends of others.

Finally, the treatments that rational beings deserve as ends in themselves, could also be seen in the form of right. People thus have right to life, and this right imposes obligation, on others not to take their life and in certain conditions to help them preserve it.

(g) **Aristotlelism (Virtue Ethics)**

The moral values of actions are often times considered on particular actions, virtue ethics, however starts from a different perspective. Instead of evaluating every single action based on

its outcomes, or its underlying principles, this approach looks at the **character of the decision maker**. Basically the theory holds that good actions come from good people.

For Aristotle, one of the original proponents of virtue ethics, the primary objective is not the abstract knowledge of the good but to become a good person or develop a moral character. He asserts that before one can even begin to inquire into the nature of the good, one must first have received a proper upbringing in moral conduct². It would appear from Aristotle's position that, in order to become good, it is necessary to be good already. Thus Crane Andrew and Matten Dirk, defined virtue ethics along the following line:

Virtue ethic contends that morally correct actions are those undertaken by actors with virtuous characters. Therefore, the formation of a virtuous character is the first step towards morally correct behaviour.

This formation of a virtuous character entails ensuring that the actor possesses the knowledge of the good, through 'good upbringing.' It does not depend on the mechanical application of universal principle (as Kant or even Mill, would have us believe)' but requires, "certain disposition, a desire, tendency or willingness to do good as well as a sufficient amount of life experience to draw from."³ This disposition, according to Aristotle can only be natured over time, preferably from childhood. Olusegun Oladipo also seems to express this view when he posits that

...morality is not simply about making obedience to rules a common social habit...but the inculcation of virtues, that is, the traits of characters that promote human conviviality...

6.4 "RULES-BASED" AND "PRINCIPLES-BASED" APPROACHES TO ETHICAL CONDUCT

The ethical standards of behaviour enunciated in the Code of Professional Conduct for adherence by the members of the Institute of Chartered Accountants of Nigeria are designed as 'pillars of guidance,' to safeguard the integrity of the professional body and obviate untold humiliation in the eyes of the world. Over time, experts have spotlighted various traits of unethical behaviour which include the following:

- (a) An act of behaviour which is irrational and unacceptable to common sense;
- (b) Conduct which is unheard of or which falls far short on moral pedestal;

- (c) Behaviour which runs counter to accepted norms; and
- (d) Any conduct which is not in consonance with the code of standard professional stipulation.

The pivotal manifestation of unethical behaviour is the failure to adhere to the moral prescriptions or objectives of a profession, that is, credibility, professionalism, quality of service and confidence. This indication is professional misconduct. By way of illustration, the Institute of Chartered Accountants of Nigeria has issued a Code of Morals or Ethics. The morals are 'rules-based' and 'principles-based', discussed as follows:

6.4.1 'Rules-Based' Ethical Behaviour

Perhaps the best way to discuss this type of unethical behaviour is to have a look at the section on the Enforcement of Ethical Standards and Enforcement Procedures issued by the Institute of Chartered Accountants of Nigeria, reproduced as follows:

"This Statement shall apply to all members:

- 1.1 The power of the Institute to enforce ethical standards is derived from The Institute of Chartered Accountants of Nigeria (ICAN) Act 1965 and this power is conferred on the Accountants' Disciplinary Tribunal and the Tribunal, in this respect, is independent of the Council of the Institute.
- 1.2 The Investigating Panel considers complaints against the conduct of members, and is empowered to initiate disciplinary action by referring appropriate cases to the Disciplinary Tribunal for adjudication.
- 1.3 Where a complaint is against the conduct of a firm having more than one partner, the complaint shall be deemed to have been made against each and every member who was partner in the said firm at the material time, for the purposes of this statement.
- 1.4 Any failure to follow the guidance in fundamental principles or in the statements shall also be taken into account by the committee of the Institute responsible for regulating the work of members and member firms.
- 1.5 Where a complaint is received by the Institute alleging a case of misconduct against a member, such a member shall be requested by the Investigating Panel to furnish his defence or reaction to the complaint within 14 days of the receipt of the request to do so.

- 1.6 If the member fails to respond within the specified time, a first reminder shall be sent to him requesting him to send his defence or reaction within 7 days from the receipt of the reminder and a warning that non-response shall amount to contempt of the Institute and is sanctionable by the Disciplinary Tribunal.
- 1.7 If the member fails to respond after the first reminder, a formal charge of contempt shall be preferred against the member before the Disciplinary Tribunal.
The provisions and/or procedures contained in paragraphs 1.5 and 1.6 above, shall apply to any other requirement or directive of the Panel to a member so that failure or neglect by the member to abide by the requirement or directive shall also be treated as contempt of the Institute and is sanctionable by the Disciplinary Tribunal.
- 1.8 If the member's current address cannot be readily obtained, The Panel shall publish the invitation in a National Newspaper after which if there is no response from the member, this shall be treated as contempt of the Institute and is sanctionable by the Disciplinary Tribunal.
- 1.9 If having considered the facts before it, and any representation made by the member, The Panel is of the opinion that in all the circumstances those facts amount to misconduct and is of the further opinion that disciplinary proceedings should be brought, it will prefer a formal complaint to the Disciplinary Tribunal.
- 1.10 It is the Disciplinary Tribunal alone that can determine, subject to the right of appeal referred to below, whether a complaint of misconduct is proved.
- 1.11 From The Accountants' Disciplinary Tribunal, a member has a right of appeal to the Court of Appeal (see Section 12(5) of The Institute of Chartered Accountants of Nigeria Act).
- 1.12 Failure of a member to respond to any publication requiring such a member to appear before the Investigating Panel, will constitute an act of professional misconduct.
- 1.13 A member of the Institute who changes his address from the original address he has with the Institute without giving the Institute notice of the change thereof, has committed an Act of professional misconduct.
- 1.14 Any member or student of the Institute who has been declared guilty of Professional misconduct by the Accountants' Disciplinary Tribunal shall not be eligible either to serve on the Institute's

Council or any of the Institute's Committees for a period of five (5) years from the date of re-admission into membership or studentship as the case may be.

(ICAN Professional Code of Conduct for Members, 2008; Part Four, Chapter Twenty One)

The Accountants' Disciplinary Tribunal has powers which are equivalent to those of a High Court. Consequently, any appeal against its verdict is passed to the Court of Appeal, and subsequently to the Supreme Court of Nigeria. The normal rules of evidence are adopted in the adjudication process.

Where a member is found guilty, he may face one or more of the Institute's sanctions for the proven act of misconduct, which include the following:

- (a) Suspension or total expulsion from membership of the Institute;
- (b) If in practice, the rights may be withdrawn;
- (c) Imposition of fine;
- (d) Reprimand; and
- (e) Payment of costs awarded by the Tribunal against the member.

When all considerations have been put together, it is obvious that a member should always conduct his professional affairs transparently, in keeping with the existing norms and code of moral **indices** to not only save himself and his family from avoidable humiliation, but also not bring the name of the Institute into disrepute.

The Institute is also operating similar disciplinary procedures, that is, Investigating Panel and Disciplinary Tribunal, in respect of ICAN Association of Accounting Technicians and Students.

6.4.2 Fundamental "Principles – Based" Ethical Behaviour, Professional Conduct, the Public Interest/Professional Values, Ethics and Attitudes and the Code of Conduct for Accountants

The fundamental principles emanate from the duties and obligations which a member owes the accountancy profession. They guide the profession and moral behaviour of each member. The principles which are integrity, objectivity, professional competence and due care, professional behavior and confidentiality advocate that a member of the Institute should:

- (a) Comport himself with dignity in all commercial and professional connections. He should demonstrate integrity and fairness by putting others in his position. A professional accountant shall preserve the confidentiality of information acquired in the course of duties. He shall not disclose any such information to third parties without authority from his clients unless there is a legal

or professional right or duty to disclose. He shall not use information obtained for his own personal advantage;

- (b) Direct his affairs with courtesy and excellent inter-personal relationship;
- (c) Execute his professional cores with thoroughness, skillfully and due diligence. He shall comply with all the relevant laws and regulations. He shall avoid all acts which can discredit the profession;
- (d) Uphold objectivity and firmness of purpose in the discharge of his professional duties. A professional accountant shall not be biased, allow conflict of interest to take over his business judgments; and
- (e) Display competence and due care in all works executed.

The public interest is the collective welfare of the people and entities which the professional accountant serves. It cannot be compromised.

An outstanding touch of a profession is acceptance of its responsibility to the members of the public which include employers, investors, business and financial community, and those who rely on the objectivity and reputation of professional accountants. The reliance thrusts public interest and responsibility on the profession of accountancy.

There are other ethical standards which are stipulated in the Code of The Institute of Chartered Accountants of Nigeria, captioned 'Statements.' They provide more information on what is expected of members in some respects. Most of the Statements refer to those in practice and employees of practicing firms. The other standards which are available only under the Statements are 'Independence' and 'Confidentiality.'

Table 1: Analysis of the Statements of Ethical Standards issued by The Institute of Chartered Accountants of Nigeria

Number	Subject Matter (sic)	Those to whom Applicable
1.	Integrity, Objectivity and Independence	All Members
	Preface – Integrity, Objectivity, Framework etc Introduction – Safeguarding Objectivity Section A –Objectivity and Independence and the Audit	All Members, Practicing Members, Affiliates and Employees of Practicing Firms
	Section B-Objectivity and Independence in Financial Reporting and similar Non-Audit Roles	Practicing Members, Affiliates and Employees of Practicing Firms
	Section C-Objectivity and Independence in	Practicing Members,

Number	Subject Matter (sic)	Those to whom Applicable
2.	Professional Roles other than covered in Section A and B	Affiliates and Employees of Practicing Firms.
	Section D-Definitions	All Members
	Conflicts of Interest	Practicing Members, Affiliates and Employees of Practicing Firms
3.	Confidentiality	All Members
4.	Changes in a Professional Appointment	Practicing Accountants, Affiliates and Employees of Practicing Firms
5.	Consultancy	Practicing Members, Affiliates and Employees of Practicing Firms
6.	Associations with Non-Members	Practicing Members, Affiliates and Employees of Practicing Firms
7.	Fees	Practicing Members, Affiliates and Employees of Practicing Firms
8.	Obtaining Professional Work	Practicing Members, Affiliates and Employees of Practicing Firms
9.	Names and Letterheads of Practicing Firms	Practicing Members, Affiliates and Employees of Practicing Firms
10.	Second and Other Opinions	All Members
11.	Members in Business	Members in Business
12.	Enforcement of Ethical Standards	All Members

No doubt, professional accountants encounter everyday dilemmas of loyalty, conflicts of value and disagreements about their roles and responsibilities in the society. There are no absolute rules on conduct for professional accountants which will assist them to provide automatic and precise solutions to all situations of dilemmas. Nevertheless, appropriately identifying moral conflicts, mulling over them and using the tools of ethical analyses as prescribed in the Code are invaluable. It is therefore up to the accountant to decide what is right and appropriate in any circumstance.

Statement No. 1 titled 'Integrity', 'Objective' and 'Independence' offers more explanations and represents the topics which have already been discussed under the Fundamental Principles, by way of reinforcement. 'Independence'

resembles a deontological principle - the issue of obligation or duty. The principle of objectivity evokes the challenge to be impartial, to display intellectual integrity in reporting and which is devoid of conflicts of interest. In order to safeguard independence, there has to be preclusion of relationships which may hinder objectivity in rendering services of attestation.

6.5 THE FOUNDATION OF THE ACCOUNTING PROFESSION

The accountant holds a fiduciary position; he is an agent of his employers or clients. The foundation of the profession therefore is trust. Shareholders base their assessment of the financial reality and performance of their company on the report of the external auditors. Potentials investors also would rely on the reports of auditors to make huge investment decisions. In all of these, for the accountant to enjoy continuous confidence and trust, he must at all time maintain high ethical standard in his job.

Suffice it therefore to say that, the value of the accounting profession can only be main through a sound understanding and application of ethical principles.

6.6 ETHICS AND THE PROFESSION

A profession is not a mere **vocation** or occupation. It is a specialized area of training, skills acquisition and knowledge attainment which makes a person an expert in the field. The characteristics of a profession include the following:

- (a) Having to undergo an educational process where discrete and edifying body of knowledge is acquired, most of the time with having to pass examinations;
- (b) The need to be a member of a professional association and licensed to practice;
- (c) The profession should have a code of ethics and a set of technical standards; and
- (d) The profession owes the larger society a lot of social and moral obligations.

6.6.1 Ethics and the Professional Accountant

In the performance of his professional duties, a chartered accountant should comply with the ethical stipulations of the Institute of Chartered Accountants of Nigeria and those of International Federation of Accountants. A serious issue of reference is the International Standard on Auditing No. 200 which carries the title “**Objectives and General Principles of Audit**”. It stipulates that “in the conduct of any audit of financial statements, auditors should comply with the ethical guidance issued by their relevant professional bodies.”

The moral dictates which cover the professional responsibilities of auditors apply with equal force and effect to every chartered accountant in every sphere of non-audit duties. The International Federation of Accountants has its own Code of Ethics for professional accountants. The Institute of Chartered Accountants of Nigeria is a member of the International Federation of Accountants (IFAC). There is a Code of professional Conduct of Members which ICAN issued and which borrows freely from and agrees with the guidelines of International Federation of Accountants (IFAC). Some of the ethical standards are unwritten. Paragraph 5 of the Introduction to ICAN's Code states **that** "the guidance on professional conduct is not exhaustive". Members are, therefore, admonished to "be guided not merely by the terms, but also by the spirit of this Guide and the fact that a particular conduct does not appear among a list of examples does not prevent it from amounting to misconduct." **In addition**, paragraph 20 of the same section of the Code states that "a member who is in doubt as to his or her ethical position in any matter may seek the advice of the Institute through the Registrar/Chief Executive."

6.7 ACCOUNTANTS AND THEIR STAKEHOLDERS

6.7.1 The Stakeholders of Accountants

A stakeholder, in business is any person or group that has a stake in an organisation. A stakeholder can also be described as any person or group of persons that may be affected by the action or inaction of any other person or group of persons.

The stakeholders of Accountants are the users of the information which they generate and on which the public rely. Some of the stakeholders to the accounting profession include:

- (a) The general public
- (b) Shareholders- potential and existing
- (c) Government at various levels
- (d) Creditors
- (e) Debtors
- (f) Employees
- (g) Management
- (h) The international community
- (i) Donor agencies
- (j) Multilateral institutions
- (k) The institute
- (l) Regulatory authorities

The stakeholders and their interest areas include the following:

- (a) Government requires and uses accounting information as a score sheet for stewardship, decision making and performance control;
- (b) Employees would like to know the profitability, solvency and liquidity positions of their establishments, including companies, to confirm stability of tenure, promotion prospects and the possibility of continued supply of recreational facilities. The knowledge of the above stated is available only from accounting information;
- (c) Employers are interested in accounting information to ascertain the profits made, compare yearly figures and take decisions on the scale of operations;
- (d) Existing investors are anxious to know whether funds placed in the business of a company will continue to earn reasonable return or be divested. Only the company's year-end accounting information can produce the answer;
- (e) New investors display the rationality of putting their money in viable, profitable and liquidity sound ventures only. Accounting information can be revealing of the indicators of performance;
- (f) Banks, creditors and lenders will not grant credit to poorly performing entities and those whose performance indices point to adverse fortune and inability to repay loans, service charges, etc.;
- (g) Companies within the same industry are interested in comparing the performance of firms so as to draw average ratios as benchmarks. The raw data used is the accounting information in the audited financial statements of such business; and
- (h) Statisticians and financial journalists compute many accounting ratios from the audited financial statements of companies. They are the human storages of accounting data from which the public and international agencies seek information.

6.8 INTERESTS OF STAKEHOLDERS AND CONFLICTS / BEHAVIOUR AND INFLUENCES OF STAKEHOLDERS

Stakeholders' interests are not only many and varied but indeed divergent and in conflict. The following contradictory positions may be examined, thus:

- (a) Employees of an organisation expect the highest possible remuneration and allowances, with excellent industrial relations and well outlined working environment. If workers have their way, they like to pay minimal tax or none at all. Employers, however, only have to implement

the elementary rules of equity and justice in paying a fair salary. This is ethically pitched at a point not as agreed with the employees, but sufficient to sustain the needs of the worker and his family. Workers have to realize that governance attracts the outlay of money, sources of which include raising taxes, levies and duties.

- (b) Government sometimes spends the tax payers' money unwisely. A responsible government is expected to provide hospitals, good roads, well equipped schools, security of lives and property, amongst others. Governments fail to carry the citizenry along, demonstrate fairness, probity and accountability. On the contrary, the leadership and its tentacles are pursuing selfish and conflicting interests by plundering the Nation's **treasury**.
- (c) It is often erroneously held that the shareholders 'own' the companies. The indication here is that the right to an asset confers unlimited control by the owner. In the face of the law, the view expressed above is valid in certain legal systems. However, from the moral point of consideration and reason, nobody has such a right. Indeed, it is held that a person who wantonly discards anything for the simple reason that the individual does not have further use for it, forgetting that, in creation, the undermined thing can be very useful to other fellow beings, has not acted rightly. The person who destroys recklessly is acting contrary to nature's design because of his conflicting interest.
- (d) **Many board members and top management staff** do not appear to be pursuing the goals and aspirations of the companies which they purport to be there for. Quite a number of them award contracts to themselves, using the names and particulars of companies which do not exist in the books of the Corporate Affairs Commission (**CAC**). The **conflict** of interests sometimes drives them to 'empire build' their corporate organisations. The directors or managers enter new businesses and bring in more employees so as to boost their ego and pay, on the ground that there is increase in the size of the companies.
- (e) Suppliers and creditors sell on credit with a view to having the indebtedness settled as early as possible or as agreed with the vendee companies. However, some insolvent companies which are pressed for cash unethically treat their suppliers and creditors. They buy on credit and sell off immediately at a loss. Such insolvent companies thus obtain the much needed cash so as to stave off much pressing demands. The suppliers and creditors would have unknowingly joined the league of organisations which the insolvent companies might not be able to pay.

6.9 PROFESSIONAL CONDUCT AND THE PUBLIC INTEREST

Professional conduct of accountants and public interest are closely connected such that one can have impact on the other. The chartered accountant must realise that unethical practices or any form of professional misconduct would jeopardize some or all the interest of the society which he is supposed to protect as a professional.

The primary concern should be to ensure that the interests of the public are protected and maximised, by carrying out their assignments in accordance with laid down rules and procedures and in compliance with relevant ethical standards.

6.10 PROFESSIONAL BEHAVIOUR AND INFLUENCE OF STAKEHOLDERS

Each stakeholder has a peculiar interest and stake in a business or organisation which often time conflict. Each of them is therefore affected by every decision, actions or conducts of a professional accountant. On the other hand, only few stakeholders can influence directly the professional behaviour of the accountants. These stakeholders are:

- (a) The Management
- (b) The Board
- (c) Major or powerful shareholders

The Management is the direct employer of the accountant and hence, gives instructions and directives to the accountant. In other instances, the accountant might be part of the management.

The Board and the shareholder express their interest and seek to actualise them through the management. In addition to actualising the interests and desires of the Board and shareholders, management may on their part have interests which may conflict with good professional behaviour of the accountant. For instance, much executive compensation is tied to specific performance parameter. As a result, management might be under pressure to achieve these parameters and thereby require an unethical conduct from the accountant. It is in the best interest of the accountant to develop ethical courage to resist such pressures.

Board members often times are shareholders and management. In this instance, they wield much influence or pressure both as management and shareholders. As shareholders, their primary interest would be to see their share values constantly appreciate. And as management, their interest would be to declare fantastic result in order to attain the necessary performance parameter which would guarantee them of an end of the year bonus.

Powerful Shareholders are only concerned with maximising their share values and as such can have significant influence on the accountants. The accountants are pressurised to achieve a predetermined result.

6.10.1 Dilemma

The Chambers Universal Learners Dictionary defines dilemma as “a position or situation giving a choice of two courses of action, usually both equally unpleasant.” Both can also be equally pleasant. In ethics, the word may be defined as “a situation in which all the available courses of action appear to include morally undesirable as well as morally desirable aspects.” A situation of dilemma carries the risk of being wrong, on one hand, and the glamour of being right, on the other hand, with the potentiality of making it or paying for it.

Ethical dilemmas tend towards uncertainty. Guidance may be rare to obtain when duties and rights conflict with each other. Nonetheless, honest and down-to-earth discussion on accounting ethics can be useful.

The nature of ethics and its framework for accountants would have to do with the business and professional way, practically, rather than the theoretical or philosophical outlook. To an accountant, therefore, ethics provokes his thoughts towards examining his personal values vis-avis those embodied in his professional activities.

ILLUSTRATION 6-2

In an organisation in which you are the internal auditor, sales promotion activities are done twice in a year. You are not comfortable with the little or no impact which the advertisement is making. To worsen the situation, grapevine says that the managing director’s wife is one of the distributors of the organisation’s product, who collects 30% trade discount. Would you inform the independent auditor about this?

SUGGESTED SOLUTION 6-2

This is an ethical dilemma. Loyalty to the company through the managing director and the need to uphold utilitarianism – the spirit of working towards the maximisation of ‘right’ or ‘good’ over ‘wrong’ or ‘bad’ – tower over emotional considerations. The two positions are in conflict. The issue poses a dilemma. It is recommended that the internal auditor who is presumed to be an accountant should seek counsel from The Institute of Chartered Accountants of Nigeria, before taking any step, so as not to impugn the integrity of the profession.

6.11 THEORY OF MORAL DEVELOPMENT

Moral development has been an issue of research interest in education and psychology for more than sixty years. Theory of moral development purposes to educate candidates on how people develop their moral values. Otherwise known as the cognitive moral development process, it describes the stages through which people progress in their development of moral thought. The process has been found to be a crucial element in ethical decision making process. The psychologist, Lawrence Kohlberg developed the six-stage model.

6.11.1 Kohlberg's Stages of Moral Development

Kohlberg (1969) proposed that moral reasoning is a direct result of an individual's progress through a series of six stages of moral development that are nested within three overarching levels: the pre-convention level, the convention level and the post-convention level.

(a) Level 1: Pre-conventional Morality

Stage 1: Obedience and Punishment

This is the earliest stage of moral development which is especially common in young children, although adults are not immune to the expression of this type of reasoning. At this stage, children perceive rules as immutable, fixed and absolute. They believe that obeying the rules is crucial as it is the only way by which punishment can be avoided.

Stage 2: Individualism and Exchange

At this moral development stage, children manifest individual points of consideration. They judge actions and return on how they meet individual needs. For example, in the Heinz dilemma, children held fervently that the most reasoned point of action was whichever best served the needs of Heinz. They further held that reciprocity has a place however only if it serves one's own interests.

(b) Level 2: Conventional Morality

Stage 3: Interpersonal Relationships

This is often referred to as the "good boy - good girl" orientation. The moral development stage focuses on living up to roles and social expectations, most especially as "persons to count on." Emphasis is on conformity, being 'nice.'

Stage 4: Maintaining Social Order

At this level of moral development, when making judgments people start to see the society as a whole. What engrosses the mind is the maintenance of law and order by obeying rules regulations and giving respect to constituted authorities.

(c) Level 3: Post-conventional Morality**Stage 5 – Social Contract and Individual Rights**

At this stage, people start to harmonise each other's differing standards, values, and opinions. Under post conventional morality, right actions are defined in the realm of general individual rights and standards which have survived the scrutiny of the whole society.

The right is an issue of personal 'values' and 'opinion,' apart from what is democratically and constitutionally agreed upon. Consequently, emphasis shifts upon the 'legal point of view,' although with possibility of changing law in terms of reasonable considerations of social utility.

Stage 6: The Universal Ethical Principle Orientation

Right is interpreted by the decision of conscience. This is in accord with chosen ethical principles by individuals. The principles should be comprehensive logically, universal and consistent. They are abstract and ethical (the Golden Rule). They are issues of justice, reciprocity and human rights equality.

6.11.2 Kohlberg's Theory of Moral Development has met with criticisms, as follows:

- (a) Moral reasoning does not necessarily lead to moral behaviour. The theory focuses moral things, whereas there is marked difference between knowing what should be done and actual actions.
- (b) Justice does not appear to be the only aspect of moral reasoning which should be considered. The concept appears to over-emphasise the idea of justice when considering moral choices. Experts counter that other issues such as caring, compassion and other interpersonal dispositions play a significant role in moral reasoning.
- (c) Individualistic cultures tend to emphasise personal rights as against collectivistic cultures which emphasise the importance of community and society. For example, Eastern cultures may

portray diverse moral perspectives which the theory of Kohlberg does not provide for.

6.12 VIRTUE ETHICS THEORY AND VALUE-BASED EDUCATION

6.12.1 Virtue Ethics Theory

To the ancient Greeks, if one were virtuous, one would be seen as somebody who managed his or her skills and opportunities well. Being virtuous is synonymous with acting with excellence. Aristotle believes that virtue is the difference between doing something and doing it well. According to Aristotle everything on this mortal earth has its own virtue, provided it performs the way it is supposed to by its nature. What is being explicitly stated here is that virtue is not reserved for human beings. To buttress the reasoning here, everything which is in existence, including human being, has a purpose. For example, a knife has a purpose and that is to cut well.

6.12.2 Value-Based Education

There is the need for concern for personal, spiritual and moral values. For many years, the countries of the world have striven for value systems so that people could live together as members of the same family. The biblical Ten Commandments and the Golden Rule are examples of such value systems. Through everyday education, pupils should have solid and enduring foundation of sound values so that they would act correctly and choose between what is right and wrong, true and untrue.

Car and Wellenberg (1966) suggest that education, practical and theoretical, on what constitutes 'value' can be imparted by the teacher in the following ways:

- (a) Assisting students to acquire understanding of the importance of values which society appreciates as worthwhile;
- (b) Assisting pupils to sustain and utilize positive values when confronted by challenges from their colleagues;
- (c) Teaching that people should be good example;
- (d) Showing young individuals how to reach conclusions or generalisations on issues of everyday experience, by means of evaluations and expression of desirable personal values; and
- (e) Helping young people to assess the situations of conflict so as to develop constructive value and attitudes.

6.13 ETHICS AND CULTURE / EFFECTS OF CULTURE ON ETHICAL ISSUES

The main thrust of ethics is the appreciation and study of “right and wrong” or “good and evil” in the affairs of man. Philosophers have, over time, sought to measure goodness in character or conduct. Two principles or approaches are employed. Either they are found to be good in themselves or good because they are in agreement with a particular moral index.

The term ‘ethics’ is sometimes used to describe issues on science, religion, arts and cultural priorities. Historically, ethics has three principal canons of conduct. Each of them has been proposed as the highest good possible. These are ‘happiness or pleasure,’ ‘duty,’ virtue or obligation,’ the fullest harmonious development of human potential otherwise known as ‘perfection.’ Much depends on the social setting.

Geert Hofstede (1980) defines culture as the “software of the mind”. It is a collective **phenomenon** which is shared with the people who are in the same social environment. Culture is the collective orientation of the mind which distinguishes the members of one social group or category of people from another. The word ‘culture’ embraces the society’s intuitions, family patterns, legal system, etc. Culture can also be seen as the interactive summation of common characteristics which pre-dispose a human group’s response to the environment in which it is.

The core of culture rests in values. The word ‘values’ **is** the basic convictions which people have as regards ‘right’ and ‘wrong’ ‘good’ and ‘bad.’ Values are among the immediate things which children learn, implicitly. Culture is a stage in civilization which has connection with tastes in art, manners and societal norms and conventions. Civilization on its own derives from societal perception and human interrelationship which have developed, based on a particular culture. Thus, there can be feudal culture and ancient civilization, modern civilization and scientific culture.

Ethics and culture are interwoven and are continually changing. One unsavoury development is that when cultural values decline, ethical values tend to be eroded, with equal force and effect. In Nigeria, the payment of ‘dowry’ (which, according to Chambers Universal Learners Dictionary, is the “money and property brought by a women to her husband when they marry”) is done by the husband to the woman that he is having as a wife, there is, therefore, a shift from the Western world perception of the idea of dowry. In the advanced societies of gender equality, the concept of dowry payments is ‘dead’ whereas in many Nigerian families, the culture is still very much alive. The conclusion can, therefore, be made that the older stranglehold of culture does not loosen grip easily in some societies.

6.14 PROFESSIONAL VALUES, ETHICS, ATTITUDE AND CODE OF CONDUCT FOR ACCOUNTANTS

The level of ethical principles that an accountant knows and complies with determines his professional values and not necessarily his technical skills.

Attitude is our disposition, perspective, viewpoint, or outlook. It is how we view the world. The level of an accountant's professional values determines his attitude. Attitude they say is everything, and one's perceived level of maturity is based on your attitude. A change in attitude is the key to success. Nothing is more important: not education, aptitude, health, wealth or opportunity. Great men and women share this opinion. For example, Thomas Jefferson wrote "Nothing can stop the man with the right mental attitude from achieving his goal; nothing on earth can help the man with the wrong mental attitude."

Accountants must be confident and not arrogant, while arrogance demonstrates ignorance confidence depicts competence.

The code of conduct is the codification of the ethical principles, values, beliefs and theories into a document which is referred when with challenges and serves as a reference guide to determine the appropriateness or otherwise of an action.

Code of conduct is a document published by a government agency, professional body, trade association etc outlining model procedures for good practice in a particular field. It gives examples of excellent and bad behaviour, and recommendations regarding how things should be done. The obvious advantage of code of conduct is that it provides guidance to people who genuinely want to behave properly but who do not know what they should do in order to achieve this aim. The code also contains practical guidance on formulating, implementing and monitoring equal opportunity policies. It is the same thing as staff handbook.

A code of ethics on the other hand is a formal statement that acts as a guide for how people within a particular organisation should act and make decisions in an ethical fashion. Codes of ethics commonly address issues such as conflict of interest, behaviour toward competitors, privacy of information, gift giving, and making and receiving political contributions.

As a professional accountant, you have the primary responsibility to comply with the institutes' code of conduct. You are also encouraged to visit www.ifac.org to download a copy of IFAC's code of conduct.

6.15 IMPORTANCE OF ETHICAL COURAGE AND ETHICAL LEADERSHIP

To be courageous means to be brave, it is the quality of not giving way to fear even when faced with danger. Courage is required for every professional accountant that wishes to be ethical, to apply his knowledge in ethics. No wonder that Theodore. Roosevelt, a past President of the United States of America once stated:

The law of worthy life is fundamentally the law of strife. It is by grim struggle and resolute courage that we move on to better things.

A Nation without ethical, courageous and effective leadership is a rudderless ship which will capsize in the 'rough and tumble' of human life and governance.

According to Koontz, O' Donnel and Weihrich (1980), 'leadership' is the influence or the art or process of influencing people so that they strive willingly and enthusiastically towards the achievement of group goals.

An ethical leader can simply be regarded as a virtuous leader; he operates with high ethical standards and pursues the good for the benefit of the society. He is a person of honesty, integrity and trust. The ethical leader is mindful that the needs and realistic expectations of others in the society must be satisfied if his own needs and realistic expectations are to be met.

An ethical leader, is one who understands his responsibilities, duties and rights and those of others and hence he seeks ways to uphold them. Such a leader is committed to upholding the social contract that guides the co-existence of all citizens.

An ethical leader therefore would influence people ethically to willingly and enthusiastically strive towards the achievement of ethical group goals. Every accountant occupies a reasonable position of authority and can indeed influence people ethically. And therefore must courageously disassociate himself actively and passively from every form or unethical practice.

6.16 SUMMARY AND CONCLUSIONS

The chapter examines the concept of ethics, nature and framework for professional accountants, "rules-based"/ "principles-based" approaches to ethical behaviour. Among others, it also discusses the foundation of the accounting profession, accountants and their stakeholders and theories of moral behaviour.

Refer to Comprehensive Questions and Suggested Solutions in Appendix II, page 269.

6.17 REVISION QUESTIONS**6.17.1 MULTIPLE-CHOICE QUESTIONS**

1. Ethics is a science of
 - A. morals.
 - B. physiology.
 - C. philosophy.
 - D. psychology.
 - E. religion.

2. Which of the following best describes 'accounting'?
 - I. Recording, classifying and summarizing transactions
 - II. Identifying, measuring and communicating financial information
 - III. Extracting trial balance.
 - A. (i)
 - B. (ii)
 - C. (iii)
 - D. (i) and (ii)
 - E. (ii) and (iii).

3. The Virtue Ethics Theory was propounded by
 - A. Hegel.
 - B. Socrates.
 - C. Immanuel Kant.
 - D. Plato.
 - E. Aristotle.

4. Where a member is found guilty by the ICAN disciplinary tribunal, he may face one or more of the following sanctions, EXCEPT
 - A. Suspension or total expulsion from membership
 - B. Prosecution in a court of law
 - C. If in practice, withdrawal of rights
 - D. Reprimand
 - E. Payment of fine.

5. The ethical approach which is concerned with the issue of obligation or duty is
 - A. Utilitarianism.
 - B. Teleology.
 - C. Deontology.
 - D. Dilemma.
 - E. Ethical Balance.

6.17.2 SHORT ANSWER QUESTIONS

1. As a means of resolving the problem of ethical requirements, The Institute of Chartered Accountants issued for its members a.....

2. W. Michael Hoffman states that "the ethical thing to do is not always in the best interest of the....."

3. According to Section 12(5) of the ICAN Act, a member has a right to proceed from the disciplinary tribunal to

4. Under the statement of ethical standards issued by ICAN, who shall respect the 'confidentiality' of clients?
5. To what doctrine is the early Christianity of 'ology' associated?

Refer to Suggested Solutions in Appendix I, Page 263.

THE ENVIRONMENT: CORPORATE, PROFESSIONAL AND REGULATORY

7.0 LEARNING OBJECTIVES

After studying this chapter, readers will be able to:

- ◆ Evaluate the corporation and its interests as well as professional responsibilities;
- ◆ Explain the concept, origin, problems of accountability and the roles of accountants in the global context;
- ◆ Describe the legal framework for businesses and accountants; and
- ◆ Explain professional (statement of accounting standards) and legal requirements in financial reporting and auditing.

7.1 THE CORPORATION AND ITS INTERESTS AND PROFESSIONAL RESPONSIBILITIES

7.1.1 Introduction

A corporation is an association of natural persons brought together to constitute an artificial legal person and is distinct from the human beings who form its membership at any point in time. A corporation is not a human being. It has a common seal which enables the company or corporation to identify its acts and be answerable for them.

