iCPAR

INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS OF RWANDA

Driving Sustainable Performance

CERTIFIED PUBLIC ACCOUNTANT

ADVANCED LEVEL 1 EXAMINATIONS

A1.3: ADVANCED FINANCIAL REPORTING

WEDNESDAY: 29 NOVEMBER 2017

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 (3) questions to choose any two (2).
4. In summary attempt three (3) questions.
5. Marks allocated to each question are shown at the end of the question.
6. Show all your workings.
7. All iCPAR Examination rules and regulations apply.

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SECTION (A)

This is a compulsory question

QUESTION ONE

(a) The following draft statements of financial position relate to Makuza Ltd, Ngoma Ltd and Kengo Ltd as at 31 October, 2017.

	Makula Ltd	**Ngoma Ltd**	**Kengo Ltd**
	Frw "million"	**Frw "million"**	**Frw "million"**
Assets:			
Non-current assets:			
Property, plant and equipment	84,960	96,800	101,200
Investment in subsidiaries:			
Ngoma Ltd	91,200	-	-
Kengo Ltd	74,240	-	-
Investment in Yuhi Ltd	5,440	-	-
Other financial assets	15,200	-	-
	271,040	**96,800**	**101,200**
Current assets	70,800	62,560	17,920
Total assets	**341,840**	**159,360**	**119,120**
Equity and liabilities:			
Equity share capital Frw 1 per share	132,000	57,600	56,000
Retained earnings	94,400	70,400	29,120
Other components of equity	10,240	6,240	4,720
Total equity	**236,640**	**134,240**	**89,840**
Non-current liabilities	91,440	15,120	13,760
Current liabilities	13,760	10,000	15,520
Total liabilities	**105,200**	**25,120**	**29,280**
Total equity and liabilities	**341,840**	**159,360**	**119,120**

Additional information:

1. Makuza Ltd acquired 70% of the equity interest of Ngoma Ltd paying cash Frw 91,200 million on 1 November, 2016 when the retained earnings and other components of equity of Ngoma Ltd were Frw 62,400 million and Frw 5,120 million respectively. The fair value of the identifiable net assets of Ngoma Ltd at 1 November, 2016 was Frw 128,000 million. It is group policy to value non-controlling interests at fair value and, at the date of acquisition, this was Frw

38,800 million. The excess in fair value of the identifiable net assets is due to non-depreciable land.

2. On 1 November, 2015 Makuza Ltd acquired 40% of the equity interest of Kengo Ltd for a cash consideration Frw 33,600 million. On this date the carrying amount and fair value of the identifiable net assets of Kengo Ltd were Frw 82,560 million. Makuza Ltd treated Kengo Ltd as an associate and equity accounted for it up to 31 October 2016.

3. On 1 November 2016, Makuza Ltd took control of Kengo Ltd, acquiring a further 45% interest for cash Frw 40,000 million and added this amount to the carrying amount of its investment in Kengo Ltd. On 1 November, 2016 the retained earnings and other components of equity of Kengo Ltd were Frw 23,440 million and Frw 4,720 million respectively and the fair value of the identifiable net assets was Frw 84,960 million. The difference between the carrying amounts and the fair values was in relation to plant with a remaining useful life of five years. The share prices of Makuza Ltd and Kengo Ltd were Frw 400 and Frw 128 respectively on 1 November, 2016. The fair value of the original 40% holding and the fair value of the non-controlling interest should both be estimated using the market value of the shares.

4. Makuza Ltd has owned a 25% equity interest in Yuhi Ltd for a number of years. Yuhi Ltd had profits for the year ended 31 October, 2017 Frw 1,600 million, which can be assumed to have accrued evenly. Yuhi Ltd does not have any other comprehensive income. On 30 April, 2017 Makuza Ltd sold a 10% equity interest in Yuhi Ltd for cash Frw 3,360 million. Makuza Ltd was unsure of how to treat the disposal and so has deducted the proceeds from the carrying amount of the investment at 1 November, 2016 which was Frw 8,800 million (calculated using the equity accounting method). The fair value of the remaining 15% shareholding was estimated to be Frw 5,200 million at 30 April, 2017 and Frw 5,360 million at 31 October, 2017. Makuza Ltd no longer exercises significant influence and has designated the remaining shareholding as fair value through other comprehensive income.

