CERTIFIED PUBLIC ACCOUNTANT

ADVANCED LEVEL 1 EXAMINATIONS

A1.3: ADVANCED FINANCIAL REPORTING

DATE: TUESDAY 27, FEBRUARY 2024

MARKING GUIDE AND MODEL ANSWERS

SECTION A

QUESTION ONE

Marking guide: Alpha Group

	Marks
Part (a) Explanation (with suitable calculations) for accounting treatment for:	
(i) The joint operation under Alpha's joint arrangement	
Award up to 1 mark for each correct accounting principle (from a relevant IFRS) explained; correct application to the scenario; and another 0.5 marks for each correct figure used in the relevant calculations done (maximum of 3 marks for calculations)	8
(ii) The leased machine by Alpha	
Award up to 1 mark for each correct accounting principle (from a relevant IFRS) explained; correct application to the scenario; and another 0.5 marks for each correct figure used in the relevant calculations done (maximum of 3 marks for calculations)	8
Total marks for Q1 (a)	**16**
Part (b): Preparation of the Alpha's consolidated statement of financial position as at 30 June	
Award 0.5 marks for each correct figure that represents the **total balance** of each relevant line item presented on the face of the consolidated statement of financial position (excluding sub/other totals) (to a maximum of 15 marks)	15
Award as below for workings (computed as separate workings or as part of the details directly presented on the face of the consolidated statement of profit or loss and other comprehensive income):	
Group Structure: Award: 1 mark for correct calculation of RIL's "indirect shareholding in BQP, 0.5 marks for a correct total (direct and indirect) shareholding in BQP and 0.5 marks for a correct calculation of the NCIs in BQP (from RIL Group perceptive). The student must show workings	
Award 0.5 marks for a correct calculation or reference to the "Group's total shareholding in the sub-subsidiary Claver"	0.5
Award 0.5 marks for a correct calculation or reference to the "Group's view for the total NCIs in the sub-subsidiary Claver"	0.5
Award 0.5 marks for a correct conclusion of "Group view of the acquisition date for the sub-subsidiary"	0.5
Fair value adjustment - Plant in Bertin: Award 0.5 marks for a correct figure / calculation used	1
Fair value adjustment - Inventory in Bertin: Award 0.5 marks for a correct figure / calculation used	1
Goodwill in Bertin: Award 0.5 marks for each correct figure used in the calculation of goodwill on the acquisition of Bertin - including the impairment loss	4.5

Goodwill in Claver: Award 0.5 marks for each correct figure used in the calculation of goodwill on the acquisition of Claver - including the impairment loss	2.5
NCIs (in Bertin and Claver): Award 0.5 marks for each correct figure used in the calculation of goodwill on the NCIs	2.5
Consolidated retained earnings: Award 0.5 marks for each correct figure used in the calculation of goodwill on the consolidated retained earnings	6
Total marks for Q1 (b)	**34**
Total Marks for Question One	**50**

Model Answer: Alpha Group

Part (a) (i): Alpha's Joint Operation

Alpha is a joint operator in a joint arrangement with two other joint operators over the operation of a factory which has been constructed by the three joint operators. In accordance with IFRS 11 *Joint arrangements*, a joint arrangement is one in which two or more parties are bound by a contractual arrangement which gives them joint control over the arrangement.

A joint arrangement can either be a joint venture or a joint operation depending on the rights and obligations of the parties to the arrangement. The accounting treatment for the arrangement will depend on the classification of the joint arrangement and the classification needs to be correctly done as accounting for a joint venture is significantly different from that applied to a joint operation.

In accordance with IFRS 11, a joint operation is a joint arrangement that is not structured through a separate entity. In Alpha's case, no separate entity has been set up for the joint arrangement and there this qualifies as a "joint operation". Alpha has joint rights to the assets, liabilities, revenue and costs of the joint arrangement.

In accordance with IFRS 11, a joint operator applies its proportional shareholding in the joint operation to account for its rights to the assets, its obligations to the liabilities, its proportionate share of revenue and costs of the joint arrangement in its financial statements (individual and consolidated financial statements).

