

CERTIFIED PUBLIC ACCOUNTANT

ADVANCED LEVEL 1 EXAMINATIONS

A1.3: ADVANCED FINANCIAL REPORTING

WEDNESDAY: 2 DECEMBER 2015

INSTRUCTIONS:

- 1. Time Allowed: 3 hours 45 minutes (15 minutes reading and 3 hours 30 minutes writing).**
- 2. This examination has two sections; A & B.**
- 3. Section A has one Compulsory Question while section B has three optional questions to choose any two.**
- 4. In summary attempt three questions.**
- 5. Marks allocated to each question are shown at the end of the question.**
- 6. Show all your workings**

SECTION A

QUESTION ONE

- (a) Kunezerwa Group of Companies ('Kunezerwa Group') was incorporated in Rwanda ten years ago. Its subsidiaries and associates engage in a wide range of business activities including retail, financial services, pharmaceuticals, import and export. During the year ended 31 December 2014, Kunezerwa embarked on a regional expansion drive, aimed at taking advantage of business opportunities created by the recently established East African Community Common Market Protocol. At the start of that year, Kunezerwa resolved to acquire interests in a Kenyan logistics entity called Amani Logistics (K) Limited ('Amani'). Draft consolidated statement of financial position as at 31 December 2014 for Kunezerwa Group and Amani Logistics (K) Ltd are shown below:

	Kunezerwa Group	Amani Logistics Ltd
	Frw million	KShs, million
Non-current assets	720	42
Other assets	288	-
Investment in Amani Ltd	240	-
Current assets	720	96
TOTAL ASSETS	<u>1,968</u>	<u>138</u>
EQUITY AND LIABILITIES		
Share capital	480	60
Retained profit	420	12
Non Controlling Interest	252	-
Non- current Liabilities	360	42
Current Liabilities	456	24
TOTAL EQUITY AND LIABILITIES	<u>1,968</u>	<u>138</u>

Additional information:

- (i) On 1 January 2014, Kunezerwa acquired 80% interest in Amani. The income of Amani is denominated and settled in Kenyan Shillings (KShs). The revenues from the logistics business are routinely realized in KShs and prices are determined initially by local supply and demand. Amani pays 40% of its costs and expenses in United States dollars (USD) with the remainder being incurred locally and settled in KShs. Amani's management has a considerable degree of authority and autonomy in carrying out its operations and is not dependent upon Kunezerwa Group for finance.
- (ii) On the same day 1 January 2014, the fair value of non-controlling interest in Amani was KShs 168 million.
- (iii) An impairment test was conducted on 31 December 2014 and revealed that there was impairment loss of KShs 6 million on goodwill.
- (iv) The draft consolidated financial statement of Kunezerwa relates to other entities that were already acquired by the Group and does not include acquisition of Amani.
- (v) It is a policy of Kunezerwa Group to account for its investment in entities using full goodwill.
- (vi) The exchange rates at the different milestones during the operations of Kunezerwa Group are given as follows:

Date	1 KShs =Frw
1-Jan-14	7.46
1-Jan-13	7.56
1-Jun-14	7.72
31-Dec-14	7.56
31-Dec-13	7.82

REQUIRED:

(i) Discuss the ways in which Amani would benefit from harmonization of its accounting policies with those of Kunezerwa in light of the East Africa Common Market protocol (6 Marks)

(i) Prepare a revised consolidated statement of financial position of Kunezerwa Group as at 31 December 2014, (10 Marks)

(b) On 22 November, 2015 Kunezerwa purchased a minibus from a bonded car dealer: Amazon Motors (R) Ltd at Frw 4,500,000. The company paid Frw 130,000 as commission to a broker for getting a seller of a minibus; while Amazon Motors (R) Ltd paid commission of Frw 260,000 to access a buyer for the minibus.