5. Goodwill has been reviewed for impairment and no impairment was deemed

necessary.

6. During the year, Ngoma Ltd sold goods to Makuza Ltd Frw 320 million at a mark-up of 25%. At 31 October, 2017, Makuza Ltd had a quarter of these goods in inventory. As a result of these sales Makuza Ltd's accounts payable include an amount of Frw 120 million owing to Ngoma Ltd (this was agreed with the balance in Ngoma Ltd's books).
7. Makuza Ltd operates a defined benefit pension scheme. On 31 October, 2017 the company announced that it was to close down a business division and agreed to pay each of its 150 staff a cash payment Frw 4 million to compensate them for loss of pension arising from wage inflation. It is estimated that the closure will reduce the present value of the pension obligation by Frw 464 million. Makuza Ltd is unsure of how to deal with the settlement and curtailment and has not yet recorded anything within its financial statements.
8. Makuza Ltd operates as an oil exploration company in several countries. It often causes environmental damage, but cleans up only when required to do so by law. In Rwanda where the company has been contaminating the environment for several years, a law has been drafted requiring companies causing contamination to clean up. This law, which will apply retrospectively to past damage, has passed through all stages of parliament before Makuza Ltd's year end of 31 October, 2017 but has not been signed into law yet as the President was out of the country. The President normally signs without question laws that are passed by parliament. It has been estimated that the costs of cleaning up the damage already caused will amount to Frw 600 million, and the damage expected to be caused in 2017 will cost Frw 140 million to repair if the law is passed.

REQUIRED:

Prepare a consolidated statement of financial position of the Makuza Ltd Group as at 31 October, 2017 in accordance with relevant international financial reporting standards.

(40 Marks)

(b) On 10 November, 2017 a heavy storm at one of Makuza Ltd's warehouses damaged an assortment of inventory. This inventory had been manufactured prior to 31 October, 2017 at a total cost Frw 64 million. The net realisable value of the inventory prior to the damage was estimated at Frw 76.8 million. Because of the damage Makuza Ltd was

required to spend a further Frw 12 million on repairing and re-packaging the inventory. The realisable value after repairs and re-packaging is estimated at Frw 72 million. Any adjustment in respect of this event would be regarded by Makuza Ltd as material.

REQUIRED:

Demonstrate the disclosure requirements for the above events in the financial statements of Mukuza Ltd for the year ended 31 October, 2017 in accordance with international financial reporting standards. **(4 Marks)**

(c) Makuza Ltd has a two-tier board structure consisting of a management and a supervisory board. Makuza Ltd remunerates its board members through an annual base salary, variable annual compensation (bonus) and share options. In the group financial statements, Makuza Ltd disclosed the total remuneration paid to directors and non-executive directors and a total for each of these boards. No further breakdown of the remuneration was provided. The management board comprises both the executive and non-executive directors.

The remuneration of the non-executive directors, however, was not included in the key management disclosures. Some members of the supervisory and management boards are of a particular nationality. The management of Makuza Ltd was of the opinion that it was not acceptable to provide information about remuneration that could be traced back to individuals. Consequently, they explained that it had provided the related party information in the annual accounts in an ambiguous way to prevent users of the financial statements from tracing remuneration information back to specific individuals.

REQUIRED:

Discuss the disclosure requirements of the above transactions in the financial statements of Makuza Ltd for the year ended 31 October, 2017 in accordance with relevant international financial reporting standards. **(6 Marks)**

(Total 50 Marks)

SECTION (B)

Attempt two questions from this section

QUESTION TWO

The management of Hitimana Ltd attended the just concluded seminar on the effects of price level changes organised by the Institute of Certified Public Accountants of Rwanda (iCPAR). The facilitator indicated that historical financial statements consist of transactions at various dates and contain measurements that represent purchasing powers at various points in time. The facilitator explained that current purchasing power accounting (CPPA) transforms the various historical measures into current purchasing power which represents purchasing power at the same point in time. Thus, CPPA makes all the accounting numbers comparable in terms of general purchasing power by removing the mixed purchasing power element from historical financial statements. The management of Hitimana Ltd have prepared the following statement of financial position of the company for the year ended 31 October, 2016 together with comparative information for the year ended 31 October, 2015 based on the advice by the facilitator.