A corporation or company does not die, as it has no soul, unlike the various persons who set it up. It may live forever because it has perpetual succession. There are two forms of corporations. These are:

- (a) Corporate Sole; and
- (b) Corporate Aggregate.

A corporate Sole is one which has only one single member at any point in time. The 'association' is successive. Examples of corporate soles are perpetual offices such as Kingship and Bishopric.

A corporate Aggregate, however, is made up of individuals who associate together and who, in the eyes of the law, become one person. Examples are Water Corporation of Oyo State and Lagos State University.

7.1.2 Its Interests and Responsibilities

The business environment perceives the interests of corporations as the various parties whose economic yearnings are affected by the actions and decisions of the firm, corporation or company. The question may be asked, “who are its stakeholders or interests?”. The list of stakeholders appears to be inexhaustible. It includes the government, current and potential investors, the corporation’s employees, suppliers of good and services, customers and financial journalists. The interests of the various stakeholders which become the responsibilities of the corporations may be briefly discussed, as follows:

7.1.3 Government

The corporation is legally obliged to pay necessary tax, duties and tariffs. In addition, government expects the corporation to not only collect withholding tax (WHT) and pay as you earn (PAYE) deductions but also remit them promptly.

7.1.4 Current and Potential Investors

Existing investors are motivated to part with their money in the expectation that the venture is viable and that there will be reasonable return on the capital employed. Potential investors study the performance indices of a company or corporation to enable them to decide whether to invest in its business or not.

7.1.5 Employees

Employees are primarily concerned with the security of tenure and reasonableness of the conditions of service. The secondary considerations may include promotion prospects. Moreover, ethically, employees deserve being treated with respect and concern. They are not just a factor to be exploited, but people with intrinsic value.

7.1.6 Suppliers of Good and Services

The credit worthiness of a body corporate is measured predominantly by its ability to meet short-term obligations of settlement of accounts as they fall due. This assurance is revealed by the profitability and liquidity positions of the company through the operating results and balance sheet.

7.1.7 Financial Journalists

Financial Journalists are researchers and disseminators. Their interests centre on collecting data, analyzing them, making comparisons between companies within the same industry and outside it and making such information available to the members of the public.

7.1.8 Customers

The basic framework should be one of co-operation, quality production of goods or services rather than exploitation, with one's customers. The relationship should be the receipt of reward for the value created for customers. This attitude fits into leading a moral life. It is the responsibility of a company to employ reasonable means at all times to prevent harms from customers in consequence of its own activities.

7.2 HOW A CORPORATION ENTERS CONTRACTUAL OBLIGATIONS

In giving an answer to the above stated poser, it has to be recalled that a company or corporation, not being a human being, has to act through people who, by law or strong tradition, are its agents or accredited representatives. A company's agents that transact business with third parties include the board members and top management, in the ordinary course of events. An agent, according to mercantile law, is a person who has express or implied authority to act on behalf of another person that, on this occasion, is a company. All the legitimate acts performed by the agent, on behalf of the principal, in the course of business, are binding on the latter. The actions taken by the agents should be inviolate and protective from expropriation or 'rip-offs' of the principals or outside investors, by insiders (including corporate board members, management, family interest and/or government).

7.3 THE CONCEPT OF ACCOUNTABILITY

7.3.1 Introduction

'Accountability' means rendering 'stewardship'. It is the act of being able to shoulder responsibilities and carry the correlative burden of performance. The concept of accountability remains constant, whether in the public or private sector. The discharge of accountability rests on natural legal persons (such as human beings) as well as artificial legal persons (such as registered companies and association).

7.3.2 The Origin of Accountability

Accountability must have started with the dawn of man. Thus, Adam and his wife, Eve, were to manage the resources placed in their care in the Garden of Eden. The full account of the biblical story is available in Genesis 2, verses 15 to 25, Genesis 3, verses 1 to 13. The couple failed

the accountability test as they could not satisfactorily explain to God Almighty why they ate the forbidden fruit. Another scriptural example is available in the Matthew's Gospel, Chapter 25, verses 14 to 30, touching on the parable of the three servants. The master who was going on a journey left the management of his property with his three servants. The master gave to the servants according to the ability of each of them. He gave five (5) talents to the first servant, two (2) talents to the second person and only one (1) to the third person.

Upon the arrival of the master, he took accountability of the three (3) servants. The first servant was able to make available ten (10) talents against the five (5) which he originally received. The second servant doubled the initial capital of two (2) talents which he received, to make it four (4). The master commended the first two servants for making efficient and effective use of the resources given to them. The master stated to them in St. Matthew's Gospel chapter 25, *"you have been faithful in managing small amounts, so I will put you in charge of large amounts. Come on in and share my happiness."* (emphasis mine)

The third servant who was given only one (1) talent was not an enterprising fellow. He angrily buried the talent while the master was away. Confronting his master, the servant remarked, *"I know you are a difficult man; you reap harvests where you did not sow, Look, here is your talent."* The master retorted, *"as for this useless servant – throw him outside in the darkness; there he will be weeping and gnashing teeth."* (emphasis mine).

7.3.3 The Problems of Accountability

People do not like to be held accountable because they revel in frauds and other forms of mal-practices. Fraud, according to the Auditing Practice Committee of Accountancy Bodies in the United Kingdom, is the "use of deception to obtain an unjust or illegal financial advantage and /or theft, whether or not accompanied by mis-statement of accounting records or the accounts."

A malpractice, on the other hand, is "unprofessional or improper conduct which may or may not involve the use of deception with a view to making unlawful gain." Malpractices are, therefore, part of fraudulent actions. Examples of the vices are:

(a) **Tax and Revenue Frauds**

It has been seriously alleged that some federal revenue generating agencies are understating their returns to the Federal Account.

(b) **Insider Dealings**

In some corporations, the highly placed members of management form businesses that receive goods as wholesalers at or below cost, thereby crippling the economy of the establishments concerned.

(c) **Advance Fee Frauds (AFF)**

The expression AFF describes fraud cases in which criminal fraudsters convince a victim that he has won a prize, been selected for either a business deal or political appointment with easy money to be gained and the only condition to obtain the gain is that the victim has to pay a small amount of money in advance for further details. When the victim pays the fee, it will not bring him closer to receiving the gain.

(d) **Professional Competence and Due Care**

Maintenance of professional knowledge and skills at the level expected of an accountant so as to ensure that a client or employer obtains competent and optimal services, based on current thinking, legislation and techniques. The professional accountant should act diligently and in consonance with applicable technical and professional standards.

(e) **Confidentiality**

A professional accountant should preserve the confidentiality of information which he acquires, resulting from all forms of business and professional relationships. He should not disclose any such information to third parties without specific and proper authority, unless there is a legal or professional right or obligation to behave otherwise, and neither should he use the information for his personal advantage or that of third parties.

7.4 THE ROLE OF THE ACCOUNTANT IN THE GLOBALIZATION CONTEXT

The role of the accountant in the globalization of knowledge and practice includes his adherence to the professional pronouncements of the Federation of Accountants, and International Financial Reporting Standards. He should be physically and mentally alert to contribute to the pool of knowledge nationally and internationally. Conclusively, understanding what constitute the public interests or expectations and knowing how to skillfully and professionally carry out one's duties is fundamental to the practice of accounting.

A professional accountant should exhibit independence of mind and appearance. The former attribute indicates the freedom of mind in the expression of a conclusion, without being affected by influences which compromise professional stand point, thereby assisting an individual to perform with integrity and uphold objectivity and professional skepticism, “Independence in appearance” addresses the avoidance of circumstances and facts which are so significant that a well informed and reasonable third party would likely conclude, having regard to the logic and reality of the situation, that a firm’s, or a member of the audit team’s integrity, objectivity or professional skepticism has been compromised.

The consequences of failure to recognize the privacy of serving public interests by professional accountants are severe. The credibility and existence of the profession are threatened by the complicity of accountants in the collapse of corporate governance and accounts manipulation, such as have been recorded against Arthur Andersen in the scandal and censorship of Enron Corporation in the United States of America.

7.5 THE LEGAL FRAMEWORK FOR BUSINESSES AND ACCOUNTANTS

The legal Framework for businesses and accountants is rooted in the Companies and Allied Matters Act, Cap. C20, Laws of the Federation of Nigeria 2004, and may be briefly discussed, as follows:

7.5.1 Incorporation of Companies

Provisions of the Act state, as follows:

- (a) Any two (2) or more persons may form and incorporate a company;
- (b) Any company, association, or partnership consisting of more than twenty (20) persons shall be registered as a company under the Act;
- (c) Provision above does not apply to:
 - (i) A cooperative society; and
 - (ii) A partnership for legal practice and chartered accountancy.

If the number of members exceeds twenty (20) and they carry on business for more than fourteen (14) days, every person shall be liable to a fine of ₦25 for every day of default.

- (d) An individual **shall not** join in the formation of a company if he is:
 - (i) Less than 18 years of age (unless two other persons who are 18 years and above have subscribed to the memorandum);
 - (ii) Of unsound mind by a court;
 - (iii) An undischarged bankrupt;
 - (iv) Disqualified from being a director of a company.

- (e) A corporate body in liquidation shall join in the formation of a company.

7.5.2 Types of Companies

The types of companies in existence are:

- (a) A company limited by shares: Members' liability is limited to the amount unpaid on the shares held by him/her;
- (b) A company limited by guarantee: This is the amount undertaken by a member to contribute in the event of winding up company;
- (c) An unlimited company is one which does not have any limit on the liability of its members;
- (d) A private company limited by share has the word 'limited' or 'Ltd' at the end of its name;
- (e) A public company limited by share has the description 'public limited company' or 'PLC' after its name.

Private Company

A private company has the following descriptions:

- (a) Stated in its memorandum to be a private company;
- (b) Restricts the transfer of its shares;
- (c) The total number of members shall not exceed fifty (50);
- (d) It shall not invite members of the public to subscribe for any shares or debentures or deposit money for fixed period or payable at call.

Public Company

Public company shall state in its memorandum of association that it is a public company.

Unlimited Company

An Unlimited Company shall be registered with a share capital.

Company Limited by Guarantee

A Company limited by guarantee has the following features:

- (a) It is formed for promoting commerce, art, science, religion, sports, culture, education, research and charity;
- (b) It shall not be registered with a share capital; and
- (c) Total liability of members in the event of its being wound up shall not be less than ₦10,000

7.5.3 Incorporation

The following documents are to be presented to the Corporate Affairs Commission for the purpose of incorporation of a company:

- (a) Memorandum and Articles of Association;
- (b) Statement of Authorized Share Capital - (2 forms) (the 'a & b') should bear the appropriate amount of stamp duty. This can be paid for, at the Federal Ministry of Finance and Economic Development Stamp Duty Office in any State of the Federation;
- (c) Other forms to be filed along with the Memorandum and Articles of Association are:
 - (i) CAC 1: Availability of name;
 - (ii) CAC 2: Allotment of shares;
 - (iii) CAC 3: Particulars of registered office;
 - (iv) CAC 4: Compliance with CAMA requirements;
 - (v) CAC 7: Particulars of directors; and
 - (vi) CAC 7A: Particulars of secretary.

The above, together with the written consent of the minimum number of directors and the appropriate amount of fees payable.

7.5.4 Registration of Specialised Companies / Business Names /Professions

Applications for incorporation / registration of companies or business names to carry on certain business must be supported with the evidence of capability.

Some of the businesses or professions affected are:

- (a) Medical or hospital, pharmaceutical;
- (b) Engineering and related professions; and
- (c) Accountancy, architecture and law.

Applications are required to be accompanied with a photocopy of the certificate of one of the directors in the field.

7.5.5 Memorandum of Association

It shall state:

- (a) Name of the company;
- (b) Registered office situated in Nigeria;
- (c) The name of the business;
- (d) Restriction on the powers of the company;
- (e) That the company is a private or public company;
- (f) That the liability of its members is limited by shares or by guarantee or is unlimited; and

- (g) The amount of authorized share capital, not less than ₦10,000 for a private company and ₦50,000 for a public company.

7.5.6 Articles of Association

These are articles for regulating companies' activities. The articles shall:

- (a) State the number of members;
- (b) Be printed;
- (c) Be signed by each subscriber; and
- (d) Bear the same stamp duty.

7.5.7 Registration of Companies (Section 35)

Upon registration of the Memorandum and Articles of Association, the Commission shall certify under the seal:

- (a) That the company is incorporated;
- (b) That the liability of the members is limited by shares or guarantee in the case of a limited company;
- (c) That the liability of the members is unlimited, in the case of an unlimited company;
- (d) That the company is a private or public company.

The certificate of incorporation is a prima facie evidence that all requirements of the Act have been complied with and that the association is a company authorized to be registered and is so duly registered under the Act.

7.5.8 Capacity and powers of Companies (Section 38)

Except to the extent that a company's memorandum or any enactment otherwise provides, every company shall, for the furtherance of its authorized business or objects, have all the powers of a natural person of full capacity.

7.5.9 Effect of Memorandum and Articles (Section 41)

The Memorandum and Articles, when registered, shall have the effect of a contract under seal between the company and its members and officers, and between the members and officers themselves whereby they agree to observe and perform the provisions of the memorandum and articles.

7.5.10 Conversion and Re-registration of Companies (Section 50)

A private company having a share capital may be re-registered as a public company if:

- (a) A special resolution that it should be so re-registered is passed; and

- (b) A statement in the company's memorandum, that the company is to be a public company.

The application shall be made to the Commission in the prescribed form and be signed by at least one director and the secretary of the company, with the following documents:

- (a) A printed copy of the memorandum and articles;
- (b) A copy of a written statement by the directors and the secretary certified that the paid up capital of the company is not less than 25% of the authorized share capital as at that date;
- (c) A copy of the balance sheet of the company as at the date of the resolution or the preceding six months, whichever is later;
- (d) A statutory declaration by a director and the secretary, that the special resolution required has been passed and that the company's net assets are not less than the aggregate of the paid up share capital and undistributed reserves; and
- (e) A copy of any prospectus or statement in lieu of prospectus delivered within the preceding 12 months to the Securities and Exchange Commission.

It is not possible that a company which is registered as limited by shares may be re-registered as unlimited.

A company which is registered as unlimited may be re-registered as limited by shares if a special resolution is passed.

Foreign Companies (Section 54)

Every foreign company which before or after the commencement of the Act was incorporated outside Nigeria and having the intention of carrying on business in Nigeria shall take necessary steps to obtain incorporation as a separate entity in Nigeria.

Penalty for non-compliance is ₦2,500 and every officer shall be liable to ₦250 and a further fine of ₦25 for every day thereafter.

Power to exempt foreign companies (Section 56)

A foreign company may apply to the National Council of Members for exemption if:

- (a) The foreign company is invited to Nigeria by or with the approval of the Federal Government to execute any specified individual project;
- (b) The foreign company is in Nigeria for the execution of specific individual loan project on behalf of a donor country or international organisation;

- (c) It is a foreign government – owned company engaged solely in export promotion activities; and
- (d) Engineering consultants and technical experts engaged on any individual specialist project under contract with any of the governments in the Federation, agencies or body approved by the Federal Government. Any person who is guilty of an offence under this section shall be liable on conviction to a fine of ₦5,000 or imprisonment for a term of three years.

7.5.11 Promoters (Sections 61 and 62)

Any person who undertakes to take part in forming a company with references to a given project and so set it going and who takes the necessary steps to accomplish that purpose, or who, with regard to a proposed or newly formed company, undertakes a part in raising capital for it, shall prima facie be deemed a promoter of the company.

A promoter stands in a fiduciary relationship to the company and shall observe the utmost good faith towards the company in any transaction with it on its behalf and shall compensate the company for any loss suffered by reason of his failure so to do.

7.5.12 Membership of the Company (Sections 79 - 98)

This may be discussed briefly, as follows:

- (a) A member of a company is a person who subscribed to the company's memorandum and agreed to become a member of the company or corporate body who subscribed in writing to the memorandum or agreed in writing to be a member of the company;
- (b) An infant, that is, one under the age of 18 years can be a member of a company, but shall not be counted for the purpose of determining the legal minimum number of the company;
- (c) A corporate body in liquidation shall not be capable of becoming a member of the company; and
- (d) Every company shall keep a register of members, showing the details of names, address and number of shares held by each member.

7.5.13 Share Capital (Sections 99 - 113)

Information about share capital is as follows:

- (a) Minimum authorized share capital is ₦10,000 and ₦500,000 for private and public companies, respectively, out of which a minimum of 25% must be taken up by the subscribers to the memorandum of association;
- (b) Shares can be increased or altered only at a general meeting;

- (c) Notice of increase of authorized share capital shall be given to the Commission within 15 days, after passing the resolution. Penalty for default is ₦50 per day;
- (d) Increase of authorized share capital shall not take effect unless within six months of giving notice of the increase to the commission, 25% of the authorized share capital, including the increase has been issued and the directors have delivered to the commission a statutory declaration verifying same;
- (e) Rights and liabilities attached to the shares of a company shall be dependent on the term of issue and of a company's articles and despite anything contrary, the articles include the right to attend any general meeting and vote at such meeting.
- (f) Returns of allotment of shares are to be within one month of the allotment and liability for default is a fine of ₦50 for every day during which the default continues;
- (g) A company should issue a certificate within two months after allotment or within three months after transfer of shares. A liability for default is ₦50 per day; and
- (h) A company should not give financial assistance for purchase of its own shares; default is a fine not exceeding ₦500.

7.5.14 Debentures (Sections 166 - 210)

Debentures are instruments issued to the company. Each debenture evidences a distinct debt, e.g. of ₦100 each. It is defined by the Act as including 'debenture stock, bonds and any other securities of a company whether constituting a charge on the assets of the company or not' (S. 650(1)).

Types of Debentures (Section 171)

These are:

- (a) Registered Debentures: Payment to the registered holder.
- (b) Bearer Debentures: Payment to bearer. They are negotiable instruments.
- (c) Perpetual Debentures: They are made "irredeemable or redeemable only on the happening of a contingency, however remote, or on the expiration of a period, however long..." (Section 171).
- (d) Convertible Debentures: They are issued "upon the terms that in lieu of redemption or payment..... may be converted into shares of the company....(Section 172).
- (e) Secured and Naked Debentures: A secured debenture is one which is secured by a charge over the company's property and naked debenture on the other hand is one which is not secured by any charge (S. 173).

Creation of Debentures

A debenture may be a simple instrument or by such an instrument covered by a trust deed. Section 168 provides for matters to be included in the statement of the debentures.

Fixed and Floating Charges (Section 178)

A 'floating charge' means an equitable charge over the whole or specified part of company's undertakings and 'assets' including cash and uncalled capital of the company, both present and future.

A 'fixed charge' on any property has priority over a floating charge affecting that property unless otherwise stated.

Power of the Court (Section 180)

Wherever a fixed or floating charge has become enforceable, the Court shall have power to appoint a receiver and in the case of a floating charge, a receiver and manager of the assets subject to the charge.

A receiver or manager shall not be appointed as a means of enforcing debentures not secured by any charge. Where a receiver or a receiver and manager is appointed by the Court, advertisement to this effect is made by the receiver or the receiver and manager in the Gazette and in two daily newspapers.

Debentures Trust Deed (Section 184 (1))

Every Trust Deed, which on its own is both contract and legal document when effected, must state the following matters:

- (a) The maximum sum which the company may raise by issuing debentures of the same class;
- (b) The maximum discount payable;
- (c) The nature of the assets involved;
- (d) The date of payment of interest and of the principal; and
- (e) The circumstances in which the mortgage, charge or security may be realized, etc.

A debentures trust deed, after its preparation, should be submitted for registration and payment of appropriate stamp duty, and thereafter, filed with the Corporate Affairs Commission. Failure to register as required will render it void against the liquidator and any creditor of the company.

Transferability of Debentures (Section 189)

Debentures are transferable, except when there is an express provision in the terms of any debenture restricting its transfer.

Memorandum of Satisfaction (Section 204)

When the debt secured by the charge has been paid, partly or in whole, the Commission may enter on the register a memorandum of satisfaction to that effect.

7.5.15 Meeting and Proceedings of Companies (Section 211 - 243)

The decisions of a company are generally taken at the meetings of its members which constitute primary organ.

Types of Meetings

These may be briefly highlighted, as follows:

(a) Statutory Meeting (Sections 211)

Section 211 provides that every public company shall, within a period of six months from the date of its incorporation, hold a general meeting of the members of the company, known as “the Statutory meeting”. The directors shall, at least twenty- one days before the day on which the statutory meeting is held, forward to every member of the company statutory report.

The statutory report, which shall be certified by not less than two directors or by a directors and the Secretary shall state:

- (i) The total amount of cash received by the company in respect of all the shares allotted, the total number of shares allotted;
- (ii) The names, addresses and descriptions of the directors, auditors, managers and secretary of the company;
- (iii) Particulars of any pre-incorporation contract;
- (iv) Any underwriting contract that has not been carried out and the reason;
- (v) The arrears on calls due from every directors;
- (vi) Particulars of any commission or brokerage paid or to be paid; and
- (vii) Non – compliance with the above shall be an offence and shall attract a fine of ₦50 for every day during which the default continues.

(b) Annual General Meeting (AGM) (Section 213)

This is for both private and public companies.

The first must be held within 18months of the company’s incorporation and not more than 15 months should elapse between the date of one AGM and the next. It is held annually to discuss, amongst others, the following:

- (i) Reports of the directors and auditors,
 - (ii) Presentation of the financial statements of the company,
 - (iii) Declaration of dividend;
 - (iv) Election of directors;
 - (v) Fix the remuneration of the directors.
 - (vi) Increase in share capital, insurance of bonuses or script shares, etc,
 - (vii) Authorise directors to fix remuneration of the auditors;
 - (viii) Appointment of members of the Audit Committee (for only public companies); and
 - (ix) Any other business.
- (c) **Extra Ordinary General Meeting (EGM) (Section 215)**

An EGM is a meeting other than an AGM. Such meetings are usually convened by the Directors. It may be required by members holding not less than one – tenth of the paid up capital of the company to deal with urgent matters which cannot wait till the next AGM.

Meetings of Classes of Shareholders

These are meetings that are regulated by the Act. It has been held that if all the shares of a class of shares are held by one person, he is entitled to do what a meeting of that class could do under the articles.

Place of Meetings (Section 216)

All Statutory and Annual General Meetings must be held in Nigeria.

Notice of General Meetings (Section 217)

Notice required for all types of general meetings is 21 days from the date on which the notice is sent. Notice is to be given to members and must contain the requisite information and sufficient time must be allowed and the notice properly served.

Persons Entitled to Attend and Vote (Section 227)

Every person who is entitled to receive notice as provided in Section 227 is entitled to attend the meeting.

Voting shall be by show of hands, except where a poll is demanded and a member is entitled to appoint a proxy to attend a meeting and vote on his behalf.

A corporation which is a member of the company or 25 members (whichever is less) present in person or by proxy, provided that where the number of members is a multiple of 3, then the number nearest to

one – third, and when the number of members is 6 or less, the quorum shall be 2 members.

7.5.16 Resolutions (Section 233)

There are two types of resolutions. These are ordinary and special resolutions.

Ordinary Resolution (Section 233.1)

An ordinary resolution is one which has been passed by a simple majority of votes cast by such members of the company voting in person or by proxy at a general meeting (Section 233(1)).

Special Resolution (Section 237)

This is a resolution which is passed by a majority of three – fourths of the votes/ proxies of persons present at a general meeting.

Registration and Copies of Resolution (Section 237)

Printed copies of certain resolutions or agreements must be sent to the Commission within 15 days of passing such resolutions for registration.

7.5.17 Directors and Secretaries of a Company (Sections 244 - 298)

Directors (Section 244)

Since a company is an artificial person, its management has to be entrusted to human agents. These are the directors and managers of a company.

Disqualifications for Directorship

The following persons are disqualified from being directors:

- (a) An infant (that is a person below 18 years of age);
- (b) An insolvent person;
- (c) Any fraudulent persons as per section 254 of the Act; or
- (d) A body corporate or a firm, consisting of members each of whom is qualified under (a) to (d) of Section 295.

Removal of Company Secretaries (Section 296)

A company secretary can be removed or suspended by the board in compliance with Section 296 (2) where he is involved in fraud and serious misconduct. However, the board shall report the matter to the next general meeting for ratification.

Duties of a Company Secretary (Section 298)

The duties of a Company Secretary are as follows:

- (a) Attending the meetings of the company, the board of directors and its committees; rendering secretarial services and advising on compliance with the applicable rules and regulations;
- (b) Maintaining the register of members, change of names and other record of meetings, etc. as required by the Act;
- (c) Rendering proper returns and giving notifications to the Corporate Affairs Commission; and
- (d) Carrying out such administrative and secretarial duties as may be required by the directors of the company.

The secretary shall not without the authority of the board exercise any power vested in the directors.

7.6 PROFESSIONAL AND LEGAL REQUIREMENTS IN FINANCIAL REPORTING AND AUDITING

7.6.1 Financial Statements and Audited Books of Accounts

Every company shall keep accounting records which shall sufficiently show and explain the transactions of the company, so as to:

- (a) Disclose with reasonable accuracy at any time the financial position of the company; and
- (b) Enable the directors to ensure that financial statements prepared under this part as to the form and contents comply with the Companies and Allied Matters Act, Cap. C20 LFN, 2004.

The accounting records shall in particular contain:

- (a) Day to day entries of all sums of money received and expended by the company and the matters in respect of which the receipts and expenditure relate; and
- (b) Record of the assets and liabilities of the company.

If the business of the company involves dealing in goods, the accounting records shall contain:

- (a) Statement of stocks held by the company at the end of year of the company;
- (b) All statements of stockings from which any such statement of stock as is mentioned in paragraph (a) of this sub – sections has been or is to be prepared; and
- (c) Except in the case of goods sold by way of ordinary retail statement of all goods sold and purchased, showing the goods, the buyers and sellers in sufficient details to enable all these to be identified.

Financial Statements (Section 334)

Annually, directors shall prepare financial statements, the contents of which, should comply with the requirement of schedule 2 of the Companies and Allied Matters Act, Cap.C20, Laws of the Federation of Nigeria 2004 and Statements of Accounting Standards issued from time to time by the Nigerian Accounting standards Board.

Within 18 months after incorporation, the directors of the company shall file financial statements which include:

- (a) Statement of Accounting Policies;
- (b) Profit and Loss Account or in the case of a company not – for profit, an Income and Expenditure Account for the year;
- (c) Balance Sheet or the year;
- (d) Notes on the Accounts;
- (e) Cash flow statement;
- (f) The auditors' report;
- (g) The directors' report;
- (h) Five-year financial summary; and
- (i) Group financial statements in the case of a holding company.

Private and small companies shall deliver modified financial statements.

The characteristics of a small company in any particular year are:

- (a) It is a private company having a share capital;
- (b) The amount of its turnover is not more than ₦2million or as may be fixed by the Corporate Affairs Commission;
- (c) The net assets value is not more than ₦1million or as may be fixed by the Corporate Affairs Commission;
- (d) None of its members is an alien;
- (e) None of its members is a government or a government corporation or agency or its nominee; and
- (f) The directors, between them, hold not less than 51% of its equity share capital.

The directors shall at the first meeting of the company, determine what date in each year shall Financial statements be made up.

Penalty for Non-Compliance (Section 346)

Every officer of the company who is in default shall be guilty of an offence and be liable to imprisonment for a term not exceeding 6 months or to a fine of ₦500.

7.6.2 Audit Committee (Section 355)

An audit committee elected and made up of maximum of 6 members consisting of equal number of directors and representatives of

shareholders of equal number shall examine the accounts of a company and make a report there on to members at the general meeting. The duties of the committee, amongst others, include: review of audit scope, planning of audit requirement, audit review in conjunction with the external auditors and make recommendation on remuneration of auditors.

7.6.3 Audits (Section 357)

Every company shall appoint or reappoint auditors to audit the financial statements of the company.

The following persons are disqualified from being appointed auditors of a company:

- (a) An officer or servant of the company;
- (b) A person who is a partner of or in the employment of an officer or servant of the company; and
- (c) Body corporate.

7.6.4 Auditors' Duties and Powers (Section 360)

The Company's auditors report whether:

- (a) Proper accounting records have been kept by the company and proper returns adequate for their audit have been received from branches not visited by them;
- (b) The company's balance sheet and (if not consolidated) its profit and loss account are in agreement with accounting records and returns.

If otherwise, the Auditors shall qualify the report to the members on the financial statements for the period under audit.

Auditors' remuneration shall be fixed by the company in a general meeting or the board of directors can be authorized by the general meeting to determine same.

Removal / Resignation (Sections 362/365)

A company's auditors can be removed by ordinary resolution. They are, however, entitled to attend any general meeting and are also entitled to receive notice to which members are entitled to even if it relates to his removal from office as auditors or his replacement. Equally, auditors can resign their appointments.

Powers of Auditors in Relation to a Subsidiary Company (Section 367)

Where a company has subsidiary(ies) which is a/are Nigerian company (ies), it is the duty of the subsidiary(ies) and its auditors to give the auditors of the holding company such information and explanations as may be reasonably required for the duties of the auditors of the holding company.

The holding company's auditors shall take all such steps as are reasonably open to them to obtain from the subsidiary information and explanations which are required for their duties.

False Statement (section 369)

It is an offence for an officer of a company to knowingly or recklessly make false statements to a company's auditors. Statement (whether written or oral) which is misleading, false or deceptive which conveys or purports any information or explanation required as the auditors.

Donations

A company shall not have or exercise power either directly or indirectly to make a donation or gift of any of its property or fraud to a political party or political association or for any political purpose. Any officer in default and any member who voted for the breach, shall be jointly and severally liable to refund to the company, the sum or value of donations or gift and in addition, the company and every such officer or member shall be guilty of an offence and liable to an amount equal to the value of the donations or gift (Section 38(2)).

7.6.5 Professional requirements in financial reporting and auditing

Professional requirements are covered by the Statements of Accounting Standards (SAS) issued by the Nigerian Accounting Standards Board (NASB) and the International Accounting Standards (IAS) adopted with an effective date of April 1, 2001 as International Financial Reporting Standards (IFRS) issued by International Accounting Standards Board (IASB). They are briefly discussed as follows:

SAS 1: Disclosure of Accounting Policies

The disclosure of Accounting Policies, such as the method of depreciation of fixed assets e.t.c, should be in accordance with the stipulations of International Accounting Standard No. 1.

SAS 2: Information to be disclosed in the Financial statements

Such information should be quantitative and qualitative in nature to assist users in making informed decisions. The requirements of the

Standard are in accord with those of the International Accounting Standard (IAS) No. 5

SAS 3: Accounting for Property, Plant and Equipment

The requirements of the Standard agree substantially with those of Internationally Accounting Standard No. 16.

SAS 4: On Stocks

The Standard discusses various valuation methods and the need to be consistent in the approach adopted. The requirements of the Standard accord substantially with the requirements of International Accounting Standard No 2 – valuation and presentation of inventories in the context of the historical cost system.

SAS 5: On Construction Contracts

The Standard discusses various valuation approaches. It is in accord with the International Accounting Standard (IAS) No. 11.

SAS 6: On Extraordinary items and prior year adjustments

The Standard discusses, among others, such concepts as “exceptional items,” “ordinary activities”. The requirements are complementary to any disclosure expectations of the Companies and Allied Matters Act and regulated regulations, and IAS 8.

SAS 7: On foreign currency conversions and translations

The Standard discusses, exchange rates, among others. It accords substantially with the stipulations of IAS No 21.

SAS 8: On accounting for employees’ retirement’s benefits

It accords substantially with the stipulations of IAS No 21.

SAS 9: Accounting for depreciation

It complies substantially with the requirements of IAS Nos. 19 and 25.

SAS 10: Accounting By Banking and non-Bank Financial Institutions (Part 1)

It complies substantially with IAS No 30.

SAS 11: On leases

Its provisions accord substantially with those on IAS No. 17.

SAS 12: Accounting for deferred taxes

The Standard complies substantially with IAS No 12.

SAS 13: Accounting for Investments

The Standard is principally in agreement with IAS 25.

SAS 14: Accounting in the petroleum Industry: Upstream Activities.

SAS 15: On accounting By Bank and non-Bank financial Institutions (Part II)

It complies with IAS No. 30.

SAS 16: Accounting for Insurance Business.

SAS 17: Accounting in the Petroleum Industry: Downstream Activities

SAS 18: Statement of Cash flow

It complies substantially with IAS 7 (Revised).

SAS 19: Accounting for Deferred taxes

The Standard is in accord with IAS 2 (Revised).

SAS 20: Abridged Financial Statements

SAS 21: Earnings per share

It complies with IAS 33.

SAS 22: Accounting for research and development costs

It complies with IAS 38.

SAS 23: Provisions, Contingent liabilities and Contingent assets.

It complies with IAS 37.

SAS 24: Segment Reporting

It accords with IAS No. 14.

SAS 25: Telecommunications Activities

SAS 26: Business Combinations

It accords with IFRS No.3.

SAS 27: Consolidated and Separated financial statements

It complies with IAS No. 27 (Revised).

SAS 28: Investments in Associates

It complies with IAS No. 28.

SAS 29: Interests In joint Ventures

It complies with IAS No. 31.

SAS 30: Interim Financial Reporting

The Standard complies with IAS 34.

7.7 SUMMARY AND CONCLUSIONS

This chapter discusses what a corporation is, its interests and professional responsibilities. It also examines the concept of accountability, the role of professional accountants in globalization, incorporation of companies and the components of financial statements of quoted entities. This chapter concludes with professional requirements in financial reporting and auditing.

Refer to Comprehensive Questions and Suggested Solutions in Appendix II, page 269.

7.8 REVISION QUESTIONS**7.8.1 MULTIPLE-CHOICE QUESTIONS**

1. A corporation sole is
 - A. a corporation which has only one single member at a time.
 - B. made up of individuals who associate together.
 - C. a sole business owner.
 - D. a partnership business.
 - E. a corporation which has two members at a time.