Kunezerwa also deals in agro forestry having planted a Jack Pine plantation in Kageyo. According to the company records as at 31 August 2015, the plantation consisted of 2,000 Jack Pine trees that were planted 5 years ago. Jack Pine takes 25 years to mature; the wood from Jack Pine is highly recommended for building material for houses and furniture. Kunezerwa's required rate of return on capital is 6% p.a. Only mature Jack Pine trees have established fair values in an active market. The fair value for a mature Jack Pine tree of the same grade as in the plantation was Frw 342,000 as at 31 August 2014; and Frw 330,000 as at 31 August 2015.

REQUIRED:

(i) Determine the entry and exit prices of the minibus in relation to the transactions between Kunezerwa and Amazon Motors (R) Ltd. (2 Marks)

(ii) Compute the fair value of the 2,000 Jack Pine trees at the point of maturity (3 Marks)

(iii) Determine the value of the Jack Pine Trees that would be recognised in the statement of financial position as at 31 August 2014 and 31 August 2015 (8 Marks)

(c) One of the subsidiaries in the Kunezerwa Group above is Gisenyi Cooperative Bank ('Gisenyi Coop'). The Bank was set up to help investors in the Agricultural sector obtain loans at reasonable rates to spearhead economic growth. There are five (5) major Cooperative Unions that have obtained loans from the Bank (loans 1-5), with the rest of the loan portfolio made up the Bank's other customers (Customer Loans).

Gisenyi Coop is at the end of its first year of operations and is preparing its financial statements. No impairment losses have yet been recognized on any of Gisenyi Coop's loans.

Loans 1-5, as well as all of the customer loans, share similar risk characteristics since they are obtained in the same geographical area. All of the loans were originated at a market rate of interest. For IAS 39-*Financial Instruments-Recognition and Measurement*, the Bank identifies three loans as 'individually significant' and assesses whether there is objective evidence of impairment individually for these loans. The Bank also chose to make this assessment on an individual basis for the two other loans even though

they are not individually significant.

Gisenyi Coop does not have historical information of its own, as this is its first year of operations. However, certain peer data and economic reports regarding similar loans in the same area indicate “incurred but not yet identified losses” for a similar portfolio = 0.005% .

Additional information about certain loans has been obtained as below:

- Loan 1 (fixed rate) is 90 days past-due.
- Loan 2 (fixed rate) is not past-due and there is no other objective evidence of impairment.
- Loan 3 (fixed rate) is not past-due, but the revenues and operating profits of the borrower have decreased because of an economic recession. Furthermore, expected increases in regulations have the potential to further negatively affect revenue and operating profit.
- These negative effects on the borrower’s operations could be significant and ongoing. As a result of these recent events and expected adverse economic conditions, the borrowers’ free cash flow is expected to be reduced to the point that the coverage of scheduled loan payments could become tight.
- Loan 4 (fixed rate) is 60 days past-due, and the borrowers have recently lost their farms containing crops and animals due to El Nino weather conditions.
- Loan 5 (variable rate) is not past-due and there is no other objective evidence of impairment.

Summarized below:

Loan N ^o	Amount Frw. million	Individually Significant?	Objective Evidence of Impairment?	PV of Est. Net Cash Flows Frw. million
1	125	Yes	Yes	90
2	160	Yes	No	N/A
3	130	Yes	Yes	120
4	45	No	Yes	32
5	40	No	No	N/A
Customer Loans	2,300	N/A	N/A	N/A

Gisenyi Coop accounts for its financial instruments under IAS 39.

REQUIRED:

- (i) Discuss the specific action Gisenyi Coop should take for each of customer loans 1-5. **(6 Marks)**
- (ii) Compute the amount of impairment loss that should be recognized in Gisenyi Coop financial statements at the end of the financial year. **(8 Marks)**
- (d) Emmanuel Ndungutse CPA is the Financial Controller at Kunezerwa Group. He is scheduled to make a presentation at an orientation workshop for newly recruited financial analysts for the Group. He requests you to prepare part of the presentation for him, highlighting the inherent limitations of ratio analysis.

REQUIRED:

Prepare lecture notes for Emmanuel Ndungutse, discussing the limitations of ratio analysis generally.