	2016		2015
Assets:	**Frw "000"**		**Frw "000"**
Monetary assets	24,000		12,000
Inventories (2015: 2,500 units; 2016: 2,000 units)	8,000		12,000
Land	16,000		16,000
Plant & equipment	20,000		20,000
	68,000	-	**60,000**
Liabilities:			
Share capital	40,000		40,000
Retained earnings	4,000		-
Accumulated depreciation	4,000		-
10% loans	20,000		20,000
	68,000	-	**60,000**

The statement of profit or loss and other comprehensive income for the year ended 31 October, 2016 is given as follows before the price level adjustments.

	Frw "000"		Frw "000"
Sales (5000 units @ Frw 16,000)			80,000
Cost of sales:			
Inventory at start (2,500 units @ Frw 4,800)	12,000		
Purchases 4,800 units @ Frw 4,000)	19,200		
	31,200		

Inventory at close (2,000 units @ Frw 4,000)	(8,000)		(23,200)
Gross margin			56,800
Distribution costs			(21,600)
Administrative costs			(25,200)
Depreciation			(4,000)
Profit before interest and tax			6,000
Interest expense			(2,000)
Profit before tax			4,000

Additional information:

1. On 31 October, 2015 the price level index was 100. The price level index on 31 October, 2016 was 180 and the average price index for 2016 had been 120.
2. You are advised that the average price level index to be used for inventory purchases is 150.
3. All revenues and costs were incurred evenly throughout the year, with the exception of the cost of goods sold (to be assumed as stated) and the depreciation expense (to use the base price index).
4. FIFO has been assumed and any damaged inventory is included in cost of sales.
5. Depreciation for plant and equipment was accumulated by the straight-line method on a five year expected useful life.

REQUIRED:

(a) You are the newly recruited accountant of Hitimana Ltd and the management has requested you to use the information above to:

(i) Ascertain the purchasing power gains or losses on monetary assets as at 31 October, 2016. **(4 Marks)**

(ii) Adjust the statement of profit or loss and other comprehensive income for the year ended 31, October 2017 by incorporating the effects of price level changes. **(4 Marks)**

(iii) Reconcile the retained earnings based on the effects of the price level changes starting with the balance as at 31 October, 2015 to the balance as at 31 October, 2016 and adjust the statements of financial position as at 31 October, 2015 by the price levels as at 31 October, 2016. **(4 Marks)**

(iv) Adjust the statement of financial position as at 31 October 2016 by the price levels as at 31 October, 2016. **(4 Marks)**

(b) The management of Hitimana Ltd reviewed the capital structure of the company and they believe there is need to improve the equity base of the company. The company financed the operations for the year ended 31 October, 2016 by short-term borrowings and management envisage that sooner or later it will run into working capital problems. To avoid this, the management of the company plan to make immediate changes in the capital structure without liquidating it. The creditors for the 10% loans are willing to convert their loans to equity share capital and sacrifice the interest benefit.

REQUIRED:
Evaluate the judgment and ethical sensitivity in the decision to undertake an internal reconstruction and the impact of the internal reconstruction on the stakeholders. **(5 Marks)**

(c) During the management meeting of Hitimana Ltd to which you were invited, one of the directors hinted on the need to address consumer concerns regarding social and environmental issues. He noted that consumers may be attracted to buying goods and services of those organizations that have a positive record in the areas of social and environmental responsibility and may avoid buying goods and services of those organizations with negative records.