2. The interests of corporations extend to
 - (i) current investors.
 - (ii) potential investors.
 - (iii) customers.
 - A. (i) and (ii) only
 - B. (ii) and (iii) only
 - C. (i) and (iii) only
 - D. (i), (ii) and (iii)
 - E. (ii) only

3. A professional accountant should comply with the fundamental principles of
 - (i) integrity.
 - (ii) objectivity.
 - (iii) confidentiality.
 - A. (iii) only
 - B. (ii) only
 - C. (ii) and (iii)
 - D. (i), (ii) and (iii)
 - E. (i) and (iii) only

4. Which ONE of the following is not true of a company director?
 - A. He must not be less than 18 years old.
 - B. He could be an insolvent person.
 - C. He should be able to hold his share qualification.
 - D. He should not be a convicted person in connection with the formation of a company.
 - E. He should not be a lunatic.

5. The annual financial statements of a quoted company must be accompanied with
 - (i) Directors' Report.
 - (ii) Internal Auditor's Report.
 - (iii) External Auditors' Report.
 - A. (i) only
 - B. (ii) only
 - C. (iii) only
 - D. (ii) and (iii)
 - E. (i) and (iii)

7.8.2 SHORT ANSWER QUESTIONS

1. What subject-matter does the Statement of Accounting Standard No. 4 of Nigeria address?

2. A professional accountant should be honest. This is an attribute of

3. In social and environmental management, the reduction of resource, energy utilization and waste production is the concept of

4. Corporate social responsibility is also known ascitizen.

5. What is another name for 'Total Cost Assessment?'

Refer to Suggested Solutions in Appendix I, Page 263.

PROFESSIONAL ETHICS

8.0 LEARNING OBJECTIVES

After studying this chapter, readers will be able to:

- ◆ Explain Self – regulation and Oversight Functions in Professional Ethics;
- ◆ Explore the Code of Ethics of International Federation of Accountants (IFAC) 2009 on Self-regulation and Current Developments in Professional Ethics;
- ◆ Describe Quality Control and Peer Review;
- ◆ Evaluate Conflict of Interests in Corporate and Professional Environments;
- ◆ Describe Specific Threats and Safeguards in Accounting;
- ◆ Explain Whistle – Blowing Concepts, Cases and Solutions; and

8.1 SELF-REGULATION AND OVERSIGHT FUNCTIONS

Introduction

How the accountancy profession should be regulated has been food for thought in recent years. There has been consequential change as governments, professional accountancy bodies and chartered accountants strive to ensure that the profession continues to make available excellent services and enhance economic growth and advancement.

8.1.1 Why Regulation is Necessary

The reasons for the regulation of professions include the following:

- (a) Every profession is characterised by the attitude, knowledge, ethics and skills of those who are in it. Regulation responds specifically to the need to standardise the requirements to be met by the prospective entrants. The nature of the regulation is, therefore, dependent on each profession and the market indices in which it operates;
- (b) Regulation can bridge the knowledge gap which exists between the seller and purchaser of professional services. It provides assurance to the consumer of the services that the provider has

acquired the necessary paper qualifications which will fulfill the professional standards set; and

- (c) As with other professions, how the accountancy profession will sustain its integrity rests on the members being able to provide quality services as well as the capacity of the profession in being able to efficiently and effectively respond to what the society and economy demand.

Regulation can be implemented through self-regulation and external regulation. Under the former, government accords the professional body the responsibility for regulating the profession. Under external regulation, government regulates the profession. This is done through an agency of government or an independent body, created and accorded delegated regulatory powers by the government. In practice, self – regulation and external regulation work together and are employed to regulate the profession.

8. 2 CODE OF ETHICS OF INTERNATIONAL FEDERATION OF ACCOUNTANTS (IFAC) ON SELF-REGULATION / CURRENT DEVELOPMENTS IN PROFESSIONAL ETHICS AND CONDUCT

The International Federation of Accountants (IFAC) through its International Ethics Standards Board for Accountants issued the revised July 2009 Code of Ethics to regulate the activities of professional accountants among member bodies, including The Institute of Chartered Accountants of Nigeria. The general application of the Code touches on many and diverse issues which include the following:

8.2.1 Integrity

According to Section 110.1 of the Code, a professional accountant owes the obligation to be honest and straight forward in all business and professional relationships. The concept of “integrity” carries along fair dealing and truthfulness. Section 110.2 of the Code says that a professional accountant should not deliberately be associated with returns, reports, etc which he believes contains a statement or statements furnished recklessly, which are false or misleading and for obscure information required to be made available. When the professional accountant is made aware that the accountant has been involved in generating such false or misleading information, the professional accountant should dissociate himself from such information.

8.2.2 Objectivity

Professional accountants are under obligation not to negotiate their business or professional judgment on account of bias, undue influence of other people or indeed conflict of interest. Situations which may impair

objectivity are not clear - cut. It is up to a professional accountant to detect situations of impairment. He should not render a professional service where a situation or relationship unduly influences or biases the accountant's professional judgment in regard to that service.

8.2.3 Professional Competence and Due Care

Professional accountants are obliged to demonstrate and maintain professional skills and knowledge so as to deliver competent services. They should act diligently, as required by applicable professional and technical standards.

Competent and diligent professional service calls for the use of sound and analytical mind in applying professional skills and knowledge in the course of executing such services. Attaining and maintaining professional competence is a continuing endeavour which should lead to the understanding of developments in business, technical and professional areas. Diligence includes the obligation to act within the requirements of an assigned work, taking into account timeliness, carefulness and thoroughness in execution.

A professional accountant should ensure that those who are under his authority and working for him in a professional situation are in possession of appropriate training and are well supervised. Where necessary, a professional accountant is obliged to prepare the minds of clients, employers and other users of the professional accountant's services on the possible limitations which are inherent in the services rendered.

8.2.4 Confidentiality

The concept of confidentiality, according to IFAC (2009), restrains professional accountants from:

- (a) Disclosing confidential information obtained in the course of business and professional interactions, outside the company or employment house, without proper and clear – cut authority, or without prejudice to a professional or legal duty to so disclose; and
- (b) Using confidential information obtained as a result of business and professional relationships, for their personal benefits or the advantage of third parties.

A professional accountant should maintain confidentiality, wherever he might be, cognisant of the possibility of inadvertent disclosure which could take place, to a close business colleague or “a close or immediate family member.” Equally, he should maintain confidentiality of

information disclosed by an employer or a potential client, or within the company or employing firm.

A professional accountant has the responsibility of ensuring that his staff and individuals from whom counsel and assistance are obtained respect the professional accountant's duty of confidentiality. The need to uphold the principle of confidentiality continues after the end of the business or professional relationships between a client or employer and the professional accountant.

Circumstances under Which Professional Accountants May Disclose Confidential Information

The Code (2009) listed the circumstances under which professional accountants are or may be required to make disclosure of confidential information, under Section 140.7 as follows:

- (a) The law permits disclosure when it is authorised by the client or the employer;
- (b) Disclosure is required by law. An example is the production of documents, etc during court proceedings or making disclosure to the enquiring public offices of infringements of the law which have been discovered; and
- (c) Where there is a professional duty or right to disclose, when the law does not prohibit it. This arises in order to comply with the quality review of a professional body or respond to an inquiry or investigation by a member body or regulatory body. It could also have to do with the protection of the professional interests of a professional accountant in legal proceedings or compliance with technical standards and requirements of ethics.

Relevant Factors to Consider In Deciding to Disclose Confidential Information

The Code of Ethics (2009) puts forward the following factors, among others, for consideration:

- (a) Whether the parties' interests, including those of third parties could be prejudiced if the employer or client gives consent to the professional accountants' disclosure of information;
- (b) Whether all the relevant information is known and substantiated, to such an extent that it is practicable; when the situation involves unsubstantiated facts, incomplete information or unsubstantiated conclusions, professional judgment shall be used to determine the type of disclosure to be made, if there is any;

- (c) The type of communication which is expected and the person or organisation to whom it is addressed; and
- (d) If the parties to whom the communication is forwarded are the appropriate recipients.

8.2.5 Professional Behaviour

Section 150.1 of the Code of Ethics (2009) deals with the concept of “professional behaviour”. The principle imposes an obligation on professional accountants to adhere to all relevant laws, rules and regulations. It obliges a professional accountant to avoid any action which he knows or is supposed to know may impugn the integrity of the profession. What may discredit the profession includes all actions which a reasonable and informed third party, having regard to all the facts and circumstances available to the professional accountant in that situation, would be likely to adversely put the reputation of the profession in jeopardy.

In marketing and promoting themselves and their services, professional accountants shall not bring the profession into ridicule. Indeed, section 150. 2 of the Code says that professional accountants shall be truthful and honest. In this regard, they shall not:

- (a) Make magnified claims for the services which they are able to offer, the academic qualifications which they possess, or practical experience they have acquired; or
- (b) Make disparaging references or unsubstantiated comparisons to the work of others.

At national levels, the various professional bodies use the instruments of regulation, ethical rules and technical standards as benchmark of performance measurement for professional accountants. They are readily available for the purpose of performing oversight functions of monitoring and punishing errant professional accountants. The Institute of Chartered Accountants of Nigeria, has a monitoring organ called, the Professional Practice Monitoring Committee, which carries out the oversight functions on its behalf.

8.3 QUALITY CONTROL AND PEER REVIEW

8.3.1 Quality Control

‘Quality Control’ is a measurement yardstick or benchmark below which standard or performance should not fall. Cole (1986) defines ‘Quality Control’ as “a system for setting quality standards, measuring performance against those standards and taking appropriate action to

deal with deviations outside permitted tolerances.” From the definition stated above, the role of ‘Quality Control’ is to make sure that standards of quality are set, so that adverse deviations may be spotlighted for corrective measures.

The ‘quality control’ requirements are clearly spelt out in the Code of Ethics for professional Accountants released by the International Federation of Accountants (IFAC) and Rules of Professional Conduct for Members issued by The Institute of Chartered Accountants of Nigeria.

8.3.2 Peer Review

A peer review programme is dedicated to enhancing the quality of auditing, accounting and attestation services performed by professional accountants in public service who are members of The Institute of Chartered Accountants of Nigeria and by that fact, of International Federation of Accountants. Peer review activities in Nigeria are handled by the Professional Practice Monitoring Committee on behalf of the Institute.

8.3.3 Peer Review Activities

Peer reviews turn out reports which provide insight into the individual firm’s implementation of the stated quality standards set, in the course of auditing, accounting and attestation services contracted and executed. Peer review exercises increase the efficiency and effectiveness of firms in public service and boost the level of trust in the profession.

8.4 CONFLICTS OF INTEREST IN CORPORATE AND PROFESSIONAL ENVIRONMENTS

An expert has defined a ‘threat’ as “the risk that relationships or circumstances could compromise a member’s compliance with the rules and regulations of laid down ethical standards of behaviour.” Safeguards are “actions or other measures designed to eliminate threats or reduce them to acceptable levels.” What, then, constitutes ‘acceptable levels?’ These can be taken as the points where a reasonable and informed independent party would be disposed to conclude that, having regards to all the underlying facts and circumstances, compliance with the ethical Code of Conduct is not compromised.

Section 220 of Code of Ethics for Professional Accountants (2009) which The Institute of Chartered Accountants of Nigeria has adopted for its members to comply with, has provisions for the management of conflicts of interest which include the following:

(a) Sub-section 220.1

A professional accountant who is in public practice is obliged to exercise due diligence and care to identify the circumstances that could bring

about conflicts of interest, resulting in threats to compliance with the fundamental principles. By way of example, objectivity may be threatened when a member of the Institute in public practice competes “directly with a client or has a joint venture or similar arrangement with a major competitor of a client.”

(b) **Sub-section 220.2**

A professional accountant in public practice shall weigh the significance of any threats and, consequently, apply necessary safeguards to eliminate or reduce them to a level considered acceptable. Before he accepts or continues a client relationship or any specific engagement, he shall evaluate the significance of any threats which are creations of business interests or relationships with a third party or the client.

(c) **Sub-section 220.3**

Depending on the occasions which give rise to the conflicts of interest, The Code (2009) recommends the application of one of the following safeguards:

- (i) Notifying the client of the firm’s business interest or activities which may bring about a conflict of interest and obtaining consent to act in such situations;
- (ii) Notifying all known parties that the professional accountant in public practice is acting for two or more parties in respect of a matter in which their interests are in conflict. The professional accountant will obtain their consent to so act; and
- (iii) Notifying the client that the professional accountant in public practice is not acting exclusively for any one client in the provision of the service proposed; for example, in a particular sector of the market or with reference to a specific service, and obtaining their consent to so act.

(d) **Sub-section 220.4**

It is the obligation of the professional accountant to apply one or more of the following additional safeguards:

- (i) Using separate engagement teams;
- (ii) Instituting procedures to prevent access to information such as strict physical separation of such teams, confidentiality and security of data filing;
- (iii) Issuing clear guidelines for members of the engagement team on matters of security and confidentiality;
- (iv) Using confidentiality agreements executed by the firm’s partners and employees; and
- (v) Reviewing regularly the application of safeguards by a senior person who is detached from the clients’ engagements.

(e) **Sub-section 220.5**

The professional accountant in public practice shall not take up a specific engagement or shall resign from one or more conflicting engagements where a conflict of interest brings about a threat to one or more of the fundamental principles which include professional behaviour, confidentiality or objectivity, which cannot be eliminated or reduced to an acceptable level through the use of safeguards.

(f) **Sub-section 220.6**

Where a professional accountant in public practice has asked for a client's consent to act for another party (whether or not the party is an existing client) on a matter in respect of which there are conflicting interests and the consent has not been granted by the client, he shall not continue to act for one of the parties in the matter which occasions the conflicts of interest.

8.5 **FUNDAMENTAL PRINCIPLES OF THE CODE OF ETHICS FOR PROFESSIONAL ACCOUNTANTS OF JULY 2009, ISSUED BY THE INTERNATIONAL FEDERATION OF ACCOUNTANTS.**

The fundamental principles are worthy of recall here, as a means of reminding professional accountants of their committed adherence to the code of ethics in all spheres of professional lives. The fundamental principles are briefly discussed as follows:

(a) **Integrity**

This is the attribute of being honest and straight forward in all business and professional relationships, without any distinction.

(b) **Objectivity**

A professional accountant should not bring in bias (that is, prejudice), conflict of interest or "undue influence of others to override professional or business judgments."

(c) **Professional Competence and Due Care**

This has to do with the continued enhancement and display of professional knowledge and skills at the appropriate required levels. The attributes stated will ensure that an employer or a client obtains the best services, on current thinking in the world of accountancy, and based on prevailing legislation and techniques. A professional accountant should act diligently and in consonance with the extant technical and professional standards.

(d) Confidentiality

A professional accountant should preserve the confidentiality of whatever information acquired during and after engaging in business and professional relationships. He should therefore not disclose such information to third parties without the express permission of his client or employer. “The exception to this rule is where there is a legal or professional right or duty to disclose.” A professional accountant should not use the information for his personal advantage or benefit of third parties.

(e) Professional Behaviour

He should comply with the relevant laws, regulations and the Code of Ethics (IFAC, 2009). A professional accountant should at all times avoid actions which are discrediting to the profession and The Institute of Chartered Accountants of Nigeria.

ILLUSTRATION 8.1

Obaluaye sighted a private car and three-men gang raping a 12 year old girl by the corner. He reasoned that he could not on his own challenge the men and save the girl from further assault. Obaluaye was hurrying to his farm but could still not face the gory sight. Walking a few yards away, he saw a patrol vehicle of the police. He ran across and reported the case to the police patrol team, supplying the vehicle descriptions of type and number and the location of the horror. In a few minutes, Obaluaye disappeared and the police apprehended the miscreants. The girl was liberated. Discuss Obaluaye’s action from the utilitarianism and deontology points of view.

SUGGESTED SOLUTION 8.1

The action of Obaluaye to come to the rescue of the teenage girl being raped is courageous, virtuous and deserving of reward. If Obaluaye saw the gory event, and failed to blow the whistle of alerting the police patrol team, the rapists would have further harmed the victim, escaped and perhaps inflicted the same or worse indignity on others they could lay their hands on.

Utilitarianism can best be described as a system of ethical balance or equation. The concept desires to locate balance of good consequences as against bad developments. Utilitarian attempts to maximise good or right over bad or wrong. The concept insists that rights and duties derive from the ultimate objective of overall good maximisation. According to Cottell and Perlin, the ethical weighting and summing of probable consequences of action is known as “ the calculus of Utilitarian ethics”.

Deontology focuses on the features of an action, rather than the consequences. Deontologists insist that morals are based upon fundamental principles and not mere results. The word “deontology” derives from the Greek language of “duty” that is “promises should be kept”, agent’s deontology. Consequently, ‘deontology’ does not strictly apply.

Obaluaye was under no duty to save the girl. Indeed, he took a risk of being caught and severely dealt with, if not killed, by the rapists. He took an utilitarian step by getting the hapless and debased girl liberated and, by so doing, became a follower of the Athenian Philosopher, Confucius, who says that “in nothing do we nearly approach the gods than in doing good to our fellow men”

8.6 SUMMARY AND CONCLUSIONS

This chapter explains self-regulation and oversight functions in professional ethics, the IFAC and ICAN code of ethics, and current developments in professional ethics. It describes quality control and peer review, evaluates conflict of interests in corporate and professional environments and describes specific threats and safeguards in accounting.

Refer to Comprehensive Questions and Suggested Solutions in Appendix II, page 269.

8.7 REVISION QUESTIONS

8.7.1 MULTIPLE-CHOICE QUESTIONS

1. A professional accountant should, during the course of duties, demonstrate
 - (I) integrity.
 - (II) subjectivity.
 - (III) objectivity.
 - (IV) confidentiality.
 - A. I only
 - B. II only
 - C. I, III, and IV
 - D. I and II

2. Which of the following is true of “Quality Control?”
 - (I) Measurement Yardstick
 - (II) Benchmark
 - (III) Corrective Measure.
 - A. I only
 - B. II only
 - C. III only
 - D. I and II
 - E. I, II and III

3. A Peer Review Programme
 - (I) enhances the quality and auditing.
 - (II) studies inter-audit firm relationship.
 - (III) improves attestation services.

- A. III only
 - B. II only
 - C. I only
 - D. I and III
 - E. I, II and III
4. The term 'oversight functions' means
- (I) supervision.
 - (II) control.
 - (III) failure to carry out functions.
- A. I and II
 - B. I only
 - C. II only
 - D. III only
 - E. II and III
5. Demonstration of sound professional behavior by a professional accountant includes
- (I) adhering to all relevant laws.
 - (II) avoiding actions which impugn the profession's integrity.
 - (III) avoiding disparaging comments on the work of colleagues.
- A. III only
 - B. II and III
 - C. I, II and III
 - D. I and II
 - E. II only

8.7.2 SHORT ANSWER QUESTIONS

1. Regulation can be implemented through self-regulation and _____
2. Under what Section of IFAC's Code of Ethics may a professional accountant disclose confidential information about his audit client?
3. Under the Civil Service Act No. 43 of 1988, the Audit Alarm Committee was headed by the _____
4. The accountancy profession in Nigeria is regulated by an international organisation called _____
5. Professional accountants are obliged to demonstrate at all times, in the course of their duties, professional competence and _____

Refer to Suggested Solutions in Appendix I, Page 263.

DECISION MAKING IN ETHICS

9.0 LEARNING OBJECTIVES

After studying this chapter, readers should be able to:

- ◆ Review two models of ethical decision making process, firstly by *Markkula Centre for Applied Ethics* and secondly by Chris MacDonald, Ph.D.
- ◆ Understand the fundamental principles, and stages in making ethical decisions.
- ◆ Apply this important tool in solving ethical dilemmas.
- ◆ Integrate ethical principles in business decisions.

9.1 TECHNICAL AND ETHICAL DECISION MAKING / ETHICAL DECISION MODELS

Accountants are faced with ethical and moral decision making in their professional dealings every day. The way people make ethical decisions in their personal lives most times is not the same way that people make these decisions when they are in a business environment. Business decisions need to be grounded in ethics and this has become a source of major concern and debate due to recent incidents of corporate scandals and failures.

Making good ethical decisions requires a trained sensitivity to ethical issues and a practised method for exploring the ethical aspects of a decision and weighing the considerations that should impact our choice of a course of action.

The problem arises from the fact that major ethical theories are not precise, which makes enforcement of ethical actions based on individual judgment. Even individuals highly trained in philosophy of ethics; do not agree about the application of ethics. The distinction between ethical and unethical behaviour is based on the cultural milieu and is a by-product of social norms. In other words, morality is largely situation specific. This makes it difficult to determine ethical behaviour.

The more novel and difficult the ethical choice we face, the more we need to rely on discussion and dialogue with others about the dilemma. Only by careful exploration of the problem, aided by the insights and different perspectives of others, can we make good ethical choices in such situations.

Whatever the nature of the decision making, the individual chartered accountant, should be guided by the fundamental principles outlined in Section 100(5) of the Code of Ethics of July, 2009, issued by the International Federation of Accountants. These may be re-cast, as follows:

(a) **Integrity**

A professional accountant should be honest and straightforward in all business and professional relationships;

(b) **Objectivity**

He should not allow conflict of interest, bias or undue influence of other people to sway his business or professional judgments;

(c) **Professional Competence and Due Care**

A professional accountant should maintain professional knowledge and skills at the right level required of his calibre, so as to ensure that a client or employer is not denied of competent professional services, based on current pronouncements and practice, approaches and laws. He should act diligently and in conformity with applicable professional and technical standards;

(d) **Confidentiality**

A professional accountant should preserve the confidentiality of information which he obtains in consequence of business and professional relationships. He should not disclose any such information to third parties without the knowledge and consent of his principal, unless there is a professional or legal obligation to disclose it. A professional accountant should not use the information obtained, for his personal benefit or that of third parties; and

(e) **Professional Behaviour**

He has to comply with relevant laws, rules and regulations. A professional accountant should avoid any action which ridicules the profession and/or The Institute of Chartered Accountants of Nigeria. Where a Professional Accountant or a member of The Institute of Chartered Accountants of Nigeria faces a dilemma in the course of duties, he is obliged to contact his professional body for guidance.

We would try to present different frameworks for ethical decision making that we consider useful for exploring ethical dilemmas and identifying ethical courses of action. First would be a framework as presented by the *Markkula Center for Applied Ethics*.

9.2 A FRAMEWORK FOR ETHICAL DECISION MAKING

(a) **Recognise an Ethical Issue**

- (i) Is there something wrong personally, interpersonally, or socially? Could the conflict, the situation, or the decision be damaging to people or to the community?
- (ii) Does the issue go beyond legal or institutional concerns? What does it do to people, who have dignity, rights, and hopes for a better life together?

(b) **Get the Facts**

- (i) What are the relevant facts of the case? What facts are unknown?
- (ii) Do individuals and groups have an important stake in the outcome? Do some have a greater stake because they have a special need or because we have special obligations to them?
- (iii) What are the options for acting? Have all the relevant persons and groups been consulted? If you showed your list of options to someone you respect, what would that person say?

(c) **Evaluate Alternative Actions from Various Ethical Perspectives**

Which option will produce the best and do the least harm?

(d) **Utilitarian Approach: The ethical action is the one that will produce the greatest balance of benefits over harms.**

Even if not everyone gets all they want, will everyone's rights and dignity still be respected?

(e) **Rights Approach: The ethical action is the one that most dutifully respects the rights of all affected.**

Which option is fair to all stakeholders?

(f) **Fairness or Justice Approach: The ethical action is the one that treats people equally, or if unequally, that treats people proportionately and fairly.**

Which option would help all to participate more fully in the life we share as a family, community, society?

(g) **Common Good Approach: The ethical action is the one that contributes most to the achievement of a quality common life together.**

Would you want to become the sort of person who acts this way (e.g., a person of courage or compassion)?

(h) **(Virtue Approach: The ethical action is the one that embodies the habits and values of humans at their best.**

(i) **Make a Decision and Test It**

(i) Considering all these perspectives, which of the options is the right or best thing to do?

(ii) If you told someone you respect why you chose this option, what would that person say? If you had to explain your decision on television, would you be comfortable doing so?

(j) **Act, and then Reflect on the Decision Later**

Implement your decision. How did it turn out for all concerned? If you had to do it over again, what would you do differently?

Source: *Issues in Ethics*, V. 1, N. 2 (Winter 1988).

9.3 A GUIDE TO MORAL DECISION MAKING - CHRIS MACDONALD, Ph.D.

This guide is intended only as an aid. It is not a formula, and it does not guarantee good decisions. Note that the order of the steps is not crucial, and may vary from one situation to the next.

(a) **Recognising the Moral Dimension**

The first step is recognising the decision as one that has moral importance. Important clues include conflicts between two or more values or ideals.

(b) **Who Are the Interested Parties? What are their relationships?**

Carefully identify who has a stake in the decision. In this regard, be imaginative and sympathetic. Often there are more parties whose interests should be taken into consideration than is immediately obvious.

Look at the *relationships* between the parties. Look at their relationships with yourself and with each other, and with relevant institutions. Do those relationships bring special obligations or expectations?

(c) **What Values are involved?**

Think through the shared values that are at stake in making this decision. Is there a question of *trust*? Is personal *autonomy* a consideration? Is there a question of *fairness*? Is anyone to be *harmed* or *helped*?

(d) Weigh the Benefits and the Burdens

Benefits — broadly defined — might include such things as the production of goods (physical, emotional, financial, social, etc.) for various parties, the satisfaction of preferences, and acting in accordance with various relevant values (such as fairness).

Burdens might include causing physical or emotional pain to various parties, imposing financial costs, and ignoring relevant values.

(e) Look for Analogous Cases

Can you think of other similar decisions? What course of action was taken? Was it a good decision? How is the present case like that one? How is it different?

(f) Discuss with Relevant Persons

The merits of discussion should not be underestimated. Time permitting; discuss your decision with as many persons as have a stake in it. Gather opinions, and ask for the reasons behind those opinions. Remember that your ability to discuss others may be limited by the other people's expectations of confidentiality.

(g) Does this Decision Accord with Legal and Organisational Rules?

Some decisions are appropriately made based on legal considerations. If one option is illegal, we should at least think very seriously before taking that option.

Decisions may also be affected by rules set by organisations of which we are members. For example, most professional organisations have Codes of Ethics which are intended to guide individual decision making. Institutions (hospitals, banks, corporations) may also have policies which limit the options available to us.

Sometimes there are bad laws, or bad rules, and sometimes those should be broken. But *usually* it is ethically important to pay attention to laws and rules.

(h) Am I Comfortable with this Decision?

Sometimes your 'gut reaction' will tell you if you have missed something.

Questions to be asked in this regard might include:

- (i) If I carry out this decision, would I be comfortable telling my family about it? My clergyman? My mentors?
- (ii) Would I want children to take my behaviour as an example?

- (iii) Is this decision one which a wise, informed, virtuous person would make?
- (iv) Can I live with this decision?

9.4 SUMMARY AND CONCLUSIONS

We have to reemphasize here that the two models of ethical decision making presented above are simply guides intended only as an aid, not a formula, and most importantly do not guarantee good decisions. However if you have ever wondered why some business people and professional accountants make what appears to be the right ethical choices and some simply do things that are unscrupulous, illegal and outrightly immoral, it is because of a neglect of these models. In other words, if you have ever wished to be ethical, study and practice either of these models.

Note that the order of the steps is not crucial, and may vary from one situation to the next.

Refer to Comprehensive Questions and Suggested Solutions in Appendix II, page 269.

9.5 REVISION QUESTIONS

9.5.1 MULTIPLE-CHOICE QUESTIONS

1. Effective integration of ethics into business decision making will solve one of these.
 - (a) Moral inconsistency
 - (b) Indecision in Business
 - (c) Ethical dilemma
 - (d) Ethical uncertainty
 - (e) Moral non-productivity.
2. Moral intensity is multidimensional, consisting of six components. Which of these is NOT one of those components?
 - (a) Magnitude of consequences and proximity
 - (b) Social Consensus and concentration of effect
 - (c) Probability of effect
 - (d) Temporal immediacy
 - (e) Social gravity.
3. Making good ethical decisions requires a trained.....
 - (a) Sensitivity to ethical issues
 - (b) Creativity to moral issues
 - (c) Philosopher
 - (d) Ethics manager
 - (e) Conscience.

4. A person who treats the equal equally and the unequal unequally or proportionately, adopts which of these approaches in ethical decision making?
 - (a) Equality approach
 - (b) Inequality approach
 - (c) Inter-quality approach
 - (d) Justice Approach
 - (e) Virtue approach.
5. The first step in making ethical decision is?
 - (a) Getting the facts
 - (b) Analysing the facts and issues
 - (c) Evaluating various ethical perspectives
 - (d) Recognising the different cultures
 - (e) Recognising an ethical issue

9.5.2 Short Answer Questions

1. Major ethical theories are not precise, hence the enforcement of ethical actions relies on_____
2. Conflicting ethical decisions may arise from conflicting sets of _____ within the same culture.
3. _____ suggests that ethical decisions are primarily contingent upon the perceived characteristics of the issues at stake.
4. The ethical action that contributes most to the achievement of a quality life together is known as_____
5. Colonel Obi's ethical actions embody the habits and values of humans at their best. He adopts_____ in making ethical decisions.

Refer to Suggested Solutions in Appendix I, Page 263.

ETHICAL THREATS AND SAFEGUARDS

10.0 LEARNING OBJECTIVES

After studying this chapter, readers will be able to:

- ◆ Describe ethical threats in other financial services; and
- ◆ Explain threats and safeguards in its various ramifications.

10.1 SPECIFIC ETHICAL THREATS AND SAFEGUARDS IN ACCOUNTING (WINDOW DRESSING / CREATIVE ACCOUNTING)

Perhaps the collapse of Enron Corporation of the United States of America would not have occurred if good corporate governance had been in existence and Andersen, the professional accounting firm which audited the company, had displayed professionalism and adhered to professional ethics and code of conduct.

Enron Corporation revealed, in 2001, that it had failed to report large amounts of debt owing and that the company's profits had been overstated for several years. When a company understates expenses and losses and consequently overstates profit earnings, just as Enron Corporation had done, the organisation's accounts are 'window dressed' or created. It is fraudulent and criminal to create accounts.

What constitutes a "threat" in professional accountancy has been very well defined in the preceding chapters of this study pack. The moral is that a professional accountant who is in public practice should not find himself in an activity, occupation or a business which compromises or might impair objectivity, integrity or the hard earned reputation of the profession and which, consequently, would be out of tune with the execution and delivery of professional services.

10.2 SPECIFIC THREATS WHICH 'CREATIVE ACCOUNTING'/ WINDOW DRESSING IN ACCOUNTING POSE

There are five general sources of threat identified by the revised Code. The APB's Ethical Standard 1 identifies a sixth threat (the management threat):

- (a) **Self-interest** threat (for example, having a financial interest in a client)

This is the threat that “a financial or other interest will inappropriately influence the professional accountant’s judgment,” conduct or behaviour. According to The Code (2009), examples which create self interest threats for a professional accountant in public practice include:

- (i) A firm entering into a contingent fee arrangement that relates to an assurance engagement;
- (ii) A firm which is concerned about the chance happening of losing a significant client;
- (iii) A member of the audit team entering into employment deals with the audit client;
- (iv) A firm having undue dependence on total fees receivable from a client;
- (v) A member of the assurance team having a different financial interest in the assurance client; and
- (vi) A member of the assurance team having a significant close business relationship with an assurance client.

- (b) **Self-review** threat (for example, auditing financial statements prepared by the firm).

- (c) **Advocacy** threat (for example, promoting the client’s position by dealing in its shares). This threat says that a professional accountant will promote the position of a client or employer to the stage that the professional accountant’s objectivity is compromised. Examples of circumstances which create advocacy threats for a professional accountant who is in public practice include:

- (i) When the firm is promoting shares in an audit client; and
- (ii) When a professional accountant is acting as an advocate on behalf of an audit client in litigation or disputes with third parties.

- (d) **Familiarity** threat (for example, an audit team member having his/her family member as an officer of the client).

- (e) **Intimidation** threat (for example, threats of replacement due to disagreement). This is the threat that a professional accountant will be prevented from performing his work objectively in view of actual or perceived pressure which includes attempts to exert undue influence over him. Examples of circumstances which may create intimidation threats for a professional accountant who is in public service include:

- (i) A firm being threatened with dismissal from a client engagement;
- (ii) A firm being threatened with litigation by the client;
- (iii) A firm being pressurized to reduce inappropriately the extent of work performed so as to reduce fees;

- (iv) An audit client indicating that it will not award a planned non-assurance contract to the firm if the firm continues to disagree with the client's accounting treatment for a particular transaction; and
 - (v) A professional accountant being informed by a partner of the firm that a planned promotion will not take place except the accountant agrees with an audit client's inappropriate accounting treatment.
- (f) **Management** threat (for example, doing a job that should be carried out by client's management, such as the design and implementation of IT systems). There are two general categories of safeguard identified by the Code:
- (i) Safeguards created by the profession, legislation or regulation
 - (ii) Safeguards within the work environment

Examples of safeguards created by the profession, legislation or regulation:

- (i) Educational training and experience requirements for entry into the profession;
- (ii) Continuing professional development requirements;
- (iii) Corporate governance regulations;
- (iv) Professional standards;
- (v) Professional or regulatory monitoring and disciplinary procedures; and
- (vi) External review by a legally empowered third party of the reports, returns, communication or information produced by a professional accountant.

Examples of safeguards in the work environment:

- (i) Involving an additional professional accountant to review the work done or otherwise advise as necessary;
 - (ii) Consulting an independent third party, such as a committee of independent auditors, a professional regulatory body or another professional accountant;
 - (iii) Rotating senior personnel;
 - (iv) Discussing ethical issues with those in charge of client governance; and
 - (v) Disclosing to those charged with governance the nature of services provided and extent of fees charged.
- (g) Involving another firm to perform or reperform part of the engagement
- The team and the firm should be independent 'during the period of the engagement.' The period of the engagement is from the commencement

of work until the signing of the final report being produced. For a **recurring audit**, independence may only cease on **termination of the contract** between the parties.