(7 Marks)

(Total 50 Marks)

SECTION B

Attempt two questions from this section

QUESTION TWO

(a) Nsengiyumva Ltd is a company based in Kigali. The General Manager, Mr. Gahigi expressed some frustration to top management about the poor work ethics and attitude of the employees under his supervision. In 2010 he proposed a share-based scheme to management which he felt would motivate the employees to perform better and it was granted. Under this scheme, on 1 October 2011, each employee was granted 1500 cash shares appreciation rights (SARS) to each of its 500 employees, on condition that employees continue to work for the entity at least until 30 September, 2013.

During the year 2011, 40 employees left. Management estimated that further 50 would leave during 2012 and 2013.

During the year 2012, 45 employees left. Management estimated that further 25 would leave during 2013.

During 2013 20 employees left.

On 30 September 2013 200 employees exercised their SARS. Another 150 employees exercised their SARS on 30 September 2014 and the remaining 45 employees exercised their SARS on 30 September 2015.

The fair value of the SARS for each year in which a liability exists are shown below, together with the intrinsic value at the date of exercise.

	Fair value (Frw)	Intrinsic Value (Frw)
2011	720	
2012	775	
2013	910	750
2014	1,070	1000
2015		1,250

REQUIRED:

Compute and show how the transactions would be disclosed in the books of Nsengiyumva Ltd for the five years. **(8 Marks)**

(b) Nsengiyumva Ltd is in the intermediate stage of a contract for the construction of a new health center in Byumba city suburb. The details of the original contract were as follows:

Estimated duration of the contract	3 years
Date of commencement	30 September, 2013
Total contract price	Frw 160 million
Estimated total cost	Frw 112 million
Work certified 31 March 2014	Frw 48 million
Work certified 31 March 2015	Frw 120 million (including Frw 48 million of 2012)
Total cost incurred:	
31 March 2014	Frw 36 million
31 March 2015	Frw 113.6 million
Progress billing 31 March 2014	Frw 100 million

On 31 March 2014 a contract variation involving an additional fee of Frw 20 million and related estimated cost of Frw 8 million were agreed to by Nsengiyumva Ltd. The cost incurred for the year

ending 31 March 2015 included Frw 10 million used to replace part of the building constructed poorly by the engineers. These costs were not part of the original agreement. Nsengiyumva Ltd through the company lawyers expects to recover all this money within the year. Nsengiyumva Ltd computes its profits on construction contracts using the percentage of completion method.

REQUIRED:

- (i) Prepare an extract of:
 - a) Statement of profit or loss for the year ended 31 March 2015 **(4 Marks)**
 - b) Statement of financial position at 31 March 2015 **(3 Marks)**
- (ii) Provide a disclosure on a contingent asset or liability if any for the year ended 31 March 2015 **(3 Marks)**
- (c) Nsengiyumva Ltd purchased land on the outskirts of Butare. Its book value is Frw 29,700,000. Two years ago a slump in land values led the company to reduce the carrying value from Frw 25,740,000. The loss in value was treated in the profit or loss account. In the current financial period value of land has greatly increased due to the increase and fast development of infrastructure around Butare town. On consultation with an expert in land issues the Directors of Nsengiyumva established that their land in Butare is worth Frw 39,600,000.

REQUIRED:

- (i) Distinguish between measurement subsequent to initial recognition under cost and revaluation models **(3 Marks)**
- (ii) Account for the revaluation in the current year **(4 Marks)**

(Total 25 Marks)

QUESTION THREE

(a) Amarwa Brewery Limited is a public limited company and is the largest brewer and soft beverage company in the Republic of Rwanda. The company operates a defined benefit pension scheme for its employees. At June 2015, the net pension liability recognised in the statement of financial position was Frw. 18 billion, excluding an unrecognised actuarial gain of Frw. 15 billion which Amarwa Brewery Limited wishes to spread over the remaining working lives of the employees. The scheme trust deed was revised on 1 June 2015. This resulted in the benefits being enhanced for some members of the plan and because benefits do not vest for these members for five years, Amarwa Brewery Limited wishes to spread the increased cost over that period. However, part of the scheme was to be closed, without any redundancy of employees.