REQUIRED:
Write a report to the board enumerating the social and environmental issues that management need to be aware of indicating the consequences, if any. **(4 Marks)**

(Total 25 Marks)

QUESTION THREE

(a) Akimana Investments Ltd (AIL) is a registered investor incorporated in Rwanda. AIL owns a vast piece of land in Gisagara district. The management of AIL resolved to open a manufacturing business and put up a manufacturing plant on the piece of land. The following transactions relate to the year ended 31 October, 2017.

1. Acquired a manufacturing plant for USD 60,000 on 1 December, 2016 when the exchange rate was Frw 860 to USD 1. The expected useful life of the plant is initially estimated at 10 years.
2. Completed the construction of a warehouse to be used as an industrial building at a cost of USD 100,000 and installed the manufacturing plant in the warehouse at a

cost of USD 5,000 on 31 July, 2017 when the exchange rate was Frw 850 to USD 1. It is the policy of AIL to expense installation costs that are less that 10% of the cost of plant and equipment. The industrial building was also brought to book on the same day and estimated to have a useful life of 10 years.

3. Secured a loan from the National Bank of Rwanda (NBR) USD 170,000 at an interest rate of 18% per annum on 1 November, 2016 when the exchange rate was Frw 855 to USD 1. The loan is repayable over five years by annual installments of USD 52,360 payable in arrears. The money from this loan was used to acquire the manufacturing plant and construction of the industrial building in 1 and 2 above. The directors of AIL resolved to capitalise the borrowing costs at each year end as appropriate.
4. On 31 October, 2017 the directors engaged a firm of registered valuers and engineers to inspect the plant and warehouse. The engineers' report indicated that the plant had a useful life of not more than 6 years from 1 November, 2017 and the warehouse was valued at Frw 120 million
5. AIL has so far issued employment contracts to a few members of staff and was compelled to register with the Rwanda Social Security Board (RSSB). You established that the annual gross salaries payable to the staff totaled Frw 153.6 million and the contribution rates to RSSB are 5% payable by the employer and 3% payable by the employee. Because of the omission, the directors have asked you to make a provision for pension benefits in the books for the year ended 31 October, 2017.
6. The exchange rate on 31 October, 2017 was Frw 845 to 1 USD and the corporation tax rate for these transactions is 30%. The management of AIL have asked you to recognise the deferred tax adjustments as far as the information permits and has also informed you that the loan installment due on 31 October, 2017 was paid.
7. AIL registration costs totaled Frw 62,500.

REQUIRED:

Advise AIL on the financial reporting requirements for each of the above scenarios with the help of suitable computations and relevant financial reporting standards. **(14 Marks)**

(b) The East African Community (EAC) Protocol includes a requirement for member states to adopt accrual-basis International Public Sector Accounting Standards (IPSAS) for central and local governments, non-trading and regulatory bodies, and International Financial Reporting Standards (IFRS) for state-owned enterprises. As a member state of the EAC, the Rwandan Government set an objective to achieve full compliance with the cash-basis IPSAS by 30 June, 2016 and aims to achieve full compliance with the accrual-basis IPSAS by June 30, 2020. Article 3 of the Law on the Institute of Certified Public Accountants (iCPAR) No. 11 of 2008 establishes iCPAR as the public sector accounting standard-setter and requires that, within public institutions, the accounting standards be consistent with the IPSAS. Under the law, iCPAR is also responsible for advising the Rwandan Government on matters related to public financial management and accountancy. You are a member of iCPAR and the management of iCPAR has requested you to prepare a document to be used to advise government on the technical pronouncements currently in issue in the public sector, implications to the Rwanda government.

REQUIRED:

Prepare a presentation that will be used to advise government on the technical pronouncements currently in issue in the public sector and implications to the Rwanda government. **(6 Marks)**

(c) In January, 2016 the International Accounting Standards Board (IASB) issued another important and long-discussed standard: International Financial Reporting Standard (IFRS) 16: Leases that will replace International Accounting Standard (IAS) 17: Leases for reporting periods beginning on or after 1 January, 2019. It can be applied before that date by entities that also apply IFRS 15: Revenue from Contracts with Customers. The management of iCPAR has also requested you to prepare a discussion paper for the members of iCPAR justifying the appropriateness of replacement of IAS 17 Leases with IFRS 16 Leases and highlighting the differences between IAS 17 and IFRS 16.