10.3 CONCEPTUAL FRAMEWORK APPROACH TO MANAGING THREATS

The Code of Ethics for Professional Accountants (2009) provides a solid conceptual framework approach for managing threats under Section 100(6) to 100(11), the summary of which, is as follows:

- (a) The situations in which professional accountants operate are not only diverse and many but may also create specific threats to compliance with the above-stated fundamental principles. The International Federation of Accountants has handed down conceptual framework handling, with broad based guidelines. The type of engagement and / or assignments will determine the approach to adopt. The conceptual framework outlined thus assists professional accountants in their choice of ethical tools, to uphold the canons of the code. However, a professional accountant is estopped from concluding that a situation is exempted once it is not specially prohibited;
- (b) When a professional accountant identifies threats which are not at acceptable level, he shall look for safeguards to counter them or reduce them to acceptable level, after having exercised qualitative and sound judgment expected of an informed third party who has skillfully weighed all the scenarios. Ultimately, compliance with the fundamental principles should not be comprised;
- (c) A professional accountant is obliged to appraise any threats to comply with the fundamental principles when it is clear that objectively, the emerging circumstances or relationships have the potentiality of compromising compliance;
- (d) He shall analyse qualitatively and quantitatively all factors when evaluating the significance of a threat. If it is too significant or appropriate safeguards cannot be found or applied, the professional accountant shall reject or discontinue the service or, as appropriate, resign from the appointment;
- (e) Where a professional accountant has mistakenly violated a provision of the Code, depending upon each development, the inadvertence may not be deemed to be an infringement, if the violation is discovered and promptly corrected with the necessary safeguards applied; and
- (f) Where a professional accountant is faced with unusual situations “in which the application of a specific requirement of the Code would result in a disproportionate outcome” or a development which may run counter

to the public interest, he is advised to seek the counsel of The Institute of Chartered Accountants of Nigeria, his member body.

10.4 ETHICAL THREATS IN OTHER FINANCIAL SERVICES

Other financial services which professional accountants offer to the public are diverse and many. There are new and emerging developments in business. Secondly, the evolution of financial markets, crises in the world economy and changes in information technology do not make possible an all-inclusive list of such services. Nonetheless, the following services, among others, can be identified and discussed briefly, namely:

(a) **Non-Assurance Services**

The 'net' of non-assurance services is wide. It is any service other than audit which a professional accountant in public or private service may offer. In accepting and executing non-assurance services, particularly, it is imperative to abide with the Code of Conduct for members of The Institute of Chartered Accountants of Nigeria and that of the International Federation of Accountants. Specific emphasis is made of the obligation to adhere to Sections 100.1 to 100(5) of the Code (IFAC, 2009) on the fundamental principles of integrity, objectivity, professional competence and care, confidentiality and professional behaviour. These canons of behaviour have been highlighted in Sections 8.2.1 to 8.2.4. of this study pack. A professional accountant has to be independent of mind and in appearance.

Acceptance of non-assurance services gives rise to or creation of threats of 'self review,' 'self-interest' and 'advocacy'. The threats of 'self – interest' and 'advocacy' have been treated in Section 8.5.3. (a) and (b). 'Self-review' threat is one under which a professional accountant cannot appropriately analyse and appraise the position of a previous judgment which he made or service rendered, or by another individual or colleague, all from the same organisation, on which the professional accountant will rely when he was forming a judgment, as part of supplying a current service.

(b) **All Services**

'All services' category suffers the risk of objectivity. There is the threat to compliance with the fundamental principle of objectivity. For example, a 'familiarly' threat to objectivity may be created from a family or close personal or business relation.

(c) **Assumption of Management Responsibilities**

Assumption of such responsibilities include authorizing transactions and taking responsibility for designing, implementing and maintaining

internal control measures. The threats which occur and discussed under (a) above are 'self-review', and 'self-interest'.

(d) **Provision of Accounting And Bookkeeping Services**

Such services include preparing accounts and bank reconciliation statements. When the professional firm subsequently audits the financial statements, it creates 'self-review' threat.

(e) **Valuation Services**

The concept of valuation involves assigning an estimated price or value in present day terms. It comprises the making of assumptions or future actions or developments. Undertaking valuation services will give rise to 'self-review' threat.

(f) **Taxation Services**

Where the idea of providing tax planning and other tax advisory services is duly approved by the tax authority or existing law, such a service may be rendered. However, a 'self-review' threat may arise where the taxation advice will affect matters to be shown in the financial statements.

(g) **Internal Audit Services**

The provision of internal audit service to an audit client brings about a 'self-review' threat to the fundamental principle of independence if the audit firm or professional accountant uses the internal work in the performance of a subsequent external audit.

(h) **Information Technology (IT) Systems Services**

Services which may be performed include:

- (i) Design or implementation of IT systems which are not related to internal control over financial reporting; and
- (ii) Design or implementation of IT systems which do not generate information which forms a significant part of the accounting records or financial statements.

However, the services not deemed to create a threat to independence, parts of which are listed above, have the proviso that the audit firm's personnel do not assume management responsibility for their implementation.

(i) **Litigation Support Services**

These may include such activities as acting as an expert witness, computing estimated amounts which could become receivable or

payable, arising from litigation or legal dispute and assisting with document management and retrieval. These services may give rise to a 'self-review' or 'advocacy' threat.

(j) **Legal Services**

According to IFAC (2009), 'legal services' are defined as "any services for which the person providing the services must either be admitted to practice law before the courts of the jurisdiction in which such services are to be provided or have the required legal training to practice law." The supply of legal services to an organisation which is an audit client may give room to 'self-review' and 'advocacy' threats, which have been discussed along with others under chapter 11.9.2.2 of this study pack.

(k) **Recruiting Services**

Rendering recruiting services to an audit client, may bring about the threats of 'self-interest,' 'familiarity' and 'intimidation' or 'trust.'

(l) **Corporate Finance Services**

Such activities include being of assistance to an audit client in formulating corporate strategies to meet diverse and ever changing economic indices, and identifying possible segments or targets for the client to purchase. The attendant threats are 'advocacy' and 'self review' in nature and essence.

10.5 ETHICAL THREATS IN ACCOUNTING, AUDITING AND ASSURANCE SERVICE, OTHER FINANCIAL SERVICES AND SAFEGUARDS

10.5.1 Different Types of Ethical Threats

Compliance with the fundamental principles may potentially or actually be threatened by a broad range of circumstances. In "ICAN's Rules of Professional Conduct for Members" threats to objectivity identified include the following:

(a) **The self-interest threat**

This may arise from a financial interest in a client or jointly holding a financial interest with a client "which will inappropriately influence the professional accountant's judgment or behaviour." (IFAC, 2009).

(b) **The self – review threat**

An example of a self-review threat is the discovery of a significant error during a re-evaluation of the work of a professional accountant in public practice, or a non-audit assignment needs to be challenged in reaching conclusions.

According to The Code (IFAC, 2009), it is the threat that a professional accountant will not appropriately evaluate the results of a previous judgment made or service performed by the professional accountant, or by another individual within the professional accountant's firm or employing organisation, on which the accountant will rely when forming a judgment as part of providing current services.

(c) **The advocacy threat**

This is an apparent threat to the auditor's objectivity, if he becomes an advocate on behalf of an assurance client in litigation or disputes with third parties.

(d) **The familiarity or trust threat**

A threat that the auditor may become over-influenced by the personality and qualities of the directors and management, and consequently too sympathetic to their interest. It could also arise where a member of the engagement team has a close or immediate family relationship with a director or officer of the client.

(e) **The intimidation threat**

It is the possibility that the auditor is being threatened with dismissal or replacement in relation to a client engagement. It could come from a dominating personality, or by other pressures, actual or feared, by a director or manager of the client or by some other party.

It is a threat that a professional accountant will be deterred from acting objectively because of actual or perceived pressure.

10.5.2 Safeguards to Independence / Introduction of Safeguards at Professional and Firm Levels

There are many safeguards and procedures to offset the different types of threats highlighted above. Auditors are admonished to always consider the utilization of safeguards and measures which may reduce or negate threats. They should be prepared to demonstrate that in relation to each specified threat, they have exhausted the availability and effectiveness of the safeguards and procedures, and are satisfied that their objectivity in carrying out the assignment will be properly preserved. The following may, therefore, be discussed:

(a) **Firm-wide safeguards in the work environment or individual firms**

The various safeguards and approaches might include the practice firm's environment in which the professionals operate, in order to offset any threat to objectivity. Admittedly, it is not possible to compile an exhaustive list of counter-measures against threats. Nonetheless, auditors should, where possible, develop the following characteristics in their practice firms:

- (i) According to ICAN's "Rules of Professional Conduct for Members," chartered accountants are obliged from the commencement of their training contracts to behave with integrity in all their professional and business relationships and to strive for objectivity in their business and professional judgements. These factors rank highly in the qualities which the chartered accountants have to display prior to admission.
- (ii) Engagement partners should have sufficient regard for their career and reputation to be encouraged towards objectivity and to the effective use of safeguards.
- (iii) Within any practice firm, there should be strong peer pressure towards integrity. Reliance on one another's integrity should be the essential force which permits partners to entrust their public reputation and personal liability to each other.
- (iv) Firms should set great store for their reputation for objectivity and impartiality. It is the foundation for their ability to practise and gain work over the medium and long term. They should not permit any firm's member to risk it for short term benefit or gain.
- (v) Firms of all sizes should have well established strong internal procedures and controls over the work of individual principals, to ensure that difficult and sensitive judgments are reinforced by the collective views of other principals, thereby also reducing the possibility of litigation.

(b) **Safeguards and / or Sanctions Built into the Structure of the Profession Itself / Legislation or Regulation**

These might include:

- (i) The long standard code of ethics of the profession of which the "Rules of Professional Conduct for Members" is part.

As appropriate, the rules impose specified prohibitions where the threat to the auditor's objectivity is significant, or generally considered to be so, that no other appropriate safeguards would be effective;

- (ii) The ethical support of The Institute of Chartered Accountants of Nigeria;
- (iii) The reinforcement accorded the safeguards stated above through a policing mechanism. It reacts to complaints, made by whether members of the public or of the profession. The system investigates the background to the complaints. Where necessary, it commences disciplinary proceedings against any erring member. Consolidated with monitoring, the policing mechanism ensures that a practicing firm's past conduct and current procedures are likely to attract close independent professional supervision if the conduct of practicing members occasions challenges over their implementation of the guidelines discussed; and
- (iv) The Professional Practice Monitoring Committee is empowered to visit audit firms and examine compliance with the laid down audit guidelines and standards.

The Code (IFAC 2009, para 100.14) recommends the following safeguards:

- (i) "Educational, training and experience requirements for entry into the profession;
- (ii) Continuing professional development requirements;
- (iii) Corporate governance regulations;
- (iv) Professional standards;
- (v) Professional or regulatory monitoring and disciplinary procedures; and
- (vi) External review by a legally empowered third party of the reports, returns, communications or information produced by a professional accountant."

10.6 WHISTLE – BLOWING CONCEPTS, CASES AND SOLUTIONS

Introduction and Nature of Whistle – Blowing

According to Deni Elliott, "whistle – blowing is an action taken by an agent to bring purported illegal or unethical behaviours to the attention of others. It always involves going outside expected channels or the chain of command." An agent may be non- human such as a guard dog backing at the physical or

imminent presence of an unfamiliar face or visitor who also may be out for some mischief. The agent may be a member of the public who is alerting his or her neighbours on the suspicious movement or presence of an uninvited guest, who may be intent on doing something funny. If the 'whistle' is blown by, say, a security staff member of an organisation, the action is in the nature of an informal and desperate report made to prevent or arrest a bad situation which may occasion the loss of life and or property or gravely misdirect judgment.

Suppose a thief snatches a purse from an elderly man, a public spirited passer-by who witnessed the incident called a nearby police station on his mobile phone. That act is whistle – blowing and is commendable.

Section 35 of the Civil Service Reforms Act No. 43 of 1988 created the Audit Alarm Committee, headed by the Auditor – General for the Federation to raise alertness and sanction any public officer that is suspected of committing an act of financial impropriety. The audit alarm is “whistle – blowing.”

One may consider the failure to attend to the crying needs of hapless others as being morally inadequate. However, the law of negligence says that the obligation to assist another person rests upon the relationship between the two parties. It is obligatory, morally and legally, to fulfill promises and contracts. Thus, children cannot be abandoned by their parents. An injured person cannot be left in a car while one is relaxing in a hotel.

The obligation to 'blow- whistle' for strangers in companies and the world of businesses is not easy to achieve. The choice is not imminent; it is predominantly a personal decision. No one likes a whistle – blower. Consequently, a potential whistle – blower in paid employment especially, will worry for himself and his family if his virtuous endeavour brings about negative effect. Some whistle-blowing endeavours evoke or give rise to ethical dilemma.

10.6.1 Justifying Whistle - Blowing

Whistle – blowing is justified when the following conditions are met:

- (a) The behaviors – corporate or individual – being reported, such as effluent discharge, mismanagement of a company, will likely result in serious health hazard;
- (b) The usual and perhaps official channels which have been tried are not successful;
- (c) All internal resources have been utilized but nothing constructive has come out;
- (d) The whistle – blowing report should likely bring about the needed changes; and
- (e) One should have a moral duty to prevent the harm.

10.6.2 Whistle Blowing Cases and Solutions

Some whistle – blowing cases are straight forward and capable of clear and once – and for all resolutions. The intricate ones which generate moral dilemmas for the agents make ‘heavy’ demand on ethically acceptable analytical tools or theories of ‘utilitarianism’, ‘deontology’, and teleology’ and ‘ethical realism. The first three concepts have earlier been discussed in chapter 6.7. The fourth is now to be examined. According to Cottell and Perling(1990), ‘ethical realism’ can be utilized along with the previous tools identified. However, a number of factors have to be present as pre – requisites. These include:

- (a) Ethical environment in which there are well – known and accomplished intellectual personalities from whom wisdom could be obtained. The moral agent or potential whistle – blower should be a member of a well established professional body such as the Institute of Chartered Accountants of Nigeria which could provide some support;
- (b) The personalities referred to in (a) above, should be able to muster power and social respectability, sufficient to transmit acceptably, their developed ethical values to the community; and
- (c) The moral agent would have had to share the values of the identified intellectual figures.

10.7 ANALYSIS OF THREATS AND SAFEGUARDS

Threats	Safeguards
1. Self-interest	(a) Stick to the conceptual framework approach to ‘independence’ of mind and appearance (section 290.4 to 290.7) of IFAC 2009 Code of Ethics. (b) Comply with the fundamental principles of objectivity, integrity, professional competence and due care, confidentiality and ethical professional behaviour. (c) Withdraw from the engagement team (d) Supervise procedures (e) Discuss with firm’s higher management (f) Terminate the relationship.
2. Self-review	As for (1a) to (1f) above. Secondly, arrange for such services to be performed by an individual who is not a member of the audit team.
3. Advocacy	As for (1a) to (1f) above.
4. Familiarity	As for above.
5. Intimidation	As for above.

However, there are supplementary safeguards which can be distributed into ‘firm-wide’ in the work environment, ‘engagement specific’ and those within the client’s systems and procedures. These may be discussed, as follows:

- (a) **Firm-wide safeguards in the work environment include the following:**
- (i) Leadership of the firm that stresses the importance of compliance with the fundamental principles;
 - (ii) Leadership of the firm that establishes the expectation that members of an assurance team will act in the public;
 - (iii) Policies and procedures to implement and monitor quality control of engagements;
 - (iv) Documented policies regarding the identification of threats to compliance with the fundamental principle, the evaluation of the significance of these threats and the identification and the application of safeguards to eliminate or reduce the threats, other than those that are clearly insignificant, to an acceptable level;
 - (v) For firms that perform assurance engagements, documented independence* policies regarding the identification of threats to independence, the evaluation of the significance of these threats and the evaluation and application of safeguards to eliminate or reduce the threats, other than those that are clearly insignificant, to an acceptable level;
 - (vi) Documented internal policies and procedures requiring compliance with the fundamental principles;
 - (vii) Policies and procedures that will enable the identification of interests or relationships between the firm or members of engagement teams and clients;
 - (viii) Policies and procedures to monitor and, if necessary, manage the reliance on revenue received from a single client;
 - (ix) Using different partners and engagement teams with separate reporting lines for the provision of non- assurance services to an assurance client;
 - (x) Policies and procedures to prohibit individuals who are not members of an engagement team from inappropriately influencing the outcome of the engagement;
 - (xi) Timely communication of a firm’s policies and procedures, including any changes to them, to all partners and professional staff, and appropriate training and education functioning on such policies and procedures;

- (xii) Designating a member of senior management to be responsible for overseeing the adequate functioning of the firm's quality control system;
 - (xiii) Advising partners and professional staff of those assurance clients and related entities from which they must be independent;
 - (xiv) A disciplinary mechanism to promote compliance with policies and procedures; and
 - (xv) Published policies and procedure to encourage and empower staff to communicate to senior levels within the firm any issue relating to compliance with the fundamental principle that concern them.
- (b) **Engagement-specific safeguards in the work environment include:**
- (i) Involving an additional professional accountant to review the work done or otherwise advise as necessary;
 - (ii) Consulting an independent third party, such as a committee of independent directors, a professional regulatory body or another professional accountant;
 - (iii) Discussing ethical issues with those charged with governance of the client;
 - (iv) Disclosing to those charged with governance of the client;
 - (v) Disclosing to those charged with governance of the client the nature of services provided and extent of fees charged;
 - (vi) Involving another firm to perform or re-perform part of the engagement; and
 - (vii) Rotating senior assurance team personnel.

Depending on the nature of the engagement, a professional accountant in public practice may also be able to rely on safeguards that the client has implemented. However, it is not possible to rely solely on such safeguards to reduce threats to an acceptable level.

- (c) **Safeguards within the client's systems and procedure include the following:**
- (i) A client appoints a firm in public practice to perform an engagement, persons other than management ratify or approve the appointment;
 - (ii) The client has competent employees with experience and seniority to make managerial decisions; and

- (iii) The client has implemented internal procedure that ensures objective choice in commissioning non-assurance engagements.

10.8 SUMMARY AND CONCLUSIONS

This chapter examines, among other things, the concepts of self-regulation and oversight function, the Code of Ethics of the International Federation of Accountants (IFAC), (2009), quality control and peer review and Ethical threats and safeguards.

Refer to Comprehensive Questions and Suggested Solutions in Appendix II, page 269.

10.9 REVISION QUESTIONS

10.9.1 MULTIPLE-CHOICE QUESTIONS

1. Where a professional accountant promotes the position of a client to the stage that his objectivity is compromised this poses
 - A. advocacy threat.
 - B. intimidation threat.
 - C. self-review threat.
 - D. self-interest threat.
 - E. familiarity threat.
2. 'Whistle – Blowing' is
 - I. informing authorities of some breach.
 - II. the act of blowing a whistle.
 - III. reporting to authorities as a statutory requirement.
 - A. I only
 - B. II only
 - C. I and II
 - D. III
 - E. II and III
3. Which ONE of the following is not a safeguard against self-interest threat?
 - A. Comply with the prescribed fundamental principles.
 - B. Terminate the relationship.
 - C. Withdraw from the engagement team.
 - D. Stick to the conceptual framework approach.
 - E. Consult with the audit client.
4. Undertaking corporate finance services for an audit client may give rise to
 - I. self – review threat.
 - II. self – interest threat.
 - III. intimidation threat.
 - A. I only
 - B. II only
 - C. III only
 - D. I and II
 - E. II and III

5. Which ONE of the following is not an engagement – specific safeguard in the work environment?
- A. Disclosing to those charged with governance of the client the nature of services provided and extent of fees charged.
 - B. Permanently stationing senior assurance team personnel.
 - C. Involving another firm.
 - D. Involving an additional professional accountant to review work done.
 - E. Consulting an independent third party.

10.9.2 SHORT ANSWER QUESTIONS

- 1. The actions or measures designed to eliminate threats or reduce them to acceptable levels are called _____
- 2. Documenting internal policies and procedures in the work environment is a firm-wide _____
- 3. What threat will undertaking valuation services bring about?
- 4. A safeguard within the client's systems requires a competent and senior employee to manage _____ decisions.
- 5. A non-assurance service is other than _____

Refer to Suggested Solutions in Appendix I, Page 263.

CORPORATE GOVERNANCE

11.0 LEARNING OBJECTIVES

After studying this chapter, readers will be able to:

- ◆ Explain the term and concept of Corporate Governance;
- ◆ Describe the nature, significance and scope of enterprise governance and threats to effective governance;
- ◆ Evaluate theoretical framework of corporate governance, including agency problems;
- ◆ Explore regulatory framework for corporate and enterprise governance;
- ◆ Explain global developments in governance;
- ◆ Evaluate the role of accountants and auditors in governance frame work; and
- ◆ Explore cases of corporate failures and causes.

11.1 INTRODUCTION

When one thinks about corporate governance, one has in mind a corporate body whose stakeholders are supposedly guided by a set of rules and code of conduct. No one person is in a position to dominate the activities of the body corporate, cognisant of the fact that the reason for its being in existence is tied to the corporation's perpetuity. In the belief that this position is attainable in practice, one expects a well ordered corporate body to be the experience, rather than the exception, of each day. Despite the existence of code of professional practices, acts of mismanagement and decisions inimical to the interests of the stakeholders and survival of the corporate body are continuously perpetrated. There is, therefore, the need to reconnect two critical areas of the corporate governance equation: these are the shareholders and board members. There is a great need to reconnect them to the decision – making process so as to maximise the value of the corporation and its reputation.

11.2 DEFINITION

Sam Nganga, Vimal Jain and Mark Artivor (2003), “*Corporate Governance in Africa – a survey of publicly listed companies*” define Corporate governance as “the set of mechanisms through which outside investors are protected from

expropriation by insiders (including management, family interests and /or governments).”

According to the Oxford Advanced Learner’s Dictionary of Current English, 7th Edition, the word ‘expropriation’ can be defined as follows:

- (a) “Of a government or an authority to officially take away private property from its owner for public use;” and
- (b) “Taking somebody’s property and using it without permission.”
The sense of ‘expropriation’ adopted in this study pack is as volunteered in (b) above, by the dictionary. Expropriation takes several and different dimensions which include the following:
- (c) Outright theft or wrongful conversion of assets. By way of example, the managing director of a company has been caught with moving a big generator which was meant for use in the organisation’s guest house to his private residence in town or country home;
- (d) Engaging in transfer pricing of the goods manufactured, to a rival business owned by a powerful member of the board, at lower the cost of production;
- (e) Approving excessive executive compensation package which erodes the cash resources of the organisation and corruptly enriches top management;
- (f) Entrenchment of inept management team which lacks focus and runs the corporate body ineffectively; and
- (g) Committing hard-earned resources on unproductive ventures which benefit only the privileged few.

Shleifer and Vishny are of the opinion that corporate governance deals with the ways suppliers of finance to corporations assure themselves of getting a return on their investments. They make sure that managers do not misappropriate the capital or invest in bad projects.” It has been observed that in the Nigerian and other experiences, members of the board on their own or working in concert with top management may be expropriating. Consequently, corporate governance is seen as “essentially about the prevention of theft”, which can take place craftily executed by either the management or board or both of them.

11.3 THE NATURE, SCOPE AND SIGNIFICANCE OF GOOD CORPORATE/ ENTERPRISE GOVERNANCE AND THREATS / GOVERNANCE: GOOD PRACTICE AND ISSUES

Having defined the concept and dynamics of corporate governance as in paragraph 11.2, it is appropriate to state as follows:

11.3.1 Nature

- (a) It encompasses efficient and effective asset management in consonance with the ambit of regulatory, compliance and risk management principles;
- (b) Good corporate governance evidences the commitment of management to adhere to conduct which is recognized as sound and appropriate all over the world;
- (c) It promotes the commercial life and profitability of a firm;
- (d) It fosters disaster recovery and ensures the going concern disposition of a corporation;
- (e) Good corporate governance ensures the compliance and enforcement of best practices;
- (f) Good corporate governance embraces sound and enduring business procedures, processes and policies. These mitigate risks and bring about optimal operational activities; and
- (g) It facilitates internal audit monitoring and evaluation of the internal controls which are designed to mitigate all kinds of risks.

11.3.2 Scope

Corporate governance as an overall concept covers the areas of compliance with the corporate and company law, code of best practices and ethical norms, risk management so as to safeguard assets from expropriation and the installation and nourishment of internal audit functions in their helper and appraisal roles.

11.3.3 Significance

The question could be asked: “Why should there be corporate governance?” A few points of illustration to the poser is as follows:

- (a) The principal consideration is to justify its existence, by being able to produce quality goods or supply efficient and economic services, at the least possible costs;
- (b) Good governance is the system by which corporations are managed. It means the obligation to ensure appropriate and adequate controls over a corporation’s operations so as to achieve the key objectives set in an ever changing environment;
- (c) It is a scientifically outlined way of generating a competitive and reasonable return on investment for the shareholders; and
- (d) The collapse of big corporate entities such as Enron in the United States of America and others such as Polly Peck and Maxwell Communications in the United Kingdom had been attributed to the large scale fraud perpetrated by their directors and auditors.

The clamour, therefore, for the institution of corporate governance has been motivated by the expectation that it will result in companies being

diligently managed by the boards and management teams who are mere stewards for the resources placed in their care.

11.3.4 Threats to Effective Governance

In most public quoted companies, shareholders are opportuned to have information about the boards and members of top echelons only at the Annual General Meetings which tend to be poorly attended. Moreover, information distributed are substantially 'window dressed' and 'fleeting'. The directors and management staff who are entrusted with the running of the affairs of businesses slightly see the accounting standards as a set of rules to be circumvented. They exert financial and moral pressure on the auditors. Although, the accounting bodies issued fresh and more pungent standards to solidify financial reporting and auditing, indications are that directors do not appear to have reviewed the existing internal controls. Expediency, probity and accountability appear lacking in the way that directors' remuneration and incentives are resolved.

11.4 THEORETICAL FRAMEWORK, INCLUDING AGENCY PROBLEMS

11.4.1 Theoretical Framework

There is a pressing need for theoretical and solid governance framework which is heralded through the recognition and written codification of the roles and responsibilities of boards and management. An effective board should, therefore, facilitate the efficient discharge of the responsibilities and duties imposed upon the directors by law, thereby adding value with reference to the peculiarities of each company. The board, expectedly, will be an assemblage of distinguished individuals from diverse backgrounds. The board has to be structured in such a way that it can achieve three ends which are stated thus:

- (a) Proper understanding of, and capability to contend with, the matters of the company;
- (b) Effective review and appraisal of the output of management; and
- (c) Exercise of incisive and unbiased judgment.

A majority of the directors should have independent status and minds. They should be independent of management and free of all business and other relationships which could materially interfere with or be perceived to materially interfere with the exercise of independent judgment. Directors who are considered as independent by the board should be so acknowledged in the statutory annual report under the subject-matter of 'corporate governance'.

The company should state clearly the indexes of moral behaviour which are required of all the directors and top management and insist that the standards should be obeyed. The company should publish its standpoint on the issue of employees and board trading in the organisation's stocks and shares and in associated products which operate to reduce the economic risk of the securities.

The body corporate should have a structure which would independently verify and preserve the honour of the entity's financial reporting. There is, therefore, the necessity for a formidable structure or framework of review and authorization to make sure that there are truthfulness and accuracy in the company's financial position furnished. Safeguarding integrity in financial reporting could be achieved through the agency of the audit committee set up and a process to bring about the independence and ingenuity of the statutory auditors.

All shareholders should have undiscriminating and timely access to material information which concerns the company's operations – financial position, governance, ownership structure and performance. Information generated and disseminated by the reporting entity should be factual and presented in unambiguous and standardized formats, in accordance with the legal and institutional framework, namely: Companies and Allied Matters Act, Cap. C20, LFN 2004, Statements of Accounting Standards issued by the Nigeria Accounting Standards Board, International Accounting Standards issued by the International Accounting Standards Board, Nigerian Standards on Auditing issued by the Institute of Chartered Accountants of Nigeria and judicial pronouncements. The shareholder's rights should be respected and facilitated effectively. A company ought to empower its shareholders by effectively communicating with them and making it painless for them to attend general meetings.

A good corporate governance calls for a solid theoretical framework which recognises and manages risks. According to Igor Ansoff (1968), a sound and imaginative process of risk oversight and management and internal control are invaluable for corporate survival, particularly in the face of global economic and financial crisis. The system calls for the tools of identification, assessment, monitoring and managing all kinds of risks relating to production, marketing, financing, inflation, etc. In the invincible words of Peter Drucker in his book "Managing in Difficult Times," a dynamic and forward looking organisation should, at all times and more especially during economic downturn, "feed the opportunities and starve the problems as they unfold, so as remain comfortably in business."

Companies should adopt remuneration policies which induce and maintain gifted and motivated employees, top management and directors, to achieve enhanced performance. It is important for corporate entities to clearly state the relationship between performance and remuneration. Additionally, the policy which underlies executive remuneration should be understood by investors. The need to disclose the remuneration policy is a pre-requisite for reporting. Shareholders' interests and the market are best catered for through the agency of a transparent and easily appreciated framework for executive reward and its cost and benefits. The board member remuneration policy should be supported by full and effective disclosure, in consonance with the spirit and intent of the Companies and Allied Matters Act (Cap. C20, LFN. 2004) and Code of Corporate Governance in Nigeria, 2003.

Corporations owe a number of legal, social and moral obligations to non-shareholder stakeholders. Examples of the stakeholders are employees, communities and customers/clients. It is held fervently that companies can create value by optimally managing social, natural, human and other forms of capital. Most companies are subject to a number of legal specifications such as trade practices, occupational health and safety, consumer protection and effluent discharge control. In orderly societies, directors and members of top management are held personally answerable for exhibiting corporate behaviour which runs counter to the laid down norms. A board which is in charge of its destiny has to set the tone and indices of moral behaviour of the corporate entity and ensure adherence by the rank and file. Examples of the activities of social responsibility are the awards of scholarship to indigent students and the employment of the physically challenged people in the local communities. According to the chairman of Guinness Nigeria Plc, Engineer (Chief) R.A. Alabi, in his year 2005 annual statement, "the company continued with its age – long sponsorships of various sporting activities such as the Kaduna International Polo Tournament. The Water of Life Programme was expanded to cover Badia in Lagos State while discussion to commence work on state-of-the-art boreholes for Port Harcourt in Rivers State is in progress.

11.4.2 Agency Problems in Corporate Governance

The agency problems which emanate are many and diverse. They include the following:

- (a) The discreet interests of the agents of a company such as board members and top management vis-a-vis those of the entity do not always converge. Rather, they are divergent. Since the individual interests run counter to those of the body corporate, there is goal incongruity, misapplication of resources, lack of

trust, possible fruitless litigations, inability to earn fair reward on the capital employed and complete corporate failure;

- (b) Many corporate boards fail to do their jobs. A lot of them revel in mundane issues and 'board room' politics, thereby derailing from their avowed responsibilities. Others are not sufficiently informed about the nature of the business of the company. Indeed, some see their positions as offers of offices and 'ego trips';
- (c) There are instances of over-bearing boards which do not give their chief executive officers any breathing space. Conversely, certain chief executive officers and top management are uncompromising with the boards. Indeed, in some instances, there have been such comments as "many boards continue to have directors whose only credence is that they have personal relationship with the chief executive officer." Such directors cannot, therefore, serve as watchdogs, nor can they perform their oversight functions; and
- (d) The job of looking for new board members is sometimes devolved on the chief executive officers who tend to select directors that they "can count on." The end result is that the fear of inflicting damage to the 'friendly' relationship between them tends to deprive the chief executive officers of the performance evaluation, counsel and criticism that they would have needed.

11.5 MINIMISING THE THREATS OF AGENCY COSTS AND BENCHMARKING GOVERNANCE CASES IN PRACTICE

11.5.1 Minimising The Threats of Agency Costs

The first requirement is to define terms. The Chambers Universal Learners Dictionary volunteers the following definitions for 'a' and 'b':

- (a) **Minimise**
"To make as little as possible."
- (b) **Threat**
"A warning that one is going to hurt or punish someone. A sign of something dangerous or unpleasant which may be, or is, about to happen."

Aluko et al (2007) define a threat as "an issue or condition in the external environment that may prevent the firm from reaching its goals."

(c) **Agency**

Big and Thompson (1966) define 'agency' as "the relationship between the principal and the agent. It is usually, though not necessarily, created by contract between the principal and agent and is then analogous to, but not identical with, the contract between a master and a servant. Apart from any express appointment of an agent, the law itself may impose the relationship of principal and agent with its attendant consequences as, for instance, where the doctrine of agency of necessity is applicable. **An agent is a person having express or implied authority to act on behalf of another person, who is called the principal, with the object of bringing the principal into legal relations with third parties**" (emphasis mine).

According to The Chambers Dictionary (2003), a principal is "a person who, being **sui juris**, that is, of legal capacity, employs someone else to do an act which he or she is competent himself to do."

- (d) Horngren (1982) defines 'costs' as "resources sacrificed or forgone to achieve a specific objective. The resources may be financial or non-monetary."

In Chapter 7.1, it is appreciated that a corporation or company is an artificial legal person which can sue and be sued through its accredited representatives or agents such as board members, top management and all the people who "call the shots" in the organisation. The corporate person has "neither body, mind nor soul." According to Mary Oliver (1971), "corporations cannot commit treason, nor be outlawed, nor excommunicate, for they have no souls. Although, corporations can sue and be sued in their names, it is the board members and / or management who are natural persons and control the destiny of the companies, as agents, who stand for them.

All the partners of a partnership are agents for one another; each partner can bind the others in the course of executing contracts on behalf of the firm. Each partner is a principal and an agent at the same time. Partners are in a fiduciary position with each other. "They must not only tell each other the truth in conducting the business, but they must disclose the whole truth." (Mary Oliver (1971)). Conclusively, partnership relationship is "uberrimae fidei," that is, of utmost good faith.

In a consignment business, the person to whom goods are forwarded or consigned is an agent. He is a representative of the consignor, in good faith, and is expected to behave as an ordinary man of business.

An agent has implied authority to act as he considers fit for effectively carrying out his duties for as long as he does not exceed the extent of the power of his principal. By the simple rule of estoppels, a wife is the agent of her husband to the extent that she has been pledging his credit with identified suppliers and the husband has been settling the bills.