John Mworozi was hired by Amarwa Brewery Limited on January 1, 2014 and is eligible to participate in the company's defined-benefit pension plan. Under the plan, he is promised an annual payment of 2% of his final annual salary for each year of service. The pension benefit will be paid at the end of each year, beginning one year after retirement. Mworozi's starting annual salary is Frw. 5m. The actuarial assumptions for the Scheme are as follows:

- The discount rate is 8%,
- Mworozi's salary will increase by 4% per year (rate of compensation growth),
- Mworozi will work for 25 years,
- He will live for 15 years after retirement and receive 15 annual pension benefit payments.

REQUIRED:

- (i) Advise Amarwa Brewery Limited on how to account for the above scheme under IAS 19 Employee Benefits including the presentation and measurement of the pension expense. **(8 Marks)**
- (ii) Compute Mworozzi's present value of Defined Benefit Obligation (PVDBO) at end of 2014 and 2015 **(9 Marks)**
- (b) Jean de Dieu and Sons Ltd have been registering good financial performance for the last four years. Its financial year ends on 30 September. During the year ended 30 September 2013 the company had a basic EPS of Frw 210 based on earnings of Frw 210,000,000. The company has 1,000,000 ordinary shares of Frw 1,000 each. It had in issue Frw 80,000,000 15% convertible debentures to be converted into ordinary shares on 30 September 2015 at the rate of 8 ordinary shares for every Frw 1000 of debentures. The ruling tax rate is 30%. In the financial year to 30 September 2015, gross profit of Frw 200,000,000 and expenses of Frw 100,000,000 were recorded including interest payable of Frw 12,000,000.

REQUIRED:

Compute the company's diluted earnings per share for the year ended 30 September 2015 basing on the above data. Comment on how dilution may affect the investors. **(8 Marks)**

(Total 25 Marks)

QUESTION FOUR

TRM (R) Ltd is engaged in petroleum trade in Rwanda. TRM (R) Ltd's financial period ends on 30 November. On 30 November, 2014, the company had petrol inventory amounting to 400,000 litres valued at Frw 295,200,000, when the market price of petrol was Frw 745 per litre. In order to hedge price fluctuations on the market, TRM (R) Ltd signed a future contract to deliver 400,000 litres of petrol on 30 April 2015, at a futures price of Frw 740 per litre. The actual futures price for delivery on 30 April 2015 was Frw 760 per litre.

Mr. Donati Ndizihiwe CEO of TRM (R) Ltd is preparing for a Corporate Governance meeting with the Board of Directors of the company. In preparation for the meeting, he has come across the following statements from an article; *"Making Financial Reporting Better: Strengthening the Financial Reporting Supply Chain"* written by Faye Choudhury, CEO, International Federation of Accountant in 2014:

"Timely and meaningful information underpins the effective functioning of any organization. Organizational leadership use financial and non-financial information to manage and direct their operations, while external stakeholders—investors, suppliers, creditors, banks, and regulators use it to make investment decisions, to undertake transactions with organizations with confidence, and to exercise regulatory oversight.

Financial statements capture much of the information that organizations prepare, publish, and use. And while it's becoming more important to report other, non-financial information that stakeholders find relevant to their decision making, financial statements prepared in accordance with internationally accepted financial reporting standards are a crucial instrument for the effective functioning of markets.

Given the critical role that financial statements play, it is imperative that efforts are made to examine ways to improve their quality, and to understand their purpose and limitations in providing a comprehensive view of an entity's financial position.

Everyone has an interest in achieving high quality financial reporting. We can't wait until the next financial reporting scandal arises to debate, discuss, examine, and assess this important issue. We need to act now, with coordinated efforts, to achieve this goal"

REQUIRED:

(a) Advise TRM (R) on the consequences of the transactions above

(ii) Without hedging

(4 Marks)

(ii) With hedging

(4 Marks)

(b) Prepare a report for Mr. Donati Ndizihiwe to be presented to the Board of Directors at the corporate governance workshop, describing accounting methods (choices and estimates) that could be used to manage earnings, Cash flows and balance sheet items.

(17 Marks)

(Total 25 Marks)

End of question pa