REQUIRED:

Critically appraise the current standards on leases and demonstrate the expected improvements by IFRS 16 to the financial reporting of leases. **(5 Marks)**

(Total 25 Marks)

QUESTION FOUR

(a) The principal aim for developing an accounting standard for small and medium-sized entities (SMEs) is to provide a framework that generates relevant, reliable, and useful information which should provide a high quality and understandable set of financial statements suitable for SMEs. There is no universally agreed definition of an SME and it is difficult for a single definition to capture all the dimensions of a small or medium-sized businesses. The main argument for separate SME accounting standards are the undue cost burden of reporting, which is proportionately heavier for smaller firms.

REQUIRED:

(i) Discuss the main differences and modifications to International Financial Reporting Standards (IFRS) which the International Accounting Standards Board (IASB) made to reduce the burden of reporting for SMEs, giving specific examples where possible, and include in your discussion how the Board has dealt with the problem of defining an SME. **(6 Marks)**

(ii) In the context of IFRS for SMEs discuss the disclosure requirements for IFRS 2 cash settled share-based transactions. **(4 Marks)**

(b) Kabera Dairy Farm Ltd (KDFL) specialises in the production of milk and milk products for supply to various customers. It is responsible for producing 40% of the country's milk consumption. The company owns 5 farms in the different provinces of the country and has a stock of 70,000 cows and 35,000 heifers which are being raised to produce milk. The farms produce 2·5 million kilograms of powdered milk per annum and normally hold an inventory of 50,000 kilograms of powdered milk.

Extracts from their draft accounts to 31 May, 2016:

70,000	3 year old cows (all purchased on or before 1 June, 2016).
25,000	heifers (average age 1½ years old; purchased 1 December, 2016).
10,000	heifers (average age 2 years; purchased 1 June, 2016).

There were no animals born or sold in the year. The per unit values less estimated costs to sell were as follows:

	Frw
2 year old animals 1 June, 2016	500,000
1 year old animals 1 June, 2016 & 1 December, 2016	400,000

3 year old animals 31 May, 2017	600,000
1½ year old animals 31 May, 2017	460,000
2 year old animals 31 May, 2017	550,000
1 year old animals 31 May, 2017	420,000

The company has had a difficult year in financial and operating terms. The cows in the northern and eastern provinces had contracted a disease at the beginning of the financial year which had been passed on in the food chain to a small number of consumers. The publicity surrounding this event had caused a drop in the consumption of milk and as a result the dairy was holding 500,000 kilograms of milk in storage. On 1 April, 2017 the government stated that it was prepared to compensate farmers for the drop in price and consumption of milk. An official government letter was received on 6 June, 2017 stating that Frw 120 million would be paid to KDFL on 1 August, 2017.

REQUIRED:
Advise the directors of KDFL on how the above transactions should be dealt with in its financial statements with reference to relevant international financial reporting standards.

(8 Marks)

(c) KDFL's management have identified the five farms as five business segments which are currently reported in its financial statements by region without the relevant segmental disclosures. The results of the segments for the year ended 31 May, 2017 are as follows.

Region	Internal revenue	External revenue	Profit /(loss)	Assets	Liabilities
	Frw "million"	Frw "million"	Frw "million"	Frw "million"	Frw "million"
Northern	300	150	150	50	30
Eastern	500	100	(50)	110	100
Western	-	650	30	80	60
Southern	500	550	120	140	120
Central	1,600	2,550	(850)	520	500

There were no significant inter region balances in the segment assets and liabilities. The farms are located in the countryside in the various regions, and the company sets individual performance indicators for each farm based on its region.

REQUIRED:
Prepare the necessary adjustments using the information provided and justify your presentation in the financial statements of KDFL based on the relevant financial reporting standards. **(7 Marks)**

(Total 25 Marks)

End of question paper