11.5.2 Minimising or reducing the threats of agency costs - financial and moral involve the following under-listed actions or developments:

- (a) Where the principal puts up a highly publicized disclaimer or alerts the suppliers from whom the purported agent collects goods or services, especially in the case of a wife who commits her husband, it is the agent who faces the liabilities to the thirty parties;
- (b) A company's agents who transact businesses, in the ordinary course of events, include the board members and managing directors/chief executive officers. All actions taken by the agents should be intra vires, inviolate and protective from expropriation, insider trading or 'rip-offs' of the principals, outside investors and members of the public. Where the story is different from the one stated, the long and enduring hand of the law of the land should apprehend and punish the officers;
- (c) Instituting dynamic and forward looking corporate governance principles, as suggested under 10.4.1. Any member of the board or top management who commits an infraction of any of the laid down procedures deserves to be shown the way out of the company;
- (d) There should be corporate rules and regulations in codified form, for every employee down the 'scalar chain' to adhere to. Infringements should not be spared; and
- (e) The measures of good governance discussed in Section 10.4.1 should be strengthened by the tenets of the Code of Corporate Governance in Nigeria, 2003 and the pronouncements of the Institute of Chartered Accountants of Nigeria (ICAN) and International Federation of Accountants (IFAC). The two publications are discussed fully under Section 10.9.1, "Regulatory Framework for Corporate and Enterprise Governance." A member of The Institute of Chartered Accountants of Nigeria who infringes any of the indices of ethical code of conduct is severely dealt with.

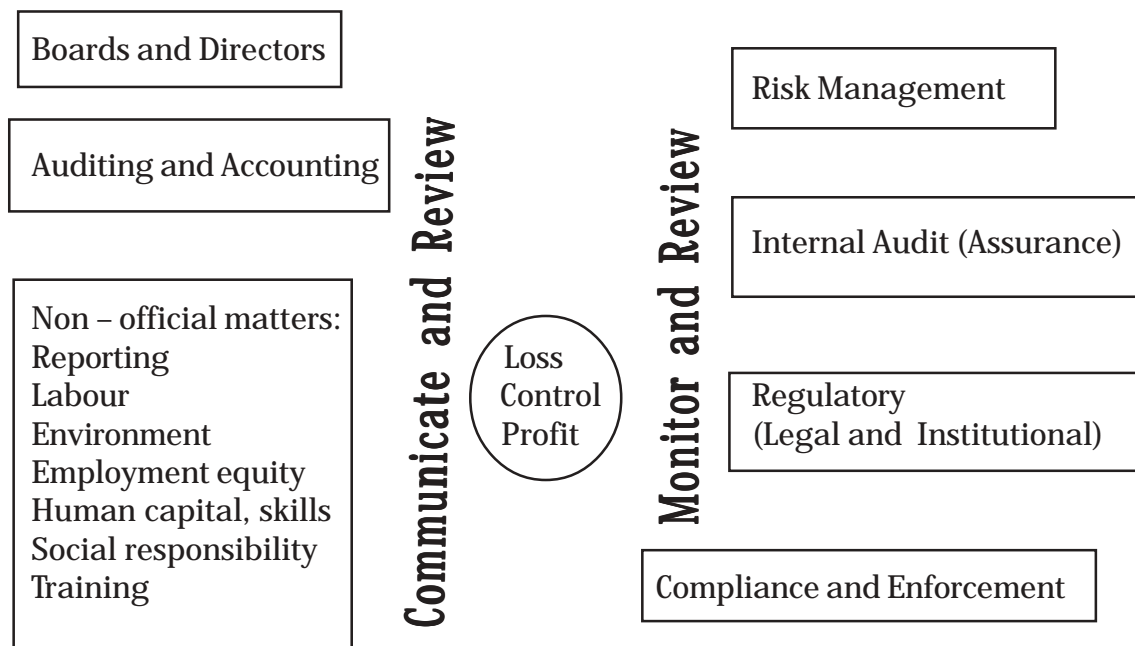


Figure 11.1 Holistic Corporate Governance Profile

Source: Unpublished

Tutorial

Figure 10.1 shows the “constituents/power points” of activities and offices of a company which consolidate into the profile of a typical good corporate governance.

11.5.3 Benchmarking Governance Cases in Practice

What does the word ‘benchmark’ mean? The Chambers Dictionary (2003) defines ‘benchmark’ as “something taken or used as a point of reference or comparison; a standard, criterion, etc.” From the definition stated above, a ‘benchmark’ is, therefore, a measure below which performance or expectation should not fall. It is a yardstick of efficiency or goal optimization. When the concept is applied to governance cases in practice what is being addressed is the sustainability of congenial business environment where there are order, discipline and strong ethical standards underlying the operations of a company. Implementing the stipulations of the Code of Best Practices in Nigeria, the Institute of Chartered Accountants of Nigeria (ICAN) Rules of Professional Conduct for Members and International Ethics Standards Board for Accountants (IESBA) Code of Ethics for Professional Accountants can be seen as ‘benchmark’ or ‘standard’ of moral behaviour. However, other areas or issues to be examined include:

- (a) Boards of directors need not be set up where there is no legal obligation to do so, unless there is assurance that they will add distinct value to the running of the affairs of the corporations. If there is a board in place, the heart of its contribution is the role it has to play in moderating the conflicts of interests among the various stakeholders;
- (b) Board members should be experts in their various fields. They should have deep knowledge of the finance, laws and regulations and complexities of the company and the industry to which it belongs. Board members who are deficient in expertise in the core industry will not be effective partners in the process of decision making;
- (c) There is the need to hire compensation or personnel consultants. The appointment should be handled by the board's compensation committee and not the company's human resources officer, for fairness. The consultants are likely to be objective and independent, since they are from external sources, rather than unduly favour top management. The consultants will most likely come up with fair and reasonable remuneration packages payable throughout the company;
- (d) There should be formal evaluation of the managing director or chief executive officer on a yearly basis. The compensation committee of the board should have vital responsibility of annual review of the succession plans for the senior management of the company, so that there will not be the personalisation of offices. Evaluating the chief executive officer by the board rather than outside agency assists him or her to preserve humility. This would otherwise not be achievable under the chief executive officer of a sizeable company; and
- (e) Just as with the chief executive officers, boards should conduct periodic review sessions of directors. With the assistance of management, directors from outside can evaluate the contribution of each of their members at, say, five yearly basis, after the first appointment. Those who are underperforming should not be put forward for re-election.

11.6 SCOPE, BACKGROUND AND CONCEPT OF CORPORATE SOCIAL RESPONSIBILITY, CORPORATE AND OTHER SOCIAL RESPONSIBILITIES, AND LIMITS OF SOCIAL RESPONSIBILITY ACTIVITIES

A school of thought believes that it is proper and sound for business organisations to lend their support to worthy community assistance such as building schools and hospitals, equipping them with material logistics, or even employing the

physically challenged people. Another insists that the only obligations of a commercial company are to obey the laws of the land and earn profits for its investors. Yet others are of the opinion that companies need to concern themselves with charitable courses only.

According to Elegido (1996), maximizing profits does not strictly imply working towards the generation of greater profits. What it means is making efforts to make large profits and subordinating literally such considerations as social welfare and the environment. While it may be desirable to render community services, it is not mandatory and neither is it a priority. Friedman (1970), the famous monetary economist, believes that a company's one and only responsibility is to maximise profits for its investors as long as it acts within the law. He is of the opinion that going beyond this objective is synonymous with having "socially responsible executives" who have to act as "redistributors who take other people's money, that is, the shareholders, and spend it on what these executives themselves defined as **general social interest**, as if they were some sort of self – appointed tax collectors." Friedman contends that it is better for the executives of a business to stick to maximising profits, as they will more appropriately and effectively be "led by an invisible hand" to enhance the comfort of the common man. Friedman supports charity and assisting the needy. He, however, does not support making available to the needy what belongs to other people. What, in effect, Friedman is saying is that a company's shareholders should be left to show generosity in the areas of their choice, at their own pace and measure.

The idea of Friedman that nobody is tied to moral responsibilities which exceed the law does not appear to be sound.

Firstly, legal prescriptions, because of the difficulties with their enforcement, tend not to create room for implementation. For example, a father has the legal duty to cater for his children. But he has moral obligations such as the provision of affection and protection from all forms of cruelty, as well. The moral duties are not matters of law, yet they have to be respected and honoured.

Secondly, the peculiarity of the law is its slowness, especially in Nigeria, in finding a solution to an identified problem. There is some time lag before a suitable law is in place. Moreover in certain societies, the cost of justice is prohibitive.

Thirdly, in some places, there are laws which are morally objectionable. An example is a law which is in existence and which has to do with religious discrimination, in some parts of the world.

In view of the reasons outlined above, it does not appear sound that all a person needs to do is to keep to the tenets of the law and nothing more. There is the duty of care to one's neighbour. The code of moral rules or responsibilities applies to both natural persons or individuals as well as body corporates.

- 11.6.1** The law is unambiguous on the issue that a body corporate's assets belong to the company, rather than the shareholders. In case of liquidation, for examples, Section 279(4) of the Companies and Allied Matters Act, Cap. C20, Laws of the Federation of Nigeria (LFN) 2004, states that the directors should take into consideration the interests of their employees. This disposition assumes that a company can make donations which have to be disclosed in the corporation's annual reports.

Most public companies in Nigeria operate corporate social responsibility initiatives which are designed to improve the quality of lives in the communities in which they operate. As an illustration, the Annual Report of Year 2005 of Guinness Nigeria Plc discloses the following information on its social responsibility initiatives, thus;

ILLUSTRATION 11.2

"In furtherance of the well known corporate objective of giving back to the community in which it operates, Guinness Nigeria plc has made several contributions to the society in the area of education, health, sports, culture and social infrastructure. Your company has continued its support to the educational sector by donating computers to several institutions in Lagos, Edo and Abia States as well as the Federal Capital Territory. The engineering scholarship scheme being sponsored by the company in collaboration with the Nigerian Society of Engineers is also on course and the first set of beneficiaries should emerge before 31st December 2005. The company continued with its age-long sponsorships of various sporting activities such as the Kaduna International Polio Tournament."

Source: Guinness Nigeria Plc Annual Report and Financial Statements (2005, p. 18)

11.6.2 Limits of Social Responsibility Activities

There are limits to what human beings and companies can pass for social responsibility initiatives. Corporate bodies and persons have specific missions for going into businesses. Social responsibility considerations are mere secondary issues. Time, financial resources and capacities impose their own limitations. Where a number of people have come together as a group, for some specialized purposes such as religious worship in a church, it would not be fair to set aside a substantial amount of the collective resources to the execution of programmes which were not anticipated at the entry point of each member of the group. The pungent fact is that it is not only body corporates which have to be socially responsible. The rest of mankind should imitate, if not surpass them.

11.7 STAKEHOLDER RELATIONSHIPS

The stakeholders of corporations and boards have earlier been identified and discussed in paragraphs 6.5 and 6.5.2 of Chapter 6. The relationships between them are expected to be of collaboration and symbiosis. The interdependence which exists can be likened to the mutual co-existence between plants and animals. An example of the area of interdependence is that plants require carbon dioxide which animals breath out, to photosynthesise for their growth and survival. Animals, including human beings, exchange the carbon dioxide which they breath out for the oxygen which plants release.

- 11.7.1** Robert H. Frank (1988) in his book “Passions Within Reason: The Strategic Role of the Emotions,” says that by being generous to people and acting out of fairness one will be exhibiting or exuding emotional traits as warmth and sympathy which tend to germinate of their own seed particularly among the parties to whom kindness has been shown. As Professor Frank highlights, even a baby whose consciousness and horizon are yet to develop can distinguish between genuine smile and frown.

Experts in the field of Ethics say that nice, benevolent and helpful individuals are the people that many others will like to associate with. They observe further that each time a person disregards the convenience of other people that individual tends to reduce the importance of his own well-being for others and the strength of the bonds which can bring them together. Professor Elegido (1996) states that being so inconsiderate is “cutting oneself from other human beings.”

- 11.7.2** There are ethical rules of behaviour or principles that stakeholders, just as other members of the human race, should embrace, to safeguard the interdependence spirit. The ethical rules include the following:

(a) **The Rule or Principle of Fairness**

Whatever standard or benchmark of behaviour which one applies in judging one’s own actions should be the same measure to be used in reference to others. The principle accords with the advice which is often given in secular life that you should “put yourself in his position.” However, the principle of fairness does not prescribe that everybody should be treated in the same way, as long as one has a reason for effecting discriminating consideration that would also be logical if other people were affected. The illustration given below depicts a scenario.

ILLUSTRATION 11.3

Gbolahan Akinlawon has just taken his salary of ₦50,000 for the month. He has to pay his driver ₦10,000 and child's school fee of ₦15,000, leaving him with only ₦25,000 to run family expenses. Gbolahan Akinlawon's mother-in-law arrived two days later, with a request for financial assistance of ₦30,000 to roof her collapsing building. Gbolahan Akinlawon tenses up on what to do. Advise him accordingly.

SUGGESTED SOLUTION 11.3

The principle of fairness never imposes the obligation to treat everybody and every case in the same way. Experts who handle ethical issues insist that fairness prevails by treating different people in different ways so long as it is logical to so discriminate, a premise or circumstance which would hold sway for others if they were in similar situations. Gbolahan Akinlawon should pay his driver and child's school fee, all amounting to ₦25,000. He is entitled to prioritizing by honouring his contractual obligations to the driver and taking care of his immediate dependents. He is, therefore, not obliged to give anything to his mother-in-law.

(b) The Principle of Co-operation, Solidarity or Community

This rule of conduct enjoins everybody to be concerned with the well-being of each other. For as long as a person neglects to do the bidding, the individual is undermining his own fulfillment as a member of the human race. Certain people believe that it is naive to be over-trusting. They believe that the principle of solidarity is altruistic; that it is as risky as the fate of the biblical 'good Samaritan.' They, therefore, hold that it gives advantage to ignore other people's conveniences and hold fast to one's interests, in the spirit of "nice people take last and worst" or "nice people get trampled upon, mean people end up on top." If everybody strives to cooperate and work towards the well-being of each other, with time and consistency, "loyal and loving people" identify themselves and form partnership, leading to fairly good results. On the other side, there are grabbers or opportunists who engage themselves in trying to reap where nothing has been sown. They 'win' a few times, though. But the co-operative people win most of the time.

(c) The Principle of Rationality

The rule here is that one should always act intelligently or reasonably. Perhaps, people desire to act intelligently all the time, except in situations where self-interests by way of emotion come in. It has

been observed that whoever acts devoid of thinking, tends to be swayed by anger, fear or enthusiasm. In endeavouring to be rational in all ways, there are two basic things to consider. The first consideration is the means which will be used that will attain most efficiently and effectively the set objectives. The second and higher level of reasoning or rationality is to consider intelligently the quality and adequacy of resources deployed in relation to the desired ends.

(d) **The Principle of Refraining from Willed Harm on a Human Being**

The principle is that it is not right to directly choose to harm a human being, no matter how worthy the cause of the action is. Inflicting harm directly is willed when the idea of who does it is just to inflict the harm. The idea may be an end in itself (for example, killing during a war for conquest, or out of hatred). It may be as a means to achieve a greater end, such as forcibly taking the victim's property.

However, harm is deemed not to be directly willed or inflicted when it is only a natural consequence or result of the action of the actor which is not intended or undertaken as a means or as an instrument of achieving a further objective. An example of an unwilling harm will be coincidental deaths of innocent civilians arising from bombing acts of legitimate military targets.

(e) **The Principle of Role Responsibility**

Nature does not equally distribute the responsibility for all the comfort and well-being of all men. The special privileges, capacities, attributes and roles allot an individual a priority responsibility for specified aspects of the welfare of fellow beings. Those who are in the medical profession care for the sick while nature cures. Engineers construct roads and bridges and manufacture vehicles. Accountants advise on finance and manage it. They keep records, prepare and interpret accounts. The natural distribution of persons into the various professions which supply the needs is 'role responsibility' arrangement.

11.7.3 Ethical Standards and Business Effectiveness

A company is an economic agent. Upholding high and consistent ethical standards contributes significantly to business effectiveness. Ethical behaviour enhances a company's good reputation, encourages other firms and individual persons to trust it. Employees tend to show their loyalty and commitment to a company which conducts its affairs in an ethically sound manner. The attributes highlighted above cannot be

imitated. They tend to confer sustainable competitive advantage upon the firm which displays and practices ethical norms, over and above other companies.

11.7.4 The synergy which the symbiotic relationships between the various stakeholders impacts on corporate governance is very strong. The following areas can be identified:

- (a) The World Bank, through its President, James Wolfensohn, once declared in 1999, “the proper governance of companies will become as crucial to the world economy as the proper governance of countries.” Raising the standards of corporate governance is therefore expected to assist developing countries as Nigeria to attract foreign investments. International institutional investors look for strong board effectiveness, transparency, accountability and financial probity wherever in the world they like to put their money.
- (b) There is strong positive association between the commitment and loyalty of employees and the moral index of a corporation. Where a country or company is selfishly run by the leaders, in a way that says “we live, others may die,” the citizens or employees will adopt the same way of life. A company has to provide a facilitating environment for high productivity and production to take place and pay its employees fair salaries.
- (c) A company produces goods and services of the right quality and quantity, in consonance with the stipulations of the Sale of Goods Act and as ordered for by the purchasers. The goods and/or services supplied solve the problems of the customers and help them lead more qualitative lives. Where a company is able to generate enough net earnings to equip it to meet its primary responsibilities, what the organisation is expected to do next is to work towards mitigating the unfavorable side effects of its activities. This is achievable by compensating the persons or communities affected. The oil producing areas of Nigeria ought to be well compensated for all the pollution and environmental degradation caused by the oil companies.

Companies pay their corporation taxes; remit withholding and pay-as-you-earn tax deductions made on behalf of Government, promptly. Companies should not undertake unethical practices by funding their cash flow shortfalls at the expense of their suppliers. A typical way of doing this is by deliberately increasing average period of paying creditors, contrary to an existing written or implied agreement to settle accounts within a specified period of time.

Firms display responsibilities towards their competitors by engaging only in ethical competition which ultimately yield quality products and services. Co-operation is fostered by not spreading damaging information, otherwise called ‘de-marketing,’ about each other.

(d) Government

Government is the greatest ‘player’ in the economy. It has to provide good roads, excellent health facilities, schools and security for the citizens. Government is expected to generate employment opportunities and create the atmosphere for the inflows of foreign investments through impeccable and enduring corporate governance. It has to manage the country’s economy diligently with the highest degree of prudence, probity, transparency and accountability. A responsible government should be a listener and borrow freely from the logic and reason behind constructive criticisms. From time to time, government has to submit stewardship for appraisal. Where government “lays good example in the society” the various other stakeholders which include those discussed earlier will collaborate to make living near perfection in the society.

11.8 GLOBAL DEVELOPMENTS AND REGULATORY FRAMEWORK FOR CORPORATE AND ENTERPRISE GOVERNANCE

Organisations over the world such as the United Nations have been clamouring for improvement in corporate behaviour. Member States of Organisation of Economic and Cultural Development (OECD) and such countries as Brazil and Chile have put their signatures on a new international code of standard behaviour relating to international models and prescriptions to be followed by the multinational companies. The collapse of big corporate entities as Enron Corporation in the United States of America and others such as Polly Peck and Maxwell Communications in the United Kingdom had been traced to large scale fraud committed by their directors and auditors.

The agitation for the installation of sound corporate governance arises from the expectation that it will result in companies being diligently directed by the boards and management - the trustees. The strategies mapped out are designed to bring in sanity and accountability in corporate governance.

Consequently in the United Kingdom, just as in Nigeria, company’s legislation has led to the establishment of audit committees. Indeed, independent committees have generated series of reports which include the following:

(a) Greenbury Report

The Greenbury Committee came into being as a reaction to continuing public agitation against the excessive remuneration and perquisites which directors are paying themselves, out of tune with the operating and financial fortune of companies, and the failure to make adequate disclosure about the former. The Greenbury Committee's recommendations on directors' remuneration have since been included in the Listing Requirements of the London Stock Exchange.

(b) Turnbull Report

The main clamour in this report is the institution of efficient and effective system of internal control and its continual review and appraisal. The report, advocates very strongly that a company's assets and shareholders' interests should be well safeguarded. The review activity should embrace all controls - administration, security, financial, accounting and risk management. The London Stock Exchange includes the installation and nurture of sound internal control system as ventilated in the Combined Code in the Listing Requirements of new companies.

Indeed, provision D.2.1 of the Combined Code states that "The directors should at least annually, conduct a review of the effectiveness of the groups' system of internal control and report to shareholders that they have done so."

(c) Cadbury Report

This Committee was set up to address the lack of public confidence in the financial reports rendered by boards of companies and the ability of the auditors to attest to their credibility. The reservation held by the public is borne out of the perceived relationship between the boards of directors and auditors.

(d) Hampel Report

The report centred generally on bringing improvement to bear on corporate governance. It restricted the regulatory commitment to comply with on companies. The London Stock Exchange considered the report of the Committee and subsequently published what is known as the 'Combined Code.'

In the United States of America and United Kingdom, political fervour is there to revolutionise corporate governance in theory and practice, through improved legislation. However, it has to be admitted that the pre-requisites on the part of every board member and management are self-regulation and personal virtues, for pragmatic and near flawless corporate governance to manifest.

In more politically and economically informed countries or societies, it has been mooted that a way of strengthening corporate governance is the operation of a structure of two-tier board. Thus, there would be an executive board, and a supervisory board, for necessary checks and balances.

11.9 CORPORATE GOVERNANCE IN NIGERIA: THEORETICAL FRAMEWORK

There is no gainsaying the fact that effective corporate governance is an enduring factor which enables an establishment to evolve business excellence. It is capable of enhancing board competence and teamwork which will result in much improved benefits to the shareholders.

As a means of obtaining good governance in Nigeria so as to move with time, the Securities and Exchange Commission and the Corporate Affairs Commission instituted a seventeen member committee headed by Atedo Peterside N. A., the Managing Director and Chief Executive of IBTC Chartered Bank Plc, in June 2000. Membership of the committee cut across regulatory bodies, personalities and disciplines. The terms of reference of the committee were:

- (a) Identifying lapses in the current corporate governance practices in Nigeria, with respect to public companies;
- (b) Examining practices in other jurisdictions with a view to adopting international best practices in corporate governance in Nigeria;
- (c) Making recommendations on appropriate changes to be effected in the current governance practices; and
- (d) Examining other issues which relate to governance in Nigeria.

The committee came up with a draft code of corporate governance on 12 July, 2001. It was highly publicized and appraised by the various stakeholders. The final report centred on Code of Best Practices on Corporate Governance in Nigeria and was approved by the Boards of the Securities and Exchange Commission, being the regulatory authority of the capital market, and the Corporate Affairs Commission as the regulatory authority of companies in Nigeria. The main thrusts of the code are the directors of the boards who row the boards of corporate organisations, and the responsibilities of other stakeholders, shareholders and professional bodies.

11.9.1 REGULATORY FRAMEWORK FOR CORPORATE AND ENTERPRISE GOVERNANCE

The Code of Best Practices (2003) identified three 'key players' in the implementation process and prescribed the functions and responsibilities for each of them. The principal actors are the boards of directors, shareholders and audit committees. They are briefly discussed, as follows:

11.9.2 Boards of Directors: Their Functions, Responsibilities and Composition.

These may be summarily highlighted, thus:

(a) **RESPONSIBILITIES AND FUNCTIONS OF A BOARD OF DIRECTORS:**

Responsibilities -----

- (i) The board of directors should be in firm control of the affairs of the company in a lawful, efficient and effective manner, such that the organisation may increasingly improve on its value creation; and
- (ii) The board should, with due regard to the other stakeholders' interests, ensure that the value created is shared among the interested parties such as the shareholders and employees.

Functions

The functions of the board should include, but not limited to, the following:

- (i) Strategic planning;
 - (ii) Selection, performance appraisal and compensation of senior executive members;
 - (iii) Succession planning;
 - (iv) Communicating with the shareholders;
 - (v) Ensuring the integrity of financial controls and reports; and
 - (vi) Ensuring that ethical standards are maintained and that the company complies with the laws of Nigeria.
- (b) The chairman's primary responsibility is to ensure effective operation of the board and as much as possible distance himself from the day-to-day running of the company which is the primary responsibility of the chief executive officer and management team;
 - (c) The board is the main custodian of the corporation's accountability; and
 - (d) It moderates the conflicting interests of the stakeholders.

11.9.3 Composition of Board of Directors

- (a) The board should be composed in such a way as to ensure the diversity of experience, without compromising compatibility, integrity, availability and independence;

- (b) Membership of the board should rest on the following attributes:
 - (i) Uprightness in character;
 - (ii) Distinctive competencies;
 - (iii) Knowledge on board matters;
 - (iv) Entrepreneurial bias; and
 - (v) Sense of accountability, integrity, commitment to the task of corporate and institutional building.
- (c) The position of the chairman and chief executive officer should ideally be separated and held by different persons;
- (d) There should be a strong non-executive independent director as vice chairman of the board, where the position of the chairman and chief executive officer are combined in one individual.

11.9.4 Managing the Affairs of the Board

- (a) The board should meet regularly, at least once in a quarter, with sufficient notices and a formal schedule of matters or agenda specifically reserved for deliberations, so as to maintain effective control over the company, the executive and management.
- (b) There should be an agreed procedure for directors to take independent professional advice whose cost should be borne by the company, in furtherance of their duties, if necessary.
- (c) All directors should have access to the advice and services of the company secretary who should be appointed by the board and is responsible for ensuring that corporate procedures are followed and that applicable rules and regulations are complied with. His removal should be decided by the board only.
- (d) All the directors should have access to the advice and services of other professionals in the areas where such assistance will improve the quality of their contributions to the overall decision making process.

11.9.5 The Position of Non-Executive Directors

- (a) Non-executive directors should bring independent judgment to bear on issues such as integrity, performance, resource management; making key appointments and ethical standards;
- (b) Shareholders' approval is required where directors' service contracts are to exceed three years;
- (c) Other than their fees and allowances, non-executive directors should not be dependent on the company for their income. They should be independent and not be involved in business

relationship with the company, a situation that could fetter or encumber their independent judgment;

- (d) Non-executive directors should neither participate in the company's share option scheme nor be pensionable by the company;
- (e) An appointment as non-executive director should be for a specified period and re-appointment should be a product of excellent performance;
- (f) It is for the entire board to decide the appointments of non-executive directors. These should be done through a well-defined formal selection process;
- (g) Skills mix of executive non-directors should reflect the range of the competency needs of the company;
- (h) Proper company and board orientation should be undertaken by newly appointed directors and, where necessary, formal training aimed at making them effective in the discharge of their duties should be given at company cost.

11.9.6 The Role of Executive Directors

- (a) There should be full and clear disclosure of directors' total emolument, those of the chairman and highest paid director, including pension contributions, stock options, where the earnings are in excess of ₦500,000;
- (b) In the determination of their remuneration, executive directors should not play any active role.

11.9.7 Compensation of Board Members

- (a) The remuneration of executive directors should not be fixed in the shareholders' meeting, but by the board;
- (b) The remuneration should be recommended by the appropriate committees, wholly or mainly composed of non-executive / independent directors and chaired by a non-executive director;
- (c) The following should be disclosed in relation to directors' remuneration:
 - (i) Directors' emolument and those of the chairman and highest paid director;
 - (ii) Relevant information about stock options and any pension contribution; and
 - (iii) Future service contract.

11.9.8 Reporting and Control

- (a) It is the duty of the board to present a balanced, reasonable and transparent assessment of the company's position;
- (b) In financial and non-financial reporting, there is an overriding need to promote transparency;
- (c) It is the primary responsibility of the board to ensure efficient and effective internal control system;
- (d) The board should ensure that objective and professional relationship is maintained with the external auditors;
- (e) External auditors should not be involved in business relationship with the company;
- (f) There should be an audit committee of at least three non-executive directors who have written terms of reference which deal clearly with its authority and duties;
- (g) A report on the effectiveness of the company's system of internal control should be presented by the directors in the annual report;
- (h) In compliance with the Companies and Allied Matters Act, the directors should report that the business is a going concern or otherwise, with supporting assumptions or qualifications as necessary, with the written terms of reference.

11.9.9 The Role of Shareholders

Shareholders' Rights and Privileges

- (a) The company, through the directors, should ensure that shareholders' statutory and general rights are protected every time;
- (b) It should be the responsibility of the shareholders to elect directors and approve the terms and conditions of their directorship positions;
- (c) The venue of the annual general meeting should be carefully chosen such that the shareholders could attend and vote and not be disenfranchised as a result of distance and cost;
- (d) Before the annual general meeting, notices should be dispatched at least 21 working days, with such details and annual reports, audited financial statements and other information that would enable the shareholders to vote properly on any issue.

- (e) A separate resolution should be proposed by the board at the general meeting on each substantive issue in such a way that they could be voted for in an organized manner;
- (f) The board has to ensure that decisions reached at the general meetings are implemented;
- (g) There ought to be at least one director on the board to represent minority shareholders;
- (h) Unless they are in a competing business or have conflicts of interest that warrant their exclusion, shareholders holding more than 20% of the total issued share capital of the company should have a representative on the board;
- (i) The board should ensure equal treatment for all shareholders, such that none is given preferential treatment or superior access to information or other materials; and
- (j) The annual general meeting should be recognized by the board as the most potent avenue to communicate with the shareholders and encourage their participation.

11.9.10 The Rights and Privileges of Institutional Investors

- (a) Shareholder activism by whether institutional or organized shareholders' group, should not be discouraged by the board;
- (b) Institutional and non-institutional shareholder with larger holdings should act and influence the standard of corporate governance, positively, thereby ensuring the optimization of stakeholders' value; and
- (c) Information made available to institutional shareholders should also be made available to other shareholders at the same time and in such a manner as to ensure that neither group enjoys preferential treatment.

11.9.11 Audit Committee

The Place of Audit Committee

- (a) Audit committees should be established by companies, with the primary idea of raising the standard of corporate governance;
- (b) The committee should not be under the influence of any dominant personality on the main board, neither should it interfere with the executive management;

- (c) Audit committees should not act as a barrier between external auditors and the executive directors or encourage the main board to abdicate responsibilities in reviewing and approving the financial statements; and
- (d) Audit committees should be made up of strong, independent and knowledgeable personalities from different backgrounds.

Composition of an Audit Committee

- (a) An audit committee should be established in accordance with Section 330 (3) of the Companies and Allied Matters Act, Cap. C20, LFN 2004, with not more than one executive director;
- (b) A majority of the non-executive members serving on the committee should be independent of the company in terms of management or business or other relationship, which could materially interfere with the exercise of their independent judgment as committee members;
- (c) A non-executive director nominated by members of an audit committee should serve as the chairman;
- (d) Membership of an audit committee should be for a fixed tenure; however, any member is eligible for re-election;
- (e) The secretary of the audit committee should be the company secretary, auditor or such other person nominated by the committee.

Qualification and Experience of Members of an Audit Committee

- (a) Members of an audit committee should be able to read and understand basic financial statements and make valuable contributions to the committee's deliberation;
- (b) An audit committee should review not only external auditor's report but also, most importantly, the report of the internal auditor;
- (c) Members of the committee should possess the following qualities:
 - (i) Integrity;
 - (ii) Dedication;
 - (iii) Thorough understanding of the business, its products and services;
 - (iv) Reasonable knowledge of the risks facing the company and the essential controls which it has in place;
 - (v) Ability to offer new or different perspective and constructive suggestions; and

- (vi) Inquisitiveness and dependable judgment.

Terms of Reference for Audit Committee

- (a) In line with Section 359 (6) (a-e) of the Companies and Allied Matters Act, Cap. C20, LFN 2004, the committee should be given terms of reference;
- (b) The performance of the committee and its members should be evaluated periodically, as could be decided by the company; and
- (c) The committee should maintain constructive dialogue between the external auditors and the board; enhance the credibility of the financial disclosures and the interest of the shareholders.

Meetings of an Audit Committee

- (a) The number of members of an audit committee will determine the quorum for the meetings and it should be specified in the terms of reference of the committee;
- (b) The committee has to meet at least three (3) times in a year;
- (c) The committee should hold a meeting with the external auditors at least once a year, without the presence of any executive member of the board.

11.9.12 Enforcement and Compliance

As can be appreciated from the above, the enforcement of good corporate governance is more of self-regulatory effort than statutory backing in the UK, USA and internationally. Large institutional investors tend to exert pressure upon companies to improve on corporate governance. It has generally been argued that in this issue, voluntary compliance should be encouraged. Where it becomes necessary and applicable, appropriate sanctions should be applied. This is the position adopted by the Securities and Exchange Commission (SEC) and Corporate Affairs Commission (CAC) in the enforcement of compliance with corporate governance Code of Best Practices in Nigeria.

11.10 THE CODE OF PROFESSIONAL CONDUCT OF THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA

- 11.10.1 The Institute of Chartered Accountants of Nigeria offers a lot of guidelines for members to diligently adhere to in its “Rules of Professional Conduct for Members.”** The Code is introduced by the expression, “Guidance Not Exhaustive.” It directs that members should be guided not just by the terms, but also by the spirit of the Code. Members

are admonished that the fact that a particular conduct not featuring amongst a list of examples does not prevent it from amounting to misconduct.

Under paragraph 6.2.2, “Table 1: Analysis of Ethical Standards issued by The Institute of Chartered Accountants of Nigeria,” effort was made by listing out the statements of moral requirements.

Further brief discussion of the attributes or virtues of behaviour include the following:

(a) **Integrity**

According to Section 110.1 of the Code of Ethics for Professional Accountants (IFAC, 2009), ‘integrity’ goes beyond honesty. A member should exhibit fair dealing and truthfulness in all his business and professional relationships.

(b) **Objectivity**

A chartered accountant and member of the Institute should not be influenced by bias or emotion in the performance of his professional obligations. His mind should be set on all considerations concerning the task in hand but no other. “The principle of objectivity imposes an obligation on all professional accountants not to compromise their professional or business judgment because of bias, conflict of interest or the undue influence of others” (IFAC, 2009);

(c) **Independence**

A professional accountant should not be under the control of other people or things. He should act independently of the proprietors of the firm that engaged his services;

(d) **Confidentiality**

Information which is confidential to a client and obtained in the course of professional assignment should not be divulged to third parties, unless with the knowledge and consent of the client or employer, or there is legal compulsion to do. Nevertheless, the chartered accountant should first notify his client or employer before making the disclosure. In case a member has a dilemma as to his right or duty to disclose information, he should seek legal advice or consult the Institute for guidance. It should be clarified that in certain situations, it could be criminal to use confidential information unjustly.

(e) Consultancy

All affiliates, employees of practising firms and practising members who engage in auditing, accounting and all forms of consultancy come under Statement No. 5 of ICAN's Rules of Professional Conduct. The rule states that "if a member in practice, that is, the practitioner obtains the advice of another member (that is, the consultant on a consultancy basis on behalf of a client), the consultant or any practising firm with which he or his consultancy organisation is associated should not, without the consent of the practitioner, accept from that client within one year of completion of the consultancy assignment any work which was, at the time the consultant was first retained in relation to that client's affairs, being carried out by the practitioner." According to the rules, the same considerations have effect where a practitioner brings in one of his clients to the consultant for consultancy work.

11.11 OTHER PROFESSIONAL RESPONSIBILITIES

There are laid down ethical standards which cover the following professional responsibilities:

- (a) Obtaining (or securing) professional work is covered in Statement No. 8 of the ICAN Code. It is applicable to practising members, affiliates, and where applicable, employees of practising firms.

A chartered accountant is guided in the way he handles various methods of obtaining professional work, such as seeking publicity through advertising of his or her services, achievements and products. Advertisements should be legal, decent, clear, honest, and truthful. Promotional materials should not make disparaging references to or "de-marketing" comparisons with the services of others. There should be no harassment of a prospective client, no "cold calling" (that is, making unsolicited contact through phone or personal visit) of a non-client, with a view to obtaining professional work from him. Any of the acts stated above would constitute misconduct.

When trying to secure a non-audit work, for example, insolvency, assignments or appointment as receivers and liquidators, members of the Institute ought to exercise due care and diligence. For instance, the appointment of a partner of a firm as receiver or liquidator should not be accepted if at any time within the preceding two years, the following situations existed:

- (i) A member firm acted as auditor to the insolvent company;
- (ii) A partner or employee of a member firm has been a director of the insolvent company; and

- (iii) A partner has been receiver of any asset or undertaking of the company (in the case of liquidator).

If the liquidation is a members' voluntary winding up, there will normally be no objection to a partner in the firm acting as a liquidator;

- (b) Disciplinary procedures are covered in Statement No. 12 of the ICAN Code entitled 'Enforcement of Ethical Standards';
- (c) Compliance with the accounting standards and professional developments is covered under Statement No. 11 of the ICAN Code, captioned '*Members in Business.*'

The compliance is to ensure that chartered accountants in business discharge their obligation in executing specialist work with proper regard for the technical and professional standard expected of them.

The Standards include Statements of Accounting Standards issued by Nigerian Accounting Standards Board (NASB), International Accounting Standards issued by the International Accounting Standards Committee (IASC prior to April 1, 2001), the International Accounting Standards (Adopted as from April 1, 2001) and International Financial Reporting Standards issued by the International Accounting Standards Board (IASB), the Federal Inland Revenue Establishment Act, 2007 and where applicable and appropriate, the rules and regulations of Securities and Exchange Commission and the requirements of Companies and Allied Matters Act. Furthermore, where chartered accountants are dealing with banks, the requirements of BOFIA (1991), CBN Act (1991) and NDIC Act (1988) and for those working with insurance companies and pension funds administrators, the requirements of the Insurance Act, 2003 and Pension Reform Act 2004, shall apply.

A member who is in gainful employment may be faced with a dilemma in seeking to comply with the accounting standards if his employers give contrary directives to him. In such a case, the employed member is advised to consult the Institute for confidential advice.

Whether the member is solely responsible or not for the preparation and approval of accounting information, he or she should ensure that such information, complies with the applicable accounting standards and relevant statutes, rules and regulations. However, if the information does not comply, he or she should ensure that the reasons for non-compliance are stated truthfully, unambiguously and fairly; and

- (d) Succession arrangement is covered under Statement No 4 of the ICAN Code captioned, '*Changes in a Professional Appointment.*'

The incoming auditor or adviser should contact his predecessor for information as to his nomination and appointment. This is to enable the member to determine whether, in all the circumstances, it would be proper for him or her to accept the assignment. Even if the previous auditor has been a sole practitioner and is now dead, the incoming auditor should try to obtain necessary information as he may need from the latter's alternate (where appropriate), the administrators of deceased's estate or other sources.

If the client does not give his consent for the existing auditor or adviser to discuss his affairs with the proposed successor, the existing auditor should report that fact to the prospective auditor or adviser who should not accept nomination or appointment.

The existing auditor or adviser should respond promptly to the communication which he may receive from the prospective auditor or adviser.

When the incoming auditor or adviser asks his predecessor for information as to the client's affairs, lack of which might prejudice the client's interest, such information should be promptly given. There should be no charge for providing such information, unless there is a good reason to the contrary such as a significant amount of work having been involved.

According to the 'Rules of Professional Conduct for Members' when there is no existing auditor or adviser, the procedures of succession and the laid down ethical considerations apply with equal force and effect to the previous auditor or adviser.

11.11.1 Relationship with Fellow Members

There are laid down ethical standards which guide a chartered accountant in the course of performing his professional duties. He has to relate with other members of the Institute. The various situations and circumstances which may manifest and under which a chartered accountant may have to relate to another member of the Institute are as follows:

- (a) There may be joint engagement as joint auditors, joint receivers, etc.;
- (b) Fresh nomination or appointment may call for communication with the predecessors;
- (c) Special assignment which requires expert or specialist advice on certain issues may come up;
- (d) There may be the need for consultancy services from other members or member firms; and

- (e) Other assurance services, for example, involvement in the audit of a company, being in the same group, as either associate or subsidiary company to other companies having other auditors.

The terminologies used above are hereby explained, as follows:

- (a) **Principal Auditors** – These are the auditors with responsibility for reporting on the audit of financial statements of an entity when those statements include financial information of one or more components handled by other auditors.
- (b) **Other Auditors** – These are auditors, other than the principal auditors, with responsibility for reporting on the financial situation of a component, which is included in the financial statements audited by the principal auditors. Other auditors include affiliated firms, whether using the same name or not, and, and correspondent firms, as well as unrelated auditors.
- (c) **Incoming Auditors** – These are the auditors who are working and reporting on the current period's financial statements, not having audited and reported on those for the preceding period.
- (d) **Predecessor Auditors** – These are the auditors who previously worked and reported on the financial statements of an entity and who have been replaced by the incoming auditors.

11.12 THE ROLE OF PROFESSIONAL ACCOUNTANTS AND AUDITORS IN GOVERNANCE FRAMEWORK

In paragraph 6.5 of Chapter 6 of this study pack, the word 'accountant' was defined and explained. What is left is to briefly discuss who an auditor is. The Chambers Dictionary (2003) defines 'auditor' as "person or persons who is / are authorized to examine accounts." In wider sense, an auditor is an examiner of:

- (a) The records of a business or company so as to ascertain the level of reliability of the information which they contain; and
- (b) The documents from which the records have been developed, in search of validity;

Using the platform of the information provided in (a) and (b) above, the auditor painstakingly detects and prevents fraud, with emphasis on the latter.

For statutory or external reporting

- (c) The financial statements (including the supporting and accompanying documents such as cash flow statements, five-year financial summary and statements of value-added), to establish their truthfulness and fairness.

In summary, accountants and auditors are like the two sides of the same coin. The former prepares and keep the records and generate accounts. The latter vouches the records as to accuracy and integrity. The auditors evaluate the correctness of the accounts prepared against the underlying records and whether or not they accord with the stipulations of the law and statements of accounting standards.

11.13 THE ROLE OF ACCOUNTANTS AND AUDITORS IN GOVERNANCE FRAMEWORK AND SOCIETY, INCLUDING AGENCY PROBLEMS

Corruption and power are closely intertwined and are the masterminds or underlying factors for corporate governance failures all over the globe. Many individuals and business outfits look up to accountants to prepare their financial returns / tax, papers etc. There is the idea of trust which enters the relationships between the public and accountants in the circumstances. The energy giant in the United States of America, Enron, is a very notorious example where those at the top institutionalized fraudulent practices by collapsing the wall of internal control mechanisms. Notwithstanding the unsavoury developments all over the world, the role of accountants and auditors include the following:

- (a) Accountants are the first set of gatekeepers. They should endure that all financial transactions are at arms-length (that is, without showing favour or familiarity so as to strengthen bargaining power), valid, captured and properly recorded in accordance with the prescriptions of the Companies and Allied Matters Act, Cap. C20, LFN 2004, statements of accounting standards, international accounting standards, local and international pronouncements and the code of ethics.
- (b) According to Frank Harding: "Corruption – Rising to the Challenge," IFAC, (May 1999), accountants and auditors hold strategic positions of access to highly privileged and confidential information which should be guarded scrupulously, without divulging them to third parties, except as a matter of duty in court proceedings or with the knowledge and consent of their clients.
- (c) Accountants and auditors should execute their functions with professionalism in such a way that they can react positively and promptly to the indicators of fraud and other irregularities, and forward reports to the highest levels of authority.
- (d) Internal auditors are the watchdogs of organisations, resources because they are there year-round, unlike the statutory external auditors who visit only once-in-awhile. The internal auditors are in a unique position to influence management and the board on risk management, enforcement and review of internal control procedures and corporate governance.

Agency Problems

Agency problems are treated in Section 11.4.2. However, it is hereby acknowledged that the agents of accountants and auditors are their professional colleagues, line staff or subordinates who may commit them on issues which are not in the best interest of the firms. Mitigating such agency problems can be done through staff motivation which promotes loyalty.

Briefings are necessary between subordinates, colleagues and senior officers before embarking on the daily chores to streamline thinking and strategies. Seminars and conferences can re-orientate staff. Soothing words as “thank you very much for job well done,” can be wonderfully rewarding. “A drop of honey catches more flies than a gallon of gall.” Nonetheless, sanctions are imposed as a last resort.

The problems of accountants and auditors are, in most cases, adversarial. Chief executive officers and board chairmen may override rules and regulations. They may set aside procedures and make mockery of the internal control system. Companies may conceal important information. Accountants and auditors who are members of The Institute of Chartered Accountants of Nigeria should seek counsel from the professional body in all their dilemma situations.

11.14 CASES OF FAILURES OF CORPORATE GOVERNANCE

The wave of corporate scandals, especially in the United States of America, within the last few years, has been marked not only by the number of cases but also the effect which they have had on investor confidence and market values all over the world. Nigeria had its portion of the crises recently, with the financial institutions, when the prices of shares nose-dived, wiping out billions of naira in market value. Investor confidence, particularly in the shares of banks, the fairness of the capital market and the credibility of companies was rocked to its foundation. Some Nigerian banks have been accused of ‘window dressing’ accounts and returns, granting un-collateralized and non-performing loans, even to phoney companies and associates.

11.14.1 Many corporate governance failures have been traced to a number of factors which include the following:

- (a) Poorly designed remuneration package;
- (b) Excessive use of share options. This development distorted the behaviour of top management and members of the boards in the short-run;
- (c) The use of stock options or rewards linked to the short-run share price performance. This led to aggressive earning management to achieve share price targets; and
- (d) When trading failed to earn the targets of earnings, manipulation of accounts to ‘window-dress’ situations, set in.

According to The Code (IFAC 2003), the situation in (d) above was very apparent in the cases of companies Ahold, Enron, WorldCom and Zerox.

A fairly representative list of cases and causes of corporate governance failures is as per the table on page 241.

Table 11.1 Showing Cases of Recent Failures of Corporate Governance

Company		Country/Location	Causes of Corporate Governance Failures
1.	A hold Supermarket	Netherlands	(a) Trading never delivered earnings targets. Aggressive earnings management. (b) Fraudulent accounting and reporting. (c) Weak internal controls. (d) Poor risk management. (e) Questionable ethical standards. (f) Behaviour at the top.
2.	Enron	United States of America	(a) Questionable ethics. (b) Behaviour at the top. (c) Auditors never queried questionable accounting. (d) Aggressive earnings disposition of management. (e) Inefficient internal control system. (f) Poor risk management. (g) Hiding of corporate debts.
3.	World Com	United States of America	(a) As for A hold and Enron. (b) Expenses treated as capital expenditure to 'window dress' accounts.
4.	Parmalat accounts	Italy	(a) Fake transactions underlying preparation and reporting. (b) Weak internal controls.
5.	Tyco	United States of America	(a) Massive looting by the chief executive officer. (b) Manipulation of business records and accounts. (c) Non-existent internal controls. (d) Improper share deals.
6.	Xerox	United States of America	(a) Non-existent internal controls. (b) Accelerated recognition of revenue, for manipulation of accounts preparation and reporting.
7.	Wal-Mart Stores Inc.	United States of America	(a) Non-compliance with governance standards.

Company		Country/Location	Causes of Corporate Governance Failures
			(b) Inability to expand or diversify. (c) Weak internal controls.
8.	Cadbury Schweppes Confectionary losses	India	(a) Single promoter run firm. (b) Company managed as personal property. (c) Taking financial risks on forex derivatives contracts (or swaps) which ended in big losses. (d) Audit committee never disclosed in the governance reports.

The struggle for good corporate governance appears to be life-long and demanding of rigorous and steady campaign. The problem, however, is not in the failure to have it as in giving up the chase.

11.15 SUMMARY AND CONCLUSIONS

This chapter discusses, among others, the concept of corporate governance, its nature, scope and significance. It identifies the agency problems in corporate governance and how to minimize the threats of agency costs. The chapter also examines the scope, background and concept of corporate social responsibilities and the limits to which organisations can go. Lastly, it highlights and discusses the cases and causes of corporate governance failures.

Refer to Comprehensive Questions and Suggested Solutions in Appendix II, page 269.

11.16 REVISION QUESTIONS

11.16.1 MULTIPLE-CHOICE QUESTIONS

- To whom, out of the following, does a corporation owe moral obligations?
 - Employees
 - Customers
 - Communities.
 - (i) and (ii)
 - (i) and (iii)
 - (ii) and (iii)
 - (iii) and only
 - (i), (ii) and (iii)
- All the following are agents, EXCEPT
 - Company Secretary
 - Divorced wife
 - Financial Controller
 - Co-partner in a Business
 - Consignee.

3. A body corporate's assets belong to
 - A. the board chairman.
 - B. the shareholders.
 - C. the company.
 - D. the employees.
 - E. the creditors.
4. Putting oneself in the position of others accords with the principle of
 - A. fairness.
 - B. solidarity.
 - C. role Responsibility
 - D. refraining from Willed Harm.
 - E. rationality.
5. A financial expectation which will inappropriately influence the professional accountant's behaviour gives rise to
 - A. the self-review threat.
 - B. the familiarity or trust threat.
 - C. the intimidation threat.
 - D. the self-interest threat.
 - E. the advocacy threat.

11.16.2 SHORT ANSWER QUESTIONS

1. One of the causes of corporate failure of Enron is the hiding of corporate
2. What company collapsed as a result of being run as a single proprietorship business?
3. Accountants and auditors are like the two sides of the
4. The reports of the external and internal auditors are reviewed by the committee.
5. Which report on governance in the United Kingdom clamoured for the institution of efficient and effective system of internal control?

Refer to Suggested Solutions in Appendix I, Page 263.

SOCIAL AND ENVIRONMENTAL ISSUES IN ETHICS

12.0 LEARNING OBJECTIVES

After studying this chapter, readers will be able to:

- ◆ Explain the concept of social responsibilities and environment;
- ◆ Describe social and environmental accounting issues;
- ◆ Evaluate measurement and accountabilities in social and environmental reporting;
- ◆ Explore developments in social and environmental frameworks;
- ◆ Evaluate the threats of social costs and liabilities; and
- ◆ Explain cases of social and environmental failures.

12.1 INTRODUCTION

Corporate social responsibility which is also known as Corporate Citizenship, Corporate Responsibility or Corporate Social Performance, is a form of corporate self-regulation which is integrated into a business model. Corporate social responsibility tends to operate as a built-in, self-regulating mechanism under which a business will monitor and ensure its compliance with law, international norms and ethical prescriptions. A business or company assumes responsibility for the impact of its activities on the environment, employees, consumers, communities and other members of the public. In addition, a business has to proactively promote the interest of the public through voluntarily avoiding activities which are harmful, regardless of legality.

12.2 THE CONCEPT OF CORPORATE SOCIAL RESPONSIBILITY

The Concepts of Corporate Social Responsibility and Business Ethics are sometimes used interchangeably. This is based on the belief that, the problems and issues in business ethics can be summed up in the challenge of being socially or morally responsible, both as a corporate organisation and as an individual in an organisation.

12.2.1 Concept of Responsibility

Rights, obligations and responsibilities are closely related. We talk about the idea of having a right to do something and the idea of having a right to receive something. Having a right to do something means the same thing as not having any obligation to refrain from doing it. If one is free to do it, one may do it, because there is nothing wrong in doing it. On the other hand, having a right to receive something is also called a right against someone else, who has an obligation to provide that which the first person is said to have a right to.

Thus if Mazi Offia has a right to some amount of money that Mazi Obi owes him, it is a right to receive the money and at the same time a right against Mazi Obi, which corresponds to his obligation to pay up. In this sense of right as a noun, it would mean an entitlement, a moral or legal claim to something due to someone. Obligation in itself is a right that restricts one from denying another person his entitlement. It is the responsibility that one has to give what one owes the other persons.

(a) Direct Responsibilities

- (i) **Internal Direct Responsibilities:** These include the responsibility for a company's mission, culture and objectives and for the aspects of the well-being of employees. These responsibilities would include: a safe working environment, fair working practices, individual autonomy within the organisation, and assistance/compensation/ retraining if a company relocates or closes a plant. The management is responsible for these sort of terms and conditions because it creates the working environment and controls it.
- (ii) **External Direct Responsibility:** Organisations owe these responsibilities **to their consumers** (safe products and information about the origin and composition of products so that the consumers can make informed purchases.) If products become contaminated in any way, the organisation has an obligation to communicate this to their consumers.

The external direct responsibility is also owned **to local communities**. They include safe processing, research to test the effects on the environment and compensation for any environmental damage in the locality.

(b) **Indirect Responsibilities**

Indirect responsibilities are defined as those outside the main sphere of a company's activities/control. It may include rectifying pollution for which the company is not itself responsible but which derives from the same industry sector. It is usually not a direct repair of damages but, to facilitate any clean-up by co-operating with the responsible company by sharing information, techniques and resources if they are available.

Companies could become an important instrument of social justice and social change. These responsibilities to the society arise from the position of power which companies have in society which enables them to influence and lobby power over government to ensure that their views are well represented.

12.2.2 The Meaning of Corporate Social Responsibility?

Corporate responsibility is a concept that describes the responsibilities that organisations take for the impact of their activities on customers, suppliers, employees, shareholders and other stakeholders. Corporate social responsibility expands on this concept by including consideration of the impact of their activities on communities, the environment and society as a whole. **Corporate Social Responsibility** therefore is the obligation a business assumes towards society. To be socially responsible is to maximise positive effects and minimise negative effects on the society.

The European Commission defines Corporate Social Responsibility as the integration by companies of social and environmental concerns in their business operations and in the interaction with their stakeholder on a voluntary basis. It can also be understood as the administration of companies in a socially responsible way

Moral Responsibility on the other hand implies that an action must be done knowingly and willingly. For instance, though I am causally responsible for the things I do in my sleep, I am not morally responsible for them. To be morally responsible would mean:

- (a) That I did the action (the cause of the result of the action);
- (b) That I did the action intentionally : knowingly and willingly.

The implication is that one is not forced to act; one had a choice, knew what one was doing and did it deliberately. One can also be morally responsible for failing to do what one was morally obliged to do; but here the failure must be intentional.

12.2.3 Background and Debate in Corporate Social Responsibility

Adolph A. Berle in a debate published in the *Harvard Law Review* in 1932 argued that the primary purpose of business organisation or corporation should be to make money for its shareholders. According to him, “All powers granted to a corporation or to any group within the corporation are at all times exercisable only for the ratable benefits of all the shareholders as their interest appears.”

In 1970, **Friedman Milton** published a short essay ‘The Social Responsibility of Business is to increase its profits’ *The New York Times Magazine*, September 13, 1970, which has generated a lot of controversy ever since. In his argument corporations should pursue their economic self interest. He held in the essay that there is one and only one social responsibility of business, which is to use its resources and engage in activities designed to maximise profits for the shareholders. According to him, “...a corporate executive is an employee of the owners of the business. He has direct responsibility to his employers. That responsibility is to conduct the business in accordance with their desires, which generally will be to make as much money as possible....”

He went further to posit that any attempt to promote corporate social responsibility, however it might be defined, amounts to moral wrong. Friedman questioned the logic of corporate social responsibility as it had developed. He insisted that in a democratic society, government was the only legitimate vehicle for addressing social concerns. Thus the function of business in a society, which is to maximise profits, should not be confused with other social functions performed by governments, institutions and charities.

Friedman and others co represent the shareholder theory which claims that the purpose of the firm is to maximise the welfare of the shareholders, perhaps subject to some moral or social constraints. The reason for this, Frederick Hayek in 1969 wrote is that the organisations are the private properties of the shareholders thus; every business organisation or corporation must aim at maximising profits to enhance shareholders value. And by the organisations pursuing their self-interests would ensure the most efficient economic activities and outcomes. Hayek goes further to argue that shareholders’ property rights in the corporation must be fully protected and their control of the corporation strengthened. This position implies that the shareholders are the only legal stakeholders of any organisation because of their investment, which also makes the corporation their private property.

Central to this theory is the belief that the managers have a fiduciary duty to act in the interest of the shareholders to maximise the return on investment, with no direct concern to the well-being of the society

because according to the advocates, it is only when business focus on profit that business will provide good service that consumers want, which would then promote the societal well-being. This was propounded by Adam Smith, to whom this theory is traceable. He maintained that the free pursuit of self-interest without the intent to benefit the society will, as if directed by an invisible hand, bring about more social benefit than if visible hands (government intervention) try to intervene and bring about just results. In *The Wealth of Nation*, this view was articulated thus:

It is not from the benevolence of the butcher, the brewer or the baker, that we expect our dinner, but from their regard to their own interest... He...neither intends to promote the public interest, nor knows how much he is promoting it ... and by directing that industry in such a manner as its produce may be of the greatest value, he intends only his own gain, and he is in this, as in many other cases led by an invisible hand to promote an end which was not part of his intention. Nor is it always the worse for society that it was no part of it. But by pursuing his own interest he frequently promotes that of the society more efficiently than when he really intends to promote it.

The stakeholder theory which opposes the shareholder theory primarily began as a response to the belief that the owners of share or stock should be the prime beneficiaries of the organisations. That is to say that the firm should be run in such a way as to maximise the wealth of shareowners. The stakeholder theory, on the other hand, suggests that there is a multiplicity of groups having a stake in the operation of the firm, all of whom merit consideration in the management's decision making and whose needs must be met. This is clearly an attempt to "redefine the purpose of the firm; this is to serve as a vehicle for coordinating stakeholder interest". In other words, the concern of the business managers ought to go beyond profit to include helping society gain a greater sense of the meaning of community by honouring individual dignity and promoting overall welfare and accommodate wider stakeholder interests.

Professor Merric Dodd of Harvard Law School disagreed with Berle's thesis and of course the shareholders theory. He posited in his view that business corporation is an economic institution which has a social service as well as a profit-making function. The ideal purpose of the corporation and of course the corporate managers, he argued is not confined to making money for shareholders. In his view, it is more secured jobs for the employees; better quality products for customers and greater contributions to the well-being of the community as a whole.

John Mackey, a businessman, founder and CEO of Whole Foods disagrees with Friedman's shareholder theory in a debate published by the *Reason Magazine*. In his opinion, every enlightened corporation should try to create value for all of its constituencies which would include customers, employees, suppliers, the shareholders and the community, who in their relationship with the corporation deserve different forms of benefits which are valid and legitimate.

- (a) **Carroll Archie in 1979** proposed the 'four part model of corporate social responsibility', which implies that corporate organisations have four responsibilities to fulfill to society: namely legal, ethical, economic, and discretionary (which was later referred to as philanthropic).
- (b) **The legal dimension** of social responsibility refers to obeying laws and regulations established by governments to set minimum standards for responsible behaviour. There are laws regulating competition, to prevent the establishment of monopolies, inequitable pricing practices, and other practices that reduce or restrict competition. There are laws protecting consumers, the environment and equity and safety.
- (c) **The ethical dimension** refers to behaviours and activities that are expected or prohibited by organisational members, the community and society, even though these behaviours are not codified into law.
- (d) **The economic dimension** of social responsibility relates to how resources for the production of goods and services are distributed within a social system. Essentially the investors who have given their financial support seem to have primary impact on management's decisions in order to ensure maximum returns on their investment.
- (e) **The philanthropic dimension** of social responsibility refers to business's contributions to society. Businesses are expected to contribute to the quality of life and welfare of society. It is the expectation that businesses also contribute to the local community.

Archie sought to "embrace businesses' legitimate economic or profit making function with responsibilities that extend beyond the basic economic role of the firm;" thereby reconcile the idea that profit maximisation and social concerns cannot be both the focus of a business. It is her view that business must be ethical and philanthropic in addition to being economic that is, ensuring that profits are maximised.

The obvious strength of her four-part of corporate social Responsibility is that it structures the various social responsibilities into different dimensions, yet does not neglect the very demand placed on a firm to being profitable and legal. The stakeholder theory has therefore proven to be a more balanced theory because of its proponents' continuous recognition of the economic responsibility of corporate organisations. It is also interesting that its proponents expect business leaders to take lead in solving social problems by funding some long-term initiatives.

12.2.4 Why do Corporations Have Responsibilities?

It is fairly widely accepted that businesses do indeed have responsibilities beyond simply making profits.

- (a) Corporations cause social problems and hence have a responsibility to solve those they have caused and to prevent further social problems arising.
- (b) Some powerful social actors, with recourse to substantial resources, corporations should use their power and resources responsibly in society.
- (c) All corporate activities have social impacts of one sort or another, whether through the provision of products and services, the employment of workers, or some other corporate activities. Hence corporations cannot escape responsibility for those impacts, whether positive or negative.
- (d) Corporations rely on the contributions of a much wider set of constituencies, or stakeholders in society, rather than just shareholders, and hence have a duty to take into account the interest and goals of these stakeholders as well as those of shareholders.

12.3 SOCIAL RESPONSIBILITIES AND ENVIRONMENT

The relationship between corporate bodies and the environment in which they operate has attracted the process of social and environmental accounting, within a company's reporting procedures. Consequently, accounting for impact on the environment may feature in a company's financial statements. It tends to address it as liabilities, contingencies and commitments to remedy contaminated land, as in the Niger Delta area of Nigeria at present. Environmental Accounting relates to the reporting of detailed environmental and quantitative data, within the sections of a company's annual report which do not deal with finance. It may be presented separately in environmental reports. Environmental reporting may account for effluent discharges, resources expended or farmland damaged or re-established.

Large companies, in their reports, tend to focus on ‘eco-efficiency.’ The concept of ‘eco-efficiency’ refers to the reduction of resource and energy utilization and waste production per unit of product or service. It has to be acknowledged that a complete picture may not be available to account for all inputs, wastes and outputs of an organisation or company. It is convenient for companies to demonstrate tremendous success in ‘eco-efficiency,’ but their ecological footprint which is an estimate of total environmental remediation may move, following changes in production, independently.

12.3.1 Corporate Social Audit

A social audit is the process of taking measurements of social responsibility to assess organisational performance in this area. It is sometimes used to describe the systematic appraisal of all the company’s activities that have an impact on wider community. The basic steps in conducting a social audit are monitoring, measuring, and appraising all aspects of an organisation’s socially responsible performance. Probably no two organisations conduct and present the results of a social audit in exactly the same way. The social audit is the process of measuring the socially responsible activities of an organisation. It monitors, measures, and appraises socially responsible performance.

An audit needs to cover all the main operations and functions of the firm, plus its relationship with national and local government and all stakeholders.

In Canada, ethics audits tend to have six major components: “values-based standard setting, document review, benchmarking, an environmental scan, multi-stakeholder surveys, and action-enabling recommendations.”

(a) **Values-based standard setting**

Reviews whether the corporation is taking into account the values of all its stakeholders, including the corporation itself, employees, retirees, shareholders, host communities, international ethical trading and human rights organisations, and industry institutions. If one stakeholder sector is being ignored, then these values and needs should be addressed in corporate policy.

(b) **Document Review**

Refers to “an in-depth review of the manual of administration, the corporate code of ethics, board minutes and corporate policies, and other policies in terms of business practices, conflict of interest, harassment, privacy and the like” (*The Corporate Ethics Monitor*, Volume 13, Issue 5, page 77). Essentially, this review asks, “does the corporation reflect its public statements on

corporate social responsibility and have its actions reflected in those policies?”

(c) **Benchmarking**

Pertains to how the corporation’s behaviour compares to industry norms and industry best practices. An “Environmental scan” addresses “macro-changes in social climate, nationalism, technology, international trade policy, and other factors that could transform the very organisation of the business or agency under study” (*The Corporate Ethics Monitor*, Volume 13, Issue 5, page 77). These scans should be regularly conducted so that a corporation can adjust its policies and practices accordingly.

(d) **Multi-stakeholder surveys**

These should be conducted to see how significant stakeholders view the policies and actions of the organisation because public opinion is often most important in terms of perception of success. A combination of written questionnaires, exit interviews, personal interviews, and other techniques are common.

(e) **Action-enabling recommendation**

Must link the audit cycle with the planning mode of the organisation” so that the findings of the audit are not lost in the corporate bureaucracy but instead are the basis for change and improvement in the company (*The Corporate Ethics Monitor*, Volume 13, Issue 5, page 77).

An ethics audit can be an important function in improving the company’s corporate social responsibility policies as well as its public ethical reputation. Even if a company starts out with a small scale ethics audit, this is often a step in the right direction and that company should be applauded and then encouraged to keep moving in the right direction to a full scale, independently-conducted, publicly disclosed, independently-verified ethics audit.

12.3.2 Procedures when Conducting a Social Audit:

- (a) An independent outside firm should be hired to conduct the audit.
◆ This will ensure autonomy and objectivity.
- (b) The company’s personnel should cooperate fully with the auditing firm while the audit is being conducted.
- (c) The auditing firm should report its findings directly to the company’s board of directors.
- (d) The results of the audit should be reviewed by the company’s board of directors.

- (e) The board of directors should determine how the company can:
 - ◆ Better meet its duty of social responsibility; and
 - ◆ Use the audit to implement a programme to correct any deficiencies it finds.

Corporations that conduct social audits will be more apt to prevent unethical and illegal conduct by managers, employees, and agents

12.4 SOCIAL AND ENVIRONMENTAL ACCOUNTING ISSUES

Environmental accounting is an inclusive field of accounting which turns out reports for internal use, supplying environmental information to assist in management decisions on pricing, controlling overhead and capital budgeting. Moreover, it generates environmental information of considerable interest to the public and the financial community. The impact of business activities on the environment is felt in several forms, such as in the air, water, underground pollution, endangered, and threatened animals.

The array of pollutants which includes toxic, hazardous and 'warming' is accountable to the business of companies. In order to analyse critically and measure the effects of environmental impacts, multiple disciplines are needed, for integration into management decisions and accounting reporting. Non-accounting tools and approaches needed include management policies and control systems, environment science, finance and risk management and environmental law and regulations. Such multi-disciplinary approach is useful in isolating and recording all the environmental costs which include energy, material usage, waste disposal, insurance, fines and penalties. A company may determine the environmental impact by using techniques which include:

(a) **Full Cost Accounting**

The cost of production is aggregated with the amount expended on environmental management and divided into the number of units manufactured, to obtain the cost per unit.

(b) **'Eco-Accounting'**

This is also referred to a "Total Cost Assessment." All costs relating to environment impact are assembled and divided into the units produced or service rendered. The smaller the cost per unit, the more 'eco efficient' is the effort of the company's management in handling environmental impact.

(c) **Life Cycle Costing**

It is an approach which seeks to optimise the use of cost. The technique identifies and sums up all costs, including environmental management expenses and the acquisition costs of production assets. Estimated lives of fixed assets to be purchased and the cost of capital are determined.

The technique is used on the logic of cost minimisation, by discounting the costs, in choosing the lesser (in case of two) or least (where three or more) fixed assets are being considered.

ILLUSTRATION 11.1

Two big plants are available, out of which, only one will be chosen. 'X' plant will cost ₦50,000,000 while 'Y' is ₦40,000,000. The estimated lives of the plants are three (3) years each. The profiles of the annual costs of the plants are:

	X (₦'000)	Y (₦'000)
Fuel	14,000	25,000
Salaries	10,000	20,000
Environmental expenses	8,000	12,000
	32,000	57,000

Assuming that the cost of capital is 20%, which of the plants should be chosen?

Discount factor at 20% for five (5) years is:

Year	1	0.8333
	2	0.6944
	3	0.5787
	4	0.4823
	5	0.4019

SUGGESTED SOLUTION 11.1

	X	
Cash flows	Discount	Present
Years	₦'000	Factor Value (₦'000)
0	(50,000)	1.0000 (50,000)
1-3	(32,000)	2.1064 (67,405)
		(117, 405)

	Y	
Cash flows	Discount	Present
Years	₦'000	Factor Value (₦'000)
0	(40,000)	1.0000 (40,000)
1-3	(57,000)	2.1064 (120,065)
		(160,065)

'X' plant will cost ₦117,405,000 in purchase and annual maintenance for three (3) years, as against ₦160,065,000 in respect of 'Y' plant. Since the expenditure is less on 'X' plant, it is recommended for purchase in preference to 'Y' plant.

Tutorial

Readers should note that the factor of 2.1064 used above to discount the costs incurred can be obtained by summing up the yearly figures of 0.8333, 0.6944 and 0.5787.

In life cycle costing technique, the experience is to sum up, before applying the discount factor, the various costs which include the following:

- (a) Historical cost of the assets;
- (b) Operating costs of materials, labour, fuel, lubricants, etc;
- (c) Lost profits; and
- (d) Salvage value. This is an item of cash inflow.

12.5 ENVIRONMENT MANAGEMENT ACCOUNTING AND ENVIRONMENTAL COST ACCOUNTING

This is a new dimension of accounting introduced to the issue of environment management. These have to do with the introduction of Environment Management Accounting and Environmental Cost Accounting which are briefly discussed as follows:

(a) Environmental Management Accounting

According to Bartolomeo et al (2000), environmental management accounting is "the generation, analysis and use of financial and related non-financial information, to support management within a company or business." The production analysis and appropriate application of costing, financial and statistical data collected assist an organisation proactively in managing its environmental issues diligently.

(b) Environmental Cost Accounting

Lally (1998) advocates that costs should be accounted for by their specific causes. The technique directly allocates every environmental cost to its immediate cause or source such as pollution and refuse dump. Environmental cost accounting is to eliminate or at least reduce the arbitrary allocation of environmental overhead, so that the true cost of products or services may be ascertained.

12.6 SOCIAL ACCOUNTING

Social Accounting which is also called Social and Environmental Accounting or Sustainability Accounting is the process of transmitting the social and environmental implications of the economic actions of companies, etc to specified interested parties within and outside a country. It is of common use in the context of business operations, or corporate social responsibility (CSR). Nonetheless, any entity - charities, government agencies and non-governmental organisations-may engage in social accounting.

Crowther D. defines social accounting in the idea of corporate accountability, as “an approach to reporting a firm’s activities which stresses the need for the identification of socially relevant behaviour, the determination of those to whom the company is accountable for its social performance and the development of appropriate measures and reporting techniques.”

Social accounting poses challenges to conventional accounting, particularly financial accounting, for narrowing the image of the interaction between companies and society. As a largely normative concept, social accounting seeks to broaden the scope of accounting by:

- (a) Concerning itself with more than only economic issues;
- (b) Not being solely expressed in financial terms;
- (c) Being accountable to a broader collection of stakeholders; and
- (d) Broadening its purpose beyond reporting financial success.

Social accounting highlights the fact that companies have influence, positively and negatively, over their external environment, through their actions and inactions and should consequently render stewardship for these effects as part of their standard accounting traditions. Social accounting makes available an alternative account of significant economic entities. It is capable of exposing the tension between the pursuit of economic profit and the drive of social and environmental objectives.

12.7 DEVELOPMENTS IN SOCIAL AND ENVIRONMENTAL FRAMEWORKS

Developments in social and environmental frameworks include the following:

- (a) Evolving Standards for accounting and reporting to benchmark or regulate corporate behaviour;
- (b) In Nigeria, the Senate arm of the National Assembly is considering a Bill which seeks “to regulate and control the manufacture, sales distribution and marketing of tobacco products in the country.” The proposed law, when enacted, will be the country’s edition of the World Health Organisation’s initiative referred to as “Framework Convention on Tobacco Control (FCTC)”;

- (c) Provision of educational programmes across the various disciplines focused strictly on environmental issues; and
- (d) The National Environmental Standards and Regulations Enforcement Agency (NESREA), in collaboration with the Nigeria Communication Commission (NCC), is brainstorming with the key stakeholders and the telecommunications industry on the various options towards safer and better environment-friendly telecommunications operations in the country.

12.8 MINIMISING THE THREATS OF SOCIAL COSTS AND LIABILITIES

To minimise the threats of social costs and liabilities, the following measures are appropriate:

- (a) Introduction and consolidation of the principles and practice of good corporate governance which carries along with it great social responsibility and maximisation of stakeholders' interests;
- (b) Optimisation of production capacity so as to accommodate environmental costs at the least possible costs;
- (c) Multi-disciplinary teams should have clear distribution of tasks and functions, so as to provide a basis for determining environmental impacts and related costs;
- (d) The nature of environmental costs should determine the capital investment assessment method. According to Grinnell and Hunt (2000), discounted cash flow technique is preferred to payback period in view of the long-time horizon for benefits to accrue from environmental capital investment;
- (e) A responsible corporate citizen should not violate laws on environmental management. Consequently, a company should collaborate with Government and non-government agencies to save the earth from ruin such as global warming and climate disruption; and
- (f) Waste on effluent discharges should be minimised.

12.9 SOCIAL AND ENVIRONMENTAL FAILURES

Cases of social and environmental failures all over the world are frightening. They include the following which are hereby briefly discussed:

- (a) About half of the world's temperate and tropical forests are no more available. The rate at which forests are being pulled down in Africa, particularly in Nigeria, in the name of timber felling, is alarming. The rate of deforestation in Africa is about an acre a second;

- (b) Environmentalists in the United States of America claim that about ninety (90) per cent of the large predator fish (the big ones which consume the smaller specie) no longer exist and that seventy five (75) per cent of marine fisheries have been exhausted;
- (c) Scientists say that human activities have increased the atmospheric carbon dioxide, engineered planetary warming and climatic disruption;
- (d) Persistent toxic chemicals are now found in all human beings;
- (e) Everywhere, earth's ice fields are melting; and
- (f) The sound and smoke emission from generators and factory plants in Nigeria constitute serious health hazards.

12.10 INVESTIGATIVE REPORTS AND PROFESSIONALISM

Something is investigative if it is concerned with research, conducting examination or enquiry, with a view to establishing the circumstances or root cause or causes of a riddle or puzzle of an issue. The Chambers Dictionary (2003) defines 'professionalism' as "the competence or the correct demeanour of those who are highly trained and disciplined....." The Chambers Dictionary further defines a "professional" as "someone who makes his or her living by an art that is also practised" at highly skilled level.

A professional accountant "who is a member of an IFAC member body" (IFAC, 2009), is obliged to demonstrate the knowledge and practice of the fundamental principles of integrity, objectivity, professional competence and due care, confidentiality and professional behaviour at all times, particularly in writing investigative reports. He should do his report as though the cases are going for trial. The qualities of a good investigative report include the following:

- (a) It should be unambiguous, straight to the point and lucid;
- (b) The report should be devoid, as much as possible, of all technical jargons;
- (c) The report should not be libellous. The issues reported upon and recommendations need only be stated; and
- (d) There is the timeliness of a report. Time is the essence in writing and delivering reports before matters get worse.

12.11 LEARNING WITH AND MANAGING PROFESSIONAL RESPONSIBILITIES THROUGH CASE STUDIES

According to Kayode A. J. (2005), "a case study is a written description of a situation which a decision-maker faced at some point in time." With

experience, case studies tend to involve full description of practical or real situations or events which the investigator ponders on with analytical power and understanding. Development and using case studies to manage professional responsibilities make heavy demand on attributes which include the following:

- (a) Ability to demonstrate flexibility. There is more than one way of looking at an issue. Case studies or investigations should be capable of many solutions or approaches. The investigators or researchers should keep their minds open;
- (b) The professional accountant who is conducting the enquiry should be able to identify the problem or problems underlying the investigation, to which he may apply his skills and knowledge, for example, drawing on 'SWOT' analysis of the strengths, weakness, opportunities and threats of the organisation or personality under focus; and
- (c) There should be clarity of expression in the language used to communicate recommendations.

12.12 SUMMARY AND CONCLUSIONS

This chapter discusses what a corporation is, its interests and professional responsibilities. It also examines the concept of accountability, the role of professional accountants in globalisation and the components of financial statements of quoted entities. It concludes by examining social and environmental issues, investigative reports/professionalism and the management of professional responsibilities through case studies.

Refer to Comprehensive Questions and Suggested Solutions in Appendix II, page 269.

12.13 REVISION QUESTIONS

12.13.1 MULTIPLE-CHOICE QUESTIONS

1. Corporate social responsibility
 - I. operates as a self-regulating mechanism.
 - II. is a built-in procedure.
 - III. ensures compliance with law and norms.
 - A. I, II and III
 - B. II and III
 - C. I and II
 - D. I only
 - E. II only
2. A company assumes responsibility for the impact of its activities on the
 - I. environment.
 - II. other companies.
 - III. Public.
 - IV. Consumers.
 - A. I, II and III

- B. II, III and IV
 - C. I, III and IV
 - D. II and III only
 - E. I and III only
3. A company caters for its environmental impact in the
- A. trading account.
 - B. profit and loss account.
 - C. appropriation account.
 - D. financial statements.
 - E. cashflow statements.
4. Environmental accounting may answer for
- I. effluent discharges.
 - II. income received.
 - III. income expended.
- A. I only
 - B. II only
 - C. III only
 - D. I and II
 - E. I and III
5. Environmental accounting assists companies in
- I. determining prices.
 - II. controlling overheads.
 - III. capital budgeting.
- A. II and III
 - B. I, II and III
 - C. I and II
 - D. I and III
 - E. I only

12.13.2 SHORT ANSWER QUESTIONS

1. In social and environmental management, the reduction of resources, energy utilisation and waste production is the concept of _____
2. Corporate social responsibility is also known as _____ citizen.
3. What is another name for 'Total Cost Assessment?'
4. What is the technique which seeks to optimise the use of cost?
5. Sustainable Accounting broadens by concerning itself with more than _____ issues.

Refer to Suggested Solutions in Appendix I, Page 263.

APPENDICES

APPENDIX I

SUGGESTED SOLUTIONS TO REVISION QUESTIONS

CHAPTER 1

MULTIPLE-CHOICE QUESTIONS

1. E
2. D
3. C
4. A
5. B

SHORT ANSWER QUESTIONS

1. Nigerian Accounting Standards Board.
2. Banks and Other Financial Institutions Act.
3. Interests in Joint Ventures
4. Earnings Per Share.
5. SAS 6

CHAPTER 2

MULTIPLE-CHOICE QUESTIONS

1. C
2. E
3. C
4. D
5. E

SHORT ANSWER QUESTIONS

1. Fair value of assets acquired.
2. Goodwill.
3. Prudence Concept.
4. Going Concern.
5. 10%

CHAPTER 3

MULTIPLE-CHOICE QUESTIONS

1. C
2. D
3. D
4. A
5. C

SHORT ANSWER QUESTIONS

1. Nil
2. ₦42.5million i.e. $\text{₦}(34.775\text{m} + 10.225\text{m}) - 2.5\text{m}$
3. ₦1,240,000 i.e. $\text{₦}42,500,000 - \text{₦}(29,030,000 + 10,970,000 + 1,260,000)$
i.e. $\text{₦}42,500,000 - 41,260,000$
4. ₦5,000,000 i.e. $\text{₦}42,500,000 - \text{₦}(25,000,000 + 12,500,000)$
i.e. $\text{₦}42,500,000 - 37,500,000$
5. Book Value.

CHAPTER 4

MULTIPLE-CHOICE QUESTIONS

1. D
2. C
3. E
4. C
5. A

SHORT ANSWER QUESTIONS

1. Consolidated Financial Statements
2. Giving meaning
3. Profitability Ratios.
4. $\text{Cash} + \text{Cash Equivalent}$
 $\text{Current Liabilities}$
5. Earnings Per Share
Market Price Per Share

CHAPTER 5

MULTIPLE-CHOICE QUESTIONS

1. B
2. C
3. E
4. D
5. A

SHORT ANSWER QUESTIONS

1. Capital Approach or Income Approach.
2. Segment Reporting
3. SAS 29
4. Financial Instruments
5. Consolidated Financial Statements.

CHAPTER 6

MULTIPLE-CHOICE QUESTIONS

1. A
2. D
3. E
4. B
5. C

SHORT ANSWER QUESTIONS

1. Code of Professional Conduct
2. Firm
3. Court of Appeal
4. All Members
5. The Doctrine of Original Sin

CHAPTER 7

MULTIPLE-CHOICE QUESTIONS

1. B
2. E
3. A
4. B
5. C

SHORT ANSWER QUESTIONS

1. Die
2. Integrity
3. Private Company
4. Promoter
5. Statement of Accounting Standard No. 4

CHAPTER 8

MULTIPLE-CHOICE QUESTIONS

1. D
2. D
3. D
4. A
5. C

SHORT ANSWER QUESTIONS

1. External Regulation
2. Section 140.7
3. Safeguards
4. International Federation of Accountants
5. Due Care.

CHAPTER 9

MULTIPLE-CHOICE QUESTIONS

1. C
2. E
3. D
4. D
5. E

SHORT ANSWER QUESTIONS

1. Individual judgement
2. Social norms
3. Moral intensity
4. Common good approach
5. Virtue approach

CHAPTER 10

MULTIPLE-CHOICE QUESTIONS

1. E
2. C
3. E
4. A
5. B

SHORT ANSWER QUESTIONS

1. Safeguards
2. Safeguards
3. Self-review Threat
4. Managerial
5. Audit

CHAPTER 11

MULTIPLE-CHOICE QUESTIONS

1. E
2. B
3. C
4. A
5. D

SHORT ANSWER QUESTIONS

1. Assets
2. Cadbury Schwepps Confectionary of India
3. Same Coin
4. Audit
5. Tumbull Report

CHAPTER 12

MULTIPLE-CHOICE QUESTIONS

1. A
2. C
3. D
4. E
5. B

SHORT ANSWER QUESTIONS

1. Eco-efficiency
2. Corporate
3. Eco-accounting
4. Life cycle costing
5. Economic

APPENDIX II

COMPREHENSIVE QUESTIONS AND SUGGESTED SOLUTIONS

QUESTION 1

Write short notes on

- (a) Utilitarianism.
- (b) Deontology.
- (c) Teleology. *(15 marks)*

SUGGESTED SOLUTION TO QUESTION 1

- (a) **Utilitarianism** has been referred to as a process of ethical balance in the same way that accountants' talk about the idea of a trial balance. The concept stands for the pursuit of the permanent and best interests of the various parties to an issue as a standard of moral standpoint. The school of thought focuses the outcomes of moral issues for appraisal. The ideology maximises good or right over harm or wrong. *(5 marks)*
 - (b) **Deontology:** This philosophy addresses the idea of an obligation or a duty. In this connection, an ethical event is justified if, by its nature, it is good. A ready evaluation of deontological issue is the ethical requirement that in the performance of duties or meeting, a moral obligation, professional integrity should be apparent. *(5 marks)*
 - (c) **Teleology:** The ethical consideration here is with the consequence and not the act itself. The concept is also referred to as 'consequentialism' or 'end-based ethics'. The ethical requirement on its own may be neither good nor bad. The focal point is the end pursued. *(5 marks)*
- (Total 15 marks)***

QUESTION 2

Philosophers have developed several theories as means of resolving moral challenges. In this context, you are required to discuss briefly the following:

- (a) The "Doctrine of Original Sin." *(5 Marks)*
- (b) The Doctrine of innate purity *(5 Marks)*
- (c) Moral Dilemmas *(5 Marks)* ***Total (15 Marks)***

SUGGESTED SOLUTION TO QUESTION 2

- (a) **The "Doctrine of Origin Sin"**

This concept connection with the early Christianity called 'ology'. A dictionary defines 'ology' as "a science whose name ends in '(o)logy". It is any science or body of knowledge such as 'biology' 'zoology' 'archeology' and 'sociology'. The doctrine asserts that man is egoistic or selfish from birth. It is only punitive socialization experiences which override the drives and bring about man's moral development. *(5 Marks)*

(b) The Doctrine of innate Purity

The word 'Innate' indicates that it is natural, inherent or inborn. The doctrine of innate purity holds that children are naturally good. Their problem, however, is that they are socially inflicted with corruption and the vices of human interactions. On the other side are adults who 'push their ways through,' rather than allow the pace of moral development to take charge. (5 Marks)

(c) Moral Dilemmas

A dilemma has been defined by the Chambers Dictionary as "a position where each of two alternatives or courses of actions is eminently undesirable. It is a predicament." For example, what should an individual do when his son who is the manager and administratively in charge, steals a valuable item from the stock of goods being sold? Should he, the father ask his son to pay for the stolen goods or report him to the police? Lawrence Kohlberg, a renowned psychologist, developed a theory of moral development applicable in dilemma situations. He fervently held that moral development covers the entire life of a human being. One of the moral challenges which the psychologist came up with is called "**the Heinz Dilemma.**" The dilemma situation in this example is that a woman was dying from cancer. Her husband could not afford the price of the drug which he believed was curative and would liberate her. The man could not afford the drug's price. He became desperate and broke into the doctor's store to steal the 'wonder medicine'. Was he right or wrong in his act? (5 Marks)

Total (15 Marks)

QUESTION 3

- (a) What is a corporation? (5 Marks)
- (b) Briefly distinguish between 'corporation sole' and 'corporate aggregate' with two examples of each. (7 Marks)
- (c) What moral responsibilities do corporations owe their employees? (3 Marks)

Total (15 Marks)

SUGGESTED SOLUTION TO QUESTION 3

- (a) A corporation or company is an association of individual natural person who associate together, in pursuit of a social, economic or moral objective. The corporate body so registered under the Corporate Affairs Commission, becomes an artificial legal person, which can sue and be sued, distinct from the natural human persons who form its membership. A corporation has no soul, unlike the various individuals who set it up. Consequently, it can not die. In view of the fact that a company has perpetual succession, it may exist forever, thereby outliving its owners. (5 Marks)
- (b) A corporation sole is one which has only a member at any point in time. The corporation passes from one hand to another in what is called, 'succession.' Examples of corporation soles are bishopric and kingship. (3 Marks)

A corporation aggregate, on the other hand, is an association of two or more human beings who come together in pursuit of economic gain through legitimate business. In the eye of the law, the various persons who form the company become one person, represented by it. The corporation aggregate sues and is sued on their behalf. Examples of corporation aggregate are the Institute of Chartered Accountants of Nigeria and Oando Plc. (4 Marks)
- (c) Moral responsibilities of corporations to employees. These include the following:
 - (i) Companies should accord concern and respect due to human beings to their employees.

- (ii) They should implement the written and implied terms of employment agreements, including the provision of conducive environment.
- (iii) Provision of stable employment. An ethical company should lay off staff most reluctantly. Where alternative actions are not available, efforts should be made to soften the harmful effects of laying off.
- (iv) Payment to the employees in the proportion of their contributions to the success of the firms, but at least at an amount which is sufficient to cover the biological needs of an ideal family.
- (v) Companies should design the work, such that it would develop the employees and contribute significantly to the well-being of fellow human beings.
- (vi) Employees have the right to form or join trade unions. Consequently, corporations should respect the freedom of their employees in this regard. However, there is the built-in assurance that the unions would be fostering troubles.
- (vii) There should be no intrusion into the privacy of their employees unless is a compelling and proportionate reason.
- (viii) There should be provision of fair hearing before sanctions are employed.

(1 Mark each for 3 correct solutions 3 Marks)

Total (15 Marks)

QUESTION 4

- (a) Discuss the concept of accountability. *(10 Marks)*
- (b) Write briefly on the manipulation/Window Dressing of Accounts *(5 Marks)*

Total (15 Marks)

SUGGESTED SOLUTION TO QUESTION 4

- (a) 'Accountability' is the ability and preparedness to render stewardship in respect of the resources placed under the care or management of another person or group of persons. In accountancy, the term 'steward' refers to the agent who keeps or manages the resources, usually money, on behalf another person, his principal. The discharge of responsibility rests squarely on human beings and companies. People do not like to be held accountable for positions of trusts, because they revel in corruption, fraudulent manipulation of accounts and records and other forms of malpractices. A malpractice has been defined as "unprofessional or improper conduct which may or may not involve the use of deception with a view to making unlawful gain.

The scope and concept of 'accountability' has been extended well beyond its core reference of being called to account for one's actions or inactions. It applies to the internal aspects of official behaviour, apart from stewardship for the management of resources. Accountability also relates to making official to be responsive to public wishes and holding democratic dialogue between the companies and the stakeholders. *(10 Marks)*

- (b) **Manipulation/Window Dressing of Accounts**

According to the Chambers Dictionary, to manipulate is "to give a false appearance to, or change the character, etc. of." The alteration of accounts so as deceive all people who come into contact with the information is manipulation or 'window dressing.' Usually, the manipulator's desire is to paint a rosy picture of the enterprise to the outside world, particularly the shareholders. 'Window dressing' is artificial creation of a situation which, although true, is not a fair representation of the underlying reality. *(5 Marks)*

Total (15 Marks)

QUESTION 5

Aristotle insists that every situation has four factors which brings it into existence in his Virtue Ethics Theory. Discuss the four factors.

SUGGESTED SOLUTION TO QUESTION 5

The factors or causes are:

- (a) **Material Causes:** The material cause of a thing or object is the actual physical material which makes it what it is. Aristotle draws from his point or theory of teleology which assumes that everything has a purpose or that the ultimate result of a particular action is all the important consideration. For example, the science of chemistry tells us that water is made from two molecules of hydrogen and one of oxygen. Consequently, it can be stated that the material cause of water is hydrogen and oxygen. *(6 Marks)*
- (b) **Efficient Creative Force or Cause.** The creative force or efficient cause is that which has brought the object into being or existence. According to Aristotle, the efficient creative force of a goat is its parents. Later, however, religious beliefs and traditions which Aristotle inspired substituted God as the efficient creative force or cause. *(3 Marks)*
- (c) **Formal cause.** Just as Plato, Aristotle, postulates that it is in this world that true reality is found, with the intellectual perspective. For example, a successfully baked bread displays the perfect form of a piece of bread, through the use of man's mortal sense of appreciation. *(2 Marks)*
- (d) **Final Cause.** Final cause illuminates the understanding of the purpose of a thing - its attributes, nature and qualities. According to this concept, the nature of a thing is not fully appreciated until its purpose is understood. As long as the object achieves its pre-determined potential, it is a success. Nature or the achieved end, therefore, becomes the 'final cause' sought. *(4 Marks)*

Total (15 Marks)

QUESTION 6

The Code of Ethics for professional Accountants of July 2009 issued by the International Federation of Accountants stipulates five fundamental principles, under Section 100.5, which a professional accountant should comply with. You are required to briefly discuss the fundamental principles.

(15 Marks)

SUGGESTED SOLUTION TO QUESTION 6

The fundamental principles are discussed, as follows:

- (a) **Integrity:** The attribute requires a professional accountant to be straightforward and honest in all his professional and commercial relationships.
- (b) **Objectivity:** He should not allow bias, undue influence or conflict of interests of others to override his business or professional judgments.
- (c) **Professional Behaviour:** A professional accountant should exhibit the characteristics of adherence to the relevant laws and regulations. He should avoid actions which would tarnish the good name of the profession.

- (d) **Professional Competence and Due care:** A professional accountant should maintain professional knowledge and skills at the point expected of a person of his status, to ensure that a client or employer receives optimal and competent services, reflexive of current legislature, techniques and current pronouncements.
- (e) **Confidentiality:** A professional accountant should have respect for the confidentiality of the information which he receives or acquires, arising from all professional and business relationships. He should not disclose any such information to third parties without due authorization, unless there is a legal or professional obligation or right to do so, and neither should he use the information to his personal advantage or that of third parties.
(Award 3 marks for each correct solution: 15 Marks)

QUESTION 7

Under the Companies and Allied Matters Act, Cap. C.20, Laws of the Federation of Nigeria. 2004.

- (a) Who may not join in the formation of a company? *(4½ Marks)*
 (b) What types of companies are in existence? *(7½ Marks)*
 (c) State three (3) features of a private company. *(3 Marks)* **(Total 15 marks)**

SUGGESTED SOLUTION 7

- (a) **Who may not join in the formation of a company?**
- (i) An individual who is less than '18 years of age (unless two other persons who are 18 years and above have subscribed to the memorandum; *(1½ Marks)*
 - (ii) A person pronounced by a court of law to be of unsound mind' *(1 Mark)*
 - (iii) An undischarged bankrupt; *(1 Mark)*
 - (iv) An individual who is disqualified from being a director of a company. *(1 Mark)*
- (b) **Types of companies in existence:**
- (i) A company limited by shares. Members' liability is restricted to the amount unpaid on the shares held;
 - (ii) A company limited by guarantee. This is referred to as the amount undertaken by a member to make available in the event that the company is winding up;
 - (iii) An unlimited company. It does not have any limit on members' liability;
 - (iv) A private company limited by shares. The company has the word 'limited' (Ltd) at the end of its name;
 - (v) A public company limited by shares. It has the description 'public limited company' (Plc) after its name. *(1½ marks for each correct answer 7½ marks)*
- (c) **Three features of a private company:**
- (i) It restricts the transfer of shares among members;
 - (ii) A private company has maximum of fifty (50) members;
 - (iii) A private company shall not invite members of the public to subscribe for any shares or debentures or deposit money for any fixed period or payable at call. *(3 Marks)* **Total (15 Marks)**

QUESTION 8

- (a) Under what Circumstances may Professional accountants disclose confidential information under IFAC code of Ethics 2009?
 (b) Write short note on "Quality Control and Peer Review Programme"

SUGGESTED SOLUTION TO QUESTION 8**(a) Circumstances of Disclosure:**

- (i) The law permits disclosure and it is authorized by the client or employers. *(1 Mark)*
- (ii) Disclosure is required by law, especially in the production of documents during court sessions or making disclosure to the enquiring public offices in respect of law infringement which has been discovered. *(2 Marks)*
- (iii) Where it is a professional duty or right to disclose, when the law does not prohibit it. There could be the need to comply to an inquiry by a member body or regulatory body. It could be in connection with the protection of the professional interests of an accountant in legal matters or compliance with technical standard and ethics requirements. *(5 Marks)*

(b) Quality Control and Peer Review

“Quality Control” is a measurement yardstick, below which the standard of performance should not fall. The role of “Quality Control” is to ensure that standard of quality or expectation is set, so that adverse deviations may be pinpointed for correction measures.

(c) Peer Review Programme

The programme is designed to enhance the quality of auditing and attestation services which are performed by professional accountants in public practice and by members of the Institute of Chartered Accountants of Nigeria and, by that fact, of International Federation of Accountants. The ‘quality control’ requirements are laid out in the Code of Ethics for professional accountants released by the International Federation of Accountants (IFAC) and rules of professional conduct for members issued by the Institute of Chartered Accountants of Nigeria. In Nigeria, peer review activities are handled by the Professional Practice Monitoring Committee of the Institute. *(7 Marks)*

QUESTION 9

- (a) What is ‘expropriation?’
- (b) Discuss briefly two (2) agency problems in corporate governance.

SUGGESTED SOLUTION TO QUESTION 9

- (a) According to Oxford Advanced Learners Dictionary of Current English, 7th Edition, the word ‘expropriation’ can be defined as “of a government or an authority, to officially take away private property from its owner for public use, taking somebody’s property and using it without permission”. However, expropriation takes different forms which include the following:
 - (i) Criminal conversion of corporate assets, for example, by highly placed individuals.
 - (ii) Undertaking transfer pricing of goods produced, to a rival organisation owned by a powerful member of the board, at lower the cost of production.
 - (iii) Payment of excessive executive remuneration package, thereby eroding the cash resources of a corporation and corruptly enriching top management.
 - (iv) Installation of inept management team which has no focus and which runs the company ineffectively.
 - (v) Committing a lot of money on un-economic projects which benefit only the top management.

(b) Agency problems include the following:

- (i) The individual interests of the board and management on one hand, and those of the entities on the other hand, do not always coincide. Consequently, there may be divided loyalty and absence of dedication.
- (ii) Many members of boards fail to do their jobs. A lot of them indulge in board room politics. Others appreciate their positions as executive employment opportunities.
- (iii) There are examples of over-bearing board which give no breathing space to their chief executive officers. Conversely, certain chief executive officers are uncompromising with their boards.
- (iv) The search for new board members is sometimes developed on the Chief Executive Officers who tend to pick directors that they “can count on”. The result is “wrong people in the right places,” a development which is inimical to the progress of the companies.

(2½ marks for each of any two answers – 5 Marks)

(Total 15 Marks)

QUESTION 10

Discuss briefly the following concepts:

- (a) Corporate Social Responsibility
- (b) Full Cost Accounting
- (c) Life Cycle Costing
- (d) Environmental Management Accounting

SUGGESTED SOLUTION TO QUESTION 10

- (a) **Corporate Social Responsibility:** which is also referred to as corporate citizenship, corporate responsibility, corporate social performance, is a kind of corporate self regulation which is built into a business model. Corporate social responsibility operates as an inbuilt, self-controlling device used by an organisation to monitor and ensure its adherence to law, ethical stipulations and international norms. An organisation takes responsibility for the impact of its environmental activities, employees, consumers, communities and members of the public. Additionally, apart from obeying the environmental laws, a company has to aggressively promote public interest through voluntarily avoiding activities which are harmful.
(8 Marks)
- (b) **Full Cost Accounting:** is the process of aggregating the cost of production with environmental management cost and dividing the figure obtained into the number of units manufactured, to obtain the cost per unit.
(1 Mark)
- (c) **Life Cycle Costing:** is an approach which seeks to optimize the use of cost. The approach identifies and sums up all costs, including environmental management expenses and the purchase cost of production assets. Estimated lives of fixed assets to be purchased and the cost of borrowing are determined. The technique is applied on the reasoning of cost minimization, by discounting the costs. The lesser the discounted cost, the greater the chance of picking or choosing the asset.
(2 Marks)
- (d) **Environmental Management Accounting:** is a technique used for “the generation, analysis and use of financial and related non-financial information, to support management within a company or business”. The production analysis and appropriate application of costing, financial and statistical data gathered assist a company in managing its environmental issues diligently.
(4 Marks)

APPENDIX III

CASE STUDY 1

Karsashi, a public company, is a high street retailer that sells clothing materials and food. Dankundalo, the managing director, is very disappointed with the current year's results. The company expanded its operations and commissioned a famous designer to restyle its clothing products. This has led to increased sales in both retail lines, yet overall profits are down.

Details of the financial statements for the two years to 30th September 2008 are shown below:

Profit and Loss Account for the Year ended:

	30th September, 2008		30th September, 2007	
	N'000	N'000	N'000	N'000
Revenue: Clothing	15,600		16,000	
Food	7,400	23,000	4,000	20,000
Cost of Sales: Clothing	14,500		13,000	
Food	4,750	(19,250)	3,100	(16,100)
Gross Profit		3,750		3,900
Other Operating expenses		(2,750)		(1,900)
Operating Profit		1,000		2,000
Interest expense		(300)		(80)
Profit before Tax		700		1,920
Income Tax expense		(250)		520
Profit for the period		450		1,400
Retained Profit b/f		1,900		(1,100)
		2,350		2,500
Dividends Paid		(600)		(600)
Retained Profits C/F		1,750		1,900

Balance Sheet as at:

	30th September 2008		30th September 2007	
	N'000	N'000	N'000	N'000
Fixed Assets:				
Property, Plant & Equipt cost	17,000		9,500	
Accumulated Depreciation	(5,000)	12,000	(3,000)	6,500
Current Assets:				
Stock: Clothing	2,700		1,360	
Food	200		140	
Trade Debtors	100		50	
Bank	-	3,000	450	2,000
		<u>15,000</u>		<u>8,500</u>

	N'000	N'000	N'000	N'000
Capital and Reserves:				
Issued Share Capital of 1.00 each		5,000		3,000
Share Premium		1,000		--
Retained Profits		1,750		1,900
		7,750		4,900
Long-term liabilities:				
Long-term loans		3,000		1,000
Current Liabilities:				
Bank Overdraft	930		—	
Trade Creditors	3,100		2,150	
Current Tax Payable	220	4,250	450	2,600
		<u>15,000</u>		<u>8,500</u>

Cash Flow Statement for the year ended 30th September 2008:

	N'000	N'000
Cash flow from operating activities:		
Operating Profit		1,000
Adjustments for:		
Depreciation	3,800	
Loss on disposal of fixtures	1,250	5,050
Operating profit before working capital changes:		6,050
Increase in Stock	(1,400)	
Increase in trade debtors	(50)	
Increase in trade creditors	950	(500)
Income Tax Paid		(480)
Net cash from operating activities		5,070
Cash flow from Investing Activities:		
Purchase of property, plant and equipment	(10,500)	
Disposal costs of fixture	(50)	(10,550)
Net cash flow from investing activities		(5,480)
Cash flow from financing Activities:		
Issue of Ordinary Shares	3,000	
Interest paid	(300)	
Long-term loans	2,000	
Ordinary Dividend paid	(600)	4,100
Net decrease in cash and cash equivalents		(1,380)
Cash and Cash equivalents at beginning of the year		450
Cash and Cash equivalents at the end of the year		<u>(930)</u>

The following information is relevant:

- (i) The directors have signalled their intention to maintain annual dividends at ₦600,000 for the foreseeable future.
- (ii) The increase in property, plant and equipment was due to the acquisition of five new stores and the refurbishment of some existing stores during the year. The carrying value of fixtures scrapped at the refurbished stores was ₦1.2 million; they had originally cost ₦3million. Karsashi Plc received no scrap proceeds from the fixtures, but did incur costs of ₦50,000 to remove and dispose of them. The losses on the refurbishment have been charged to operating expenses. Depreciation is charged to cost of sales apportioned in relation to floor area (see below).

- (iii) The floor sales areas (in square metres) were:
- | | 30th September 2008 | 30th September 2007 |
|----------|---------------------|---------------------|
| | ₦ | ₦ |
| Clothing | 48,000 | 35,000 |
| Food | 6,000 | 5,000 |
| | <u>54,000</u> | <u>40,000</u> |
- (iv) The share price of Karsashi plc averaged ₦6.00 during the year to 30th September 2007, but was only ₦3.00 at 30th September 2008.
- (v) The following ratios have been calculated:
- | | 2008 | 2007 |
|-------------------------------|-----------|-----------|
| Return on capital employed | 9.3% | 33.9% |
| Net assets turnover | 2.1 times | 3.3 times |
| Gross profit margin: | | |
| Clothing | 9.4% | 18.6% |
| Food | 32.1% | 25% |
| Net profit (after tax) margin | 2.0% | 7.1% |
| Current Ratio | 0.71:1 | 0.77:1 |
| Stock holding period: | | |
| Clothing | 68days | 39days |
| Food | 15days | 17days |
| Creditors' payment period | 59days | 50days |
| Gearing | 28% | 17% |
| Interest Cover | 3.3 times | 2.5 times |

Required:

Write a report analyzing the financial position of Karsashi Plc for the two years ended 30th September 2007 and 2008. Your report should utilize the above ratios and the information in the cash flow statement. It should refer to the relative performance of the clothing and food sales, and be supported by any further ratios you consider appropriate.

SUGGESTED SOLUTION**KARSASHI PLC**

- (a) Report on the financial performance of KARSASHI PLC for the year ended 30th September 2008:

To:
From:
Date:

Operating Performance:

Karsashi plc's overall performance as measured by the return on capital employed has deteriorated markedly. This ratio is effectively a composite of the company's profit margins and its asset utilization. The expansion represented by the acquisition of the five new stores has considerably increased investment in net assets. The asset turnover (a measure of asset utilization) has fallen from 3.3 times to 2.1 times. This is a relatively large fall and is partly responsible for the deteriorating performance. However, it should be borne in mind that it often takes some time before new investment generates the same level of sales as existing capacity so it may be that the situation will improve in future years.

Of more concern in the current year, is the deteriorating gross profit margin of the company's clothing sales. This has fallen from 18.6% to 9.4%. The effect of this is more marked because sales of clothing (in the current year) represents nearly 70% of turnover. It should also be

noted that the stock holding period of clothing has also increased significantly from 39 days in 2007 to 68 days in the current year. This may be a reflection of a company policy to increase stock levels in order to attract more sales, but it may also be an indication that there is some slow-moving or obsolete stock.

The clothing industry is notoriously susceptible to fashion changes. The new designs may not have gone down well with the buying public. By contrast, the profit margin on food sales has increased substantially (from 25% to 32.1%) as indeed have the sales themselves (up to 75% on last year). These improvements have helped to offset the weaker performance of clothing sales.

A more detailed analysis shown by the ratios in the appendix confirms the position. The expansion has created a 35% increase in the sales floor area, but the proportionate increase in turnover is only 17.3%. Breaking this down between the two sectors shows that the clothing sector is responsible for this deterioration; an increase in capacity of 37% has led to an increase in sales of only 2.6%, whereas a more modest increase of 20% in the food floor area has led to a remarkable increase of 75% in food sales. In the current year, food retailing has generated sales of 1,167,000 per square meter, whereas clothing sales per square meter has fallen from ₦446,000 to ₦333,000. When the relative profit margins of clothing and food are considered, it can be seen that food retailing has been far more profitable than clothing retailing and this gap in margins has increased during the current year.

This deterioration in trading margins has continued through to net profit margins (falling from 7.1% to only 2.0%). It can be observed that operating expenses have increased considerably, but this is to be expected and is probably in line with the increase in the number of stores.

In summary, the increase in capacity has focused on clothing rather than food retailing. On reflection, this seems misguided as the performance of food retailing was superior to that of clothing (in 2007) and this has continued (even more so) during the current year.

Liquidity/Solvency

The increase in the investment in new stores and the refurbishment of existing stores has been largely financed by increasing long term loans by 2 million and issuing 3 million of equity. The effect of this is an increase in gearing from 17% to 28%. Although the level of gearing is still modest, the interest cover has fallen from a very healthy 25 times to a worrying low 3.3 times.

The investment has also taken its toll on the bank balance falling from ₦450,000 in hand to an overdraft of ₦930,000. This probably explains why the company has stretched its payment of accounts payable to 59 days in 2008 from 50 days in 2007.

The company's current liquidity position has deteriorated slightly from 0.77:1 to 0.71:1. No quick ratios have been given, nor would they be useful. Liquidity ratios are difficult to assess for retailing companies.

Most of the sales generated by such companies are for cash (thus there will be few trade receivables) and normal liquidity benchmarks are not appropriate. The cash flow statement reveals cash flows generated from operating activities of ₦5,550,000. This is a far more reliable indicator of the company's liquidity position. The ₦5,500,000 is more than adequate to service the tax and the dividend payments. Indeed the operating cash flows have contributed significantly to the expansion programme.

Share price and dividends

Karsashi's share price has halved from 6.00 to 3.00 during the current year. The dilution effect of the share issue at 1.50 per share (2 million shares for 3 million) would account for some of this fall (to approximately 4.20), but the further fall probably represents the market's expectations of the company's performance. It is worth noting that the company has maintained its dividends at ₦600,000 despite an after tax profit of only ₦450,000. Whilst this dividend policy can not be maintained indefinitely (at the current level of profits), the directors may be trying to convey to the market a feeling of confidence in the future profitability of the company. It may also be a reaction designed to support the share price. It should also be noted that although the total dividend has been maintained, the dividend per share will have decreased due to the share issue during the year.

Summary

The above analysis of performance seems to give mixed messages, the company has invested heavily in new and upgraded stores, but operating performance has deteriorated and the expansion may have been misfocused. This appears to have affected the share price adversely. Alternatively, it may be that the expansion will take a little time to bear fruit and the deterioration may be a reflection of the current state of the economy. Cash generation remains sound and if this continues, the poor current liquidity position will soon be reversed.

Signed
BMA & Co.

The following additional ratios can be calculated:

	CLOTHING	FOOD	OVERALL
Increase in Sales area	13,000 = 37%	1,000 = 20%	14,000 = 35%
	35,000	5,000	40,000
Increase/(Decrease)	(400) = -2.5%	3,400 = 85%	3,000 = 15%
	16,000	4,000	20,000
Sales per square meter (2008)	Sales per square meter (2007)		
	₦'000	₦'000	
Overall	(23,000/54) = 426	(20,000/40) = 500	
Clothing	(15,600/48) = 325	(16,000/35) = 457	
Food	(7,400/6) = 1,233	(4,000/5) = 800	

CASE STUDY 2

BMA & Co. is a firm of Chartered Accountants acting as financial consultants to Mr. Jones, the proprietor of “the ice cream parlour”. Mr. Jones has produced draft accounts for the year ended 31st May 2008 which include a trading account as follows:

Trading account for the year ended 31st May 2008:

	N
Sales	144,000
Cost of Sales	90,720
Gross Profit	53,280

He has noticed from reading the journal of his trade association that the average gross profit is 40% on sales and he requests that an investigation be carried out to explain why his gross profit appears to be lower than the average and also apparently worsening.

An analysis was carried out by Anibema & Co. of the make-up of the sales for the last two months. This analysis is shown below:

	April	May
	N	N
Ice Cream	3,000	3,900
Coffee-percolated	2,800	3,300
Coffee-prepacked Cups	1,700	1,500
Lemonade	1,200	900
Orangeade	2,000	1,800
Black Currant Cordial	1,100	900
	<u>11,800</u>	<u>12,300</u>

A comparison of the purchase invoices with the price list showed the gross profit % on sales to be coffee-percolated 33%, coffee-prepacked cups 40%, lemonade 46%, orangeade 48%, blackcurrant cordial 42%.

The gross profit % of the ice cream was calculated as an average based on comparing total monthly cost of ice cream with total monthly sales of ice cream- the result was 25%.

Required:

- (a) Draft a letter to Mr. Jones with supporting data to explain why the gross profit % appears to be worsened from April to May.
- (b) Draft a note to the partner quantifying any possible loss and specifying any further work you think should be carried out to confirm the reason why the gross profit % of the “the ice cream parlor” is lower than the industry average.

SUGGESTED SOLUTION

(A) A letter to Mr. Jones explaining why his gross profit % is on the decline.

ANIBEMA & CO. CHARTERED ACCOUNTANTS

Jones Esq.
The Ice Cream Parlor,
14 Oweh Street,
Lagos.
29th June 2009

Dear Mr. Jones

RE: ICE CREAM BUSINESS

In accordance with your instructions, we have conducted an investigation into the reasons why your gross profit percentage appears to be lower than the industry average and why the situation worsened from April to May 2008.

We have analyzed the sales together with their associated gross profit percentages and have obtained the overall gross profit percentages of 36.7% in April and 35.1% in May, which are in line with your suspicion (attached appendix refers). The reasons for this decline might be poor fixing of selling prices, poor sales mix, high cost of purchase and errors in stock counting or valuation. However, from available information, the main reason for the decline is that a lower sales mix was achieved in May. Although total sales rose from 11,800 to 12,300, the rise came mainly from ice-cream and percolated coffee, where the gross profit achieved were 25% and 33% respectively. On all other items, where gross profits are 40% and above, sales were down in May. We trust that this reason has satisfied your curiosity and would wish to investigate more on your sales mix.

We would be gladly and readily available to offer further clarifications should the need arise.

Yours Sincerely,
Anibema & Co.
(Chartered Accountants)

Determination of the company's average gross profit % for April and May including Sales Mix%.

	APRIL				MAY			
	Sales	Gp%	Gr(₦)	Mix(%)	Sales	GP%	GR(₦)	Mix(%)
Ice cream	3,000	25	750	25.40	3,900	25	975	31.80
Coffee Percolated	2,800	33	925	23.70	3,300	33	1,080	26.80
Coffee - prepacked cups	1,700	40	680	14.40	1,500	40	600	12.20
Lemonade	1,200	46	552	10.02	900	46	414	7.30
Orangeade	2,000	48	960	17.00	1,800	48	864	14.60
Blackcurrant	1,100	42	462	9.30	900	42	378	7.30
	<u>11,800</u>		<u>4,329</u>	<u>99.82</u>	<u>12,300</u>		<u>4,311</u>	<u>100.00</u>

Average GP%:

April

$$= \frac{4,328}{11,800} \times 100 = 36.7\%$$

$$\text{May} = \frac{4,320}{12,300} \times 100 = 35.1\%$$

(B) From: Audit Manager

To: Partner

Subject: The Ice-cream parlour (year ended 31st May 2008)

Our Client's trading account for the year ended 31st May 2008 is as follows:

	₦
Sales	144,000
Cost of Sales	90,720
Gross Profit	53,280

The result of this trading account shows a gross profit of 37%, which when compared to the industry average of 40%, has a short fall of 3%.

The effect of this difference indicates that sales of approximately ₦7,200 have been omitted from the records. That is, $90,720/0.6$ less $144,000 = 7,200$. The total cost of ₦90,720 needs to be analysed into its constituent parts and the sales estimate based on that analysis. Purchase invoices will need to be obtained for this purpose and sales mix compared with that of other companies in the same industry. There could be a reconciliation of physical stock movements to identify whether there has been any misallocation of sales to product type.

Yours faithfully,
Aminu Ranger

CASE STUDY 3

The following information was extracted from the balance sheet of BMA plc, a company newly quoted on the second tier security market.

	N'000
Total fixed assets (As at 31st December 2008)	10,000
Closing Stock (As at 31st December 2008)	1,000

A financial analyst interested in investing in the company computed the following ratios in respect of the company for the year ended 31st December 2008:

Gross profit margin	25%
Net profit/sales	20%
Stock turnover ratio	10 times
Net profit/capital	20%
Closing capital to total liabilities	50%
Fixed asset/capital	5:4
Fixed asset/total current assets	5:7

Required:

With the information available, your Managing Director has asked you to prepare the trading, profit and loss account for the year ended 31st December, 2008 and a balance sheet as at that date.

SUGGESTED SOLUTION

BMA PLC

Trading, Profit and Loss Account for the year ended 31st December 2008

	N'000	N'000
Sales (wk1)		8,000
Opening Stock (wk 2 & 3)	200	
Purchases	6,800	
Closing Stock	(1,000)	
Cost of Sales (wk 4)		(6,000)
Gross Profit (wk 5)		2,000
Expenses		(400)
Net profit (wk 6)		<u>1,600</u>

Balance Sheet as at 31st May, 2008

	N'000	N'000
Fixed Assets		10,000
Current Assets (wk 7):		
Stock	1,000	
Other current assets (wk 8)	13,000	
Total current assets	14,000	
Less Current Liabilities (wk 9)	(16,000)	
Net current assets		(2,000)
Net Assets		8,000
Financed By:		
Opening Share Capital		6,400
Net Profit		1,600
Closing Capital (wk 10):		<u>8,000</u>

- (WK 1) Net Profit = 20% of Sales
Sales = 1,600,000
20%
= 1,600,000
0.2%
= ₦8,000,000
- (WK 2) Average Stock = 6,000,000
10
= ₦600,000
i.e. $\frac{\text{Opening Stock} + \text{Closing Stock}}{2}$
- (WK 3) Average Stock = $\frac{\text{OS} + \text{CS}}{2}$
2 x Average Stock = Opening Stock + Closing Stock
2 x 600,000 = Opening Stock + Closing Stock
Opening Stock = 1,200,000 - 1,000,000
= ₦200,000
- (WK 4) Stock Turnover Ratio = $\frac{\text{Cost of Sales}}{\text{Average Stock}}$
Cost of Sales = Sales - Gross Profit
8,000,000 - 2,000,000
₦6,000,000
- (WK 5) Gross profit = 25% of Sales
Gross profit = 25% of 8,000,000
= ₦2,000,000
- (WK 6) Net Profit = 20%
Capital
Net Profit = 20%
8,000,000
Net Profit = ₦1,600,000
- (WK 7) Fixed Assets = 5:7 = $\frac{5}{7}$
Total Current Assets
Total current assets = 10,000,000 x $\frac{7}{5}$
= ₦14,000,000
- (WK 8) Other current assets = 14,000,000 - 1,000,000
= ₦13,000,000
- (WK 9) Capital = 1 : 2 i.e. 50%
Total liabilities
Total liabilities = 8,000,000 x 2
= ₦16,000,000
- (WK 10) Fixed Assets = 5 : 4
Closing Capital
Closing Capital = $\frac{4}{5}$ x 10,000,000
= ₦8,000,000

CASE STUDY 4

Ologbojo is an accomplished tradi-medical practitioner who has unorthodox herbal mixture which is acclaimed throughout Ejugi state of Elepa country to cure malaria. He has a 3 - member staff laboratory technician and one homoeopathist. “Ologbojo baba Egungun” (that is great man of herbal medicine) is very popular and drawn serious patronage from which he makes a fortune.

Ologbojo is member of the state’s traditional medicine practitioners board and indeed the chairman. His homoeopathist staff claimed that his boss was using a component which, although effective, damages the liver. The staff homoeopathist has advised his boss several times but to no avail. Out of frustration, he alerted the traditional medicine board which conducted series of tests and found the report to be authentic.

SUGGESTED SOLUTION

Larmer (1992) in his “ Whistleblowing and Employee” defines “Whistle – blowing “ done by an employee as “ the act of complaining, either within the corporation or outside about a corporation’s unethical practices.”

Whistle blowers who are in paid employment are often condemned for disloyalty to their organisations. They are criticized for breaching the rules of confidentiality by bringing to public domain issues of which their organisations would rather keep secret.

Employees, as of duty, should be loyal to their business organisations. They are not expected to behave as detached strangers. This position is in accord with the theory of deontology.

Although, employees owe their companies loyalty, it does not require that they should do whatever the organisations like them to do. What it requires is that one should do what one honestly holds is in one’s best interest and philosophy of life. Larmer R. A (1992) puts it in this way, “ I am not for example, disloyal to a friend if I refuse to lend her money for an investment. I am sure reproaches me for denying her what is so obviously a golden opportunity to make a fortune”. If the only known approach to stop the tradi-medical practitioner from infecting people with his herbal preparation which would terminate innocent lives, was to blow the whistle on it, it is very logical to hold that Ologbojo’s homoeopathic staff actually showed great loyalty. This is in contrast to the attitudes of the other employees who simply moved on while the herbal company was selling the lethal drug to the members of the public. According to Elegido (1996) “the duty of loyalty is not absolute.” Employees have also obligation to the people who could be harmed by their firms’ actions, more so that such duties could impact very negatively to evoke action from staff.

The homoeopathic employee has acted in the interest of the larger society and in keeping with the utilitarian principles, and should be commended rather than denounced.

APPENDIX IV

Table 1: SUMMARY OF INTERNATIONAL ACCOUNTING STANDARDS

IAS	STANDARD	DATE ISSUED/ REVISED
IAS 1	Presentation of Financial Statements.	1975/97
IAS 2	Inventories.	1976/93
IAS 3*	Consolidated Financial Statement (Replaced by IAS 27 & 28 in 1998).	
IAS 4*	Depreciation Accounting (Withdrawn in 1999).	
IAS 5*	Information to be Disclosed in Financial Statements (Suspended by Revised IAS 1).	
IAS 6*	Accounting Responses to Changing Prices (Suspended by IAS 15)	
IAS 7	Cash flow Statements	1979/92
IAS 8	Net Profit for Loss for the Period, Fundamental Errors & Changes in accounting policies.	1979/93
IAS 9*	Research & Development Costs (Superseded by IAS 38, in 1998)	1993
IAS 10	Events after the Balance-sheet Date.	980/94
IAS 11	Construction Contracts	1980/93
IAS 12	income Taxes	1981/96
IAS 13 *	Presentation of Current Assets & Current Liabilities (suspended by Revised IAS 1)	
IAS 14	Segment Reporting	1983/97
IAS 15*	Information Reflecting the Effects of Changing Prices (Withdrawn in 2003)	
IAS 16	Property, Plant and Equipment	1983/93–98
IAS 17	Leases	1984/97
IAS 18	Revenue	1984/93
IAS 19	Employee Benefits	1985/95–98
IAS 20	Accounting For Governmental Grants & Disclosure of Government Assistance	1984/94
IAS 21	Effects of Changes in foreign exchange rates	1985/93
IAS 22*	Business Combinations (Suspended by IAS 3, in)1985/95–98	
IAS 23	Borrowing Costs	1986/93
IAS 24	Related Party Transactions	1986/94
IAS 25*	Accounting for Investments (Superseded by IAS 39 & 40)	
IAS 26	Accounting & Reporting by retirement benefit plans 1988/94	
IAS 27	Consolidated Financial Statements & Accounting for Investments in Subsidiaries	1990/94
IAS 28	Accounting for Investments in associates.	1990/98
IAS 29	Financial Reporting in Hyper-inflationary economies 1990/94	
IAS 30*	Disclosures in the Financial Statements of Banks & Similar Fin. Inst. (Superseded by IFRS 7)	1991/94
IAS 31	Financial Reporting of Interests in joint ventures.	1992/98
IAS 32	Financial Instruments Disclosure.	1996/98
IAS 33	Earnings Per Share	1997
IAS 34	Interim Financial Reporting	1998
IAS 35*	Discontinuing Operations (Superseded by IFRS 5) 1998	
IAS 36	Impairment of Assets.	1998
IAS 37	Provisions, Contingent Liabilities & Contingent Assets	1998

IAS 38	Intangible Assets	1998
IAS 39	Financial Instruments: Recognition & Measurement	1999
IAS 40	Investment Property	2000
IAS 41	Agriculture	2001
IFRS 1	First-time Adoption of IFRSs.	
IFRS 2	Share-Based Payments.	
IFRS 3	Business Combinations	
IFRS 4	Insurance Contracts.	
IFRS 5	Non-Current Assets held for Sale & Discontinued Operations	
IFRS 6	Exploration for & Evaluation of Mineral Resources.	
IFRS 7	Financial Instruments: Disclosures.	

Source: Comparative International Accounting, Nobes, C. and Parker, R. Prentice Hall (2006); and Unshackling Accountants, Myddelton, D.R., The Institute of Economic Affairs 2 Lord North Street Westminster London sw1p 3lb (2004).

NB: Where two dates are given (e.g. 1986/94) this denotes date of first issue followed by date of revision. Where three dates are given (e.g. 1985/95–98) the third date relates to further revision. The IAS in asterisk are withdrawn, suspended or superseded by other standards.

Table 2: STATEMENTS OF ACCOUNTING STANDARDS ISSUED SO FAR

Since its establishment in 1982, the NASB has issued 30 accounting standards which include:

SAS 1	Disclosure of Accounting Policies
SAS 2	Information to be Disclosed in Financial Statements
SAS 3	Accounting for Property, Plant and Equipments
SAS 4	Stocks
SAS 5	Construction Contracts
SAS 6	Extraordinary Items and Prior Year Adjustments
SAS 7	Foreign Currency Conversions and Translations
SAS 8	Accounting for Employees Retirement Benefits
SAS 9	Accounting for Depreciation
SAS 10	Accounting for Banks and Non-Banks Financial Institutions (Part I)
SAS 11	Leases
SAS 12	Accounting for Deferred Taxes
SAS 13	Accounting for Investments
SAS 14	Accounting in the Petroleum Industry: Upstream Activities
SAS 15	Accounting for Banks and Non-Banks Financial Institutions (Part II)
SAS 16	Accounting for Insurance Companies
SAS 17	Accounting in the Petroleum Industry: Downstream Activities
SAS 18	Statement of Cash flows
SAS 19	Accounting for Taxes
SAS 20	Abridge Financial Statements
SAS 21	Earnings Per Share
SAS 22	Research and Development Costs
SAS 23	Provisions, Contingent Liabilities and Contingent Assets
SAS 24	Segment Reporting
SAS 25	Telecommunications Activities
SAS 26	Business Combinations
SAS 27	Consolidated and Separate Financial Statements
SAS 28	Investments in Associates
SAS 29	Interests in Joint Ventures
SAS 30	Interim Financial Reporting

Table 3: Members of IASB

Australia	Iceland	Paraguay
Austria	India	Peru
Bahamas	Indonesia	Philippines
Bahrain	Iraq	Poland
Bangladesh	Ireland	Portugal
Barbados	Israel	Saudi Arabia
Belgium	Italy	Singapore
Bolivia	Jamaica	South Africa
Botswana	Japan	Spain
Brazil	Jordan	Sri Lanka
Canada	Kenya	Sudan
Chile	Korea	Swaziland
Colombia	Kuwait	Sweden
Croatia	Lebanon	Switzerland
Cyprus	Lesotho	Syria
Czech Republic	Liberia	Taiwan
Denmark	Libya	Tanzania
Dominican Republic	Luxembourg	Thailand
Ecuador	Malawi	Trinidad and Tobago
Egypt	Malaysia	Tunisia
Fiji	Malta	Turkey
Finland	Mexico	United Kingdom
France	Netherlands	United States of America
Germany	New Zealand	Uruguay
Ghana	Nigeria	Zambia
Greece	Norway	Zimbabwe
Hong Kong	Pakistan	
Hungary	Panama	

Source: IASB, 2002.

APPENDIX V

GLOSSARY OF TERMS

Absorption

The takeover of one company by another.

Accounting Bases

These are methods adopted by an enterprise for applying a fundamental accounting concept to its financial transactions.

Accounting Concepts

These are the generally accepted assumptions and norms followed in the presentation of financial statements, which are expected to be disclosed.

Accounting Method

This is the medium through which the fundamental accounting concepts are applied to financial transactions.

Accounting Policies

These are the bases, rules, principles, conventions and procedures adopted in preparing and presenting financial statements. **OR** These are specific bases used by a particular business and regarded as appropriate to the circumstances of the business and suitable for the fair presentation of its results and financial position.

Accounting Standards

These are statements issued by the various accounting standards board aimed at providing guide to accountants in the preparation of financial statements.

Altruism

Holds that an action is right only if it is more favourable to others except the agent.

Amalgamation

This is the joining together of two or more companies carrying on a similar business.

Assets

These are resources controlled by an enterprise as a result of past events and from which future economic benefits are expected to accrue to the enterprise.

Attitude

Is our disposition, perspective, viewpoint, or outlook.

Basic Earnings Per Share

This is defined as the earnings per share based on the Weighted Average number of shares outstanding during the reporting period.

Capital Reconstruction

This involves the revamping of activities of a failing company or a company faced with capital inadequacy so as to put the company in the path of success in terms of profitability, liquidity, survival, growth and continuity.

Capital Reduction

This is a scheme approved by the court in which the nominal par values of a company's paid up share capital is reduced.

Cash Equivalents

These are the short-term highly liquid investments that readily convert into specific amount of cash and which are subject to an insignificant risk of changes in values.

Code of Conduct

It is a document published by a government agency, professional body, trade association etc outlining model procedures for good practice in a particular field, or body.

Code of Ethics

It is a formal statement that acts as a guide for how people within a particular organisation should act and make decisions in an ethical fashion.

Control

This is the power to govern the financial and operating policies of another so as to obtain benefits from its activities.

Deontologism

It holds that what makes an action right is not the sum of its consequences, but the fact that it conforms to the moral law.

Descriptive Ethics

It is the study of people's beliefs about morality.

Dilution

A decrease in the proportional claim on earnings and assets of a share of a common stock because of the issuance of additional shares.

Emotivism

Moral propositions are expressions one's emotions about some specific behaviour.

Empirical

It is based on observation or experience, derived solely from experience.

Ethical Egoism

This is the theory in ethics which holds that an action is morally right if the consequences of that action are more favourable than unfavourable only to the agent performing the action.

Ethical Leader

Can simply be regarded as a virtuous leader; he operates with high ethical standards and pursues the good for the benefit of the society.

Ethical Objectivism

It holds Moral values are absolute or eternal, not changing.

Ethical Relativism

It denies the objectives status of normal values.

Ethics

It is the study of principles or standard of human conduct.

Euthanasia

Mercy killing or painless killing to relieve suffering.

Exceptional Items

These are those items that, though are normal to the activities of an enterprise, are abnormal because of the frequency of occurrence and size. An example is abnormally high bad debt figure. They are material items from ordinary activities of an entity that need to be disclosed separately because of their size or incidence.

Financial Instrument

This is any contract that gives rise to both a financial asset of one entity and financial liability or equivalent instrument of another entity.

Financial Statements

These are the means of communicating to interested parties information on the resources, obligations and performances of the reporting entity or enterprise. They include, Balance Sheet; Profits and Loss Accounts; Cash flow statements; Value Added Statement and Five-year financial summary.

Foreign Entity

This is a foreign operation whose activities are not integral part of those of the parent.

Foreign Operations

This is a subsidiary, associated company, joint venture or branch whose activities are based or conducted in a country other than the country of the parent. It may or may not constitute a foreign entity.

Intangible Asset

This is an identifiable non-monetary asset without physical substance held for use in the production and supply of goods or services or for rental to others.

Justification

Giving reasons for something, confirmation.

Liabilities

These represent obligations of the enterprise arising from past events, settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits.

Meta-ethics

The study of the origin and meaning of ethical concepts.

Morality

Morality refers to the beliefs, principles or standards of human conduct or accepted moral standards.

Net Investment in a Foreign Entity

This is the parent equity share in the net assets of a foreign entity.

Norms

Standard pattern of behaviour.

Ontologism

Basically the theory holds that good actions come from good people.

Purchase Consideration

This is the price paid to the seller (vendor) by the buying company. It is the aggregate amount, which the new company is to pay the owners (that is, the stakeholders) of the discontinuing business and creditors.

Responsibility

The state, fact or position of being accountable to somebody or for something.

Super Profit

This is the difference between expected profit and fair return on the net tangible assets of a company.

Synergy

This is the benefit realized in a merger where the performance of the combined firm exceeds that of its previously separate parts (firms).

Teleologism

It judges the rightness or wrongness of an action based on its consequences. Actions are therefore not good in themselves; their moral values are totally based on the effects that follow upon them.

Theory of conduct

This is the study of right and wrong, of obligation and permissions, of duty, of what is above and beyond the call of duty, and of what is so wrong as to be evil.

Utilitarianism

Otherwise known as the 'greatest happiness principle', is an ethical theory that holds that an action is right if it produces, or if it tends to produce, the greatest amount of good for the greatest number of people affected by the action.

Values

They are the basic conviction which people have as regards 'right' and 'wrong' 'good' and 'bad'.

APPENDIX VI

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APPENDIX VII

STUDY AND EXAMINATION TECHNIQUES

This appendix contains notes on:

- a. Using the questions and answers provided in the manual;
- b. Effective study; and
- c. Examination technique.

7.1 **Questions and answers**

Introduction

1. Two types of questions are provided in this manual.
 - a. Questions set at the end of chapters *with answers* provided in Appendix 1
 - b. Questions *with answers* set in Appendix 2

Questions with answers

2. These questions are either
 - a. intended to test the understanding of the points arising out of the particular chapter; or
 - b. inserted at a stage where it is considered the student will be best able to give a reasonable answer.
3. Most answers are given in outline but some examination answers go a little further in order to provide greater guidance and provide students with the basis for study.
4. When answers are *comprehensive*, you could not be expected to write them in the time allowed. *Do not* worry if you feel you could not write such answers; you are not expected to. But you *must* grasp the main points or principles involved which will form the basis for good marks in an examination.
5. Do not worry if your answer differs, there is often more than one approach. You must satisfy yourself however, that it is *only* the approach that differs, and that you have not missed the fundamental principles.
6. Authors' Comments. These have been included to give *additional* points or elaborate on matters arising out of the subject covered by the question to which it is felt you should give some thought.

Using the answers

7. Have a shot at each question yourself *before* consulting the answer, you will achieve nothing if you do not do this. Write your answer out in full or jot down the main points. *Do not* hurry to the answer.
8. Look at the answer. (See para 5 in the case of examination answers). Study the particular area *thoroughly* now making sure of your understanding. *Repeat* the process outlined in para 7 and this paragraph after a suitable interval. You *must* do this to get any benefit at all. Make sure the main points *stick*.
9. Just browsing through the answers will really get you *nowhere*. You *must* test yourself by *writing* down your version of the answer.

7.2 Effective study

Introduction

1. These notes are intended for those who are new to studying for examination subjects, although those who are not, may also benefit. They have been written in relation to study involving the reading of *textbooks*, and they apply to *all* subjects. It is often very difficult to pick out the important principles from such books. Careful reading of these notes will be of benefit even in studying the manual.

General

2. Study means more than *just reading* a piece of literature. It means *close concentrated reading* with a *notebook* at your side. Unless you are one of a *few* people do not kid yourself you can absorb material by *just one* general read through it, you cannot!
3. Read a small area, *making notes* as you go along. Then ask yourself – what have I just learnt? *Write* down what you think it was all about. Then look again and you may be surprised to find you have missed a *key* point or points – they *must* be down in your notebook and eventually in your head.

Compilation of notebook

4. A *well-compiled* NOTEBOOK is a must. Use block capitals or different colour inks to *headline* the main areas and subdivisions of those areas. Notes made during lectures or private study should *not* go straight into your NOTEBOOK. Take them down on a “rough” paper and write them in your NOTEBOOK *as soon as possible* after the lecture or study period, thinking about what you are writing.

Memory aids

5. **Mnemonics** are very useful – if the sequence of points in the textbook *is not* significant, *change it* if it makes for a better mnemonic.
6. **Association** of the points with familiar objects which will serve to recall them is also useful.
7. Some people memorise things by *saying* them over and over *out loud*, others have to *write* them down *time after time*.
8. Many students have *small blank cards* and using one side of each card for each study area, put down the main points. They carry the cards everywhere with them and use every opportunity to study them. As they are small they are easily carried. It is surprising how much of your day can be utilized this way.

Programme

9. Map out a programme for yourself; set targets and *achieve* them. One thing is certain, studying is not easy but it is *not* too difficult if you go about it in an orderly purposeful way. Many students fail their examinations through *bad preparation*. Tackle your studies as you would a project at work, *systematically*. Allocate a number of hours each week to each subject. Try fixing *specific times* for each subject, then *keep to them* by refusing to let *anything* keep you from your planned task.

Revision

10. Revise periodically. The nearer the examination gets, the more you should concentrate on the major headlines in your notebook and less with the supporting details.

7.3 Examination technique

First impressions

1. However well prepared you may be, you are still likely to look at the paper on the day and say to yourself, after a quick look at the questions, "There's not much *there* I can do".
2. The atmosphere of the exam room has something to do with this. Try to blot everything from your mind other than the job in hand. *Concentrate* hard. If you feel a bit panicky (most people do – despite the apparent looks of serenity around you) grip the table, take a deep breath, and *get on with it*. Remember things are *never* as bad as they seem!

Time allocation

3. *Allocate* each question *time* appropriate to the number of marks. At the end of the allotted time for a question, *go on to the next* – remember, the *first* 5 or 10 marks on the *new* question are more readily picked up than the *last* 1 or 2 on the *previous* question.
4. The *temptation* will be to say "I'll write just *one* more sentence", but before you know where you are you would have written *several* more and probably just managed to score another mark, whereas the same time on the next question could have earned 5 or 6 marks. TIME ALLOCATION IS IMPORTANT.
5. If you *are* running out of time, write down the *main headings first*, leaving a few lines between each – at least the examiner will see that you had the overall picture. *Then* go back putting in as much supporting detail as you can.

General approach

6. Read the *instructions* at the top of the paper.
7. Read the question paper once through. Make your choice of questions quickly. Pick the easiest (if one appears so) and *get on with it*.

Individual question

8. Read the question again carefully. The question will involve a key principle or set of principles. What are they? It is so easy to make the wrong decision at this stage, so read the question, underlining what appear to be the *key words*. This should help you. Irrelevancy has been heavily criticized by examiners.
9. Do not rush into action with your pen *yet*. Jot down on a piece of scrap paper the *main headings* you will use in your answer. All this will take time – about 5 minutes or more, but the *careful thought* and outline answer represents *marks* already earned.
10. If the question is *set out* in a particular sequence, that is:
 - a.
 - b.
 - c. etc.
 then answer it *in that sequence* or you'll have a *hostile examiner* to cope with.
11. Use the particular terminology *used in the question*, the examiner can then *link the points* in your answer to the relevant parts of the question.
12. Assumptions are sometimes required (for example because of the lack of standardization of terminology in this subject). Having stated your assumptions, make sure that what you write is *consistent* with them. Do ensure, however, that your assumptions *are valid* and are *not* just a device for changing the *meaning* of the question to suit your knowledge!

Layout of answer

13. Tabulate where appropriate, using block capitals for your main headings and underline subheadings. Underline *words* or phrases which require emphasis. *Use a ruler.*
14. Leave a line *between* your paragraphs and subparagraphs. This makes for a *good* layout. However, do *not* write one very other line within paragraphs, or on one side of the paper only – examiners are waste conscious!
15. The use of different colour pens, where appropriate, is useful but do not overdo it. In fact, one black and red felt-tip pen would be sufficient (use the felt-tip pens which have a *fine point*).

Charts and diagrams

16. A descriptive heading or title must be given to each diagram (using the one in the question if indicated).
17. Do not squeeze a diagram into a corner – *spread it out*.
18. Do not clutter your diagram up with too much details – this defeats the object, which should be clarity.
20. Give a key to the symbols and the different lines you've used, and again – use a ruler.

End of examination procedure

20. Have a quick look at each answer, checking for grammatical errors and badly formed letters.
21. Ensure each answer sheet has your *number* on it and *do not* leave any lying on the table.

Conclusion

22. Good technique plays a *large* part in examination success; this is a *fact*. *Refuse* to be panicked, keep your head, and with reasonable preparation you *should* make it.
23. Remember – you do not have to score *100%* to pass.
24. A final point; once you're in the examination room, *stay there* and make use of every minute at your disposal.
25. Practice your technique when answering the questions set in the

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