Therefore, Alpha, in its capacity as a joint operator must recognize on a line-by-line basis its own assets, liabilities, revenue and expenses of the joint arrangement in accordance with IFRS 11. Alpha shall apply this accounting treatment to both the separate and consolidated financial statements. This will include:

- The factory building (to be presented in the "property, plant and equipment" on 30th June 2023) at (FRW 15,000 million x 40%) FRW 6,000 million
- The principal amount for the loan note (to be presented in the "long-term liabilities" on 30th June 2023) at (FRW 15,000 million x 40%) FRW 6,000 million

In accordance with IAS 23 *Borrowing costs*, a borrowing cost that is directly attributable to the acquisition, construction or production of a qualifying asset shall form part of the cost of that asset. IAS 23 defines a qualifying asset as an asset that takes a substantial period of time to get ready for its intended use or sale.

In this case, Alpha should recognize the finance cost of (20% x FRW 15,000 million x 40%) FRW 1,200 million as a capitalized cost as part of its share of the construction cost for the factory building and also as an addition to the long-term borrowings.

The total carrying amount in regard to the joint operation in both the separate and consolidated financial statements for Alpha on 30th June 2023 shall be:

- The factory building (to be presented in the "property, plant and equipment" on 30th June 2023) at (6,000 + 1,200) FRW 7,200 million
- The principal amount for the loan note (to be presented in the "long-term liabilities" on 30th June 2023) at (6,000 + 1,200) FRW 7,200 million

Part (a) (ii): Finance lease accounting for Alpha

IFRS 16 accounting treatment for a finance lease by the lessor

In accordance with IFRS 16 *Leases*, a lessor in a finance lease shall on the commencement date (i.e., the date the lessor makes the underlying asset available for use by the lessee):

- Derecognize the underlying asset from the financial assets at the lower of the fair value of the asset on that date and the present value of the lease payments receivable by the lessee. Consequently, recognize a gain or loss on the derecognition in the profit or loss; and
- Recognizes a "finance lease receivable" at an amount equal to the "net investment in the lease"

Under IFRS 16, the "net investment in the lease" is computed as the sum of:

- Present value of the lease payments receivable by the lessor; plus
- Present value of any unguaranteed residual value accruing to the lessor

The guaranteed residual value by the lessee is explicitly stated in the lease contract and these is therefore included in the "present value of the lease payments receivable by the lessor"

However, the unguaranteed residual value arises where a lessor expects to be able to sell the asset at the end of the lease term for more than any minimum amount guaranteed by the lessee in the lease contract. Therefore, the unguaranteed residual value is separately added to the "net investment in the lease" as this amount will accrue to the lessor as the owner of the underlying asset.

Subsequently, the lessor shall account for the finance income over the lease period based on a pattern reflecting a constant periodic rate of return on the lessor's net investment in the lease. The finance income is credited to the profit or loss and debited (increases) the lease receivable in the statement of financial position.

Application of IFRS 16 to the leased asset by Alpha (as a lessor in a finance lease)

In the case given, Alpha Ltd as the manufacturer of the leased machine is taken as a lessor in such an arrangement that constitutes a finance lease and shall apply IFRS 16 *Leases* to account for the transaction.

Derecognition of the asset

On the commencement date (01st July 2022), Alpha shall derecognize the asset from property, plant and equipment at a carrying amount of FRW 3,200 and recognize the disposal proceeds on the derecognition at the lower of the "fair value of the asset" and the "present value of the lease payments" (both are FRW 3,791 million). A gain of (3,791 – 3,200) FRW 591 million shall be recognized in the profit or loss (i.e., the retained earnings) of both the separate and consolidated financial statements of Alpha. In summary:

	Debit (FRW million)	**Credit (FRW million)**
Lease Receivable (at the present value of future lease payments receivable)	3,791	
Property, plant & equipment (carrying amount of the asset)		3,200
Profit or Loss (i.e., retained earnings) – gain on derecognition of the asset		591

Subsequently on the reporting date (30th June 2023):

Recognize the "finance income" of (3,791 x 10%) FRW 379 million in the profit or loss (i.e., the retained earnings) and as an increase on the Lease receivable account

	Debit (FRW million)	**Credit (FRW million)**
Lease Receivable (with the finance income)	379	
Profit or Loss (i.e., retained earnings) – with the finance income		379

Recognize the annual lease rental of FRW 1,000 as cash-in-transit as an increase to the cash account and a decrease in the lease receivable

	Debit (FRW million)	**Credit (FRW million)**
Cash and Bank (with the lease rental cash-in-transit)	1,000	
Lease Receivable (with the lease rental cash-in-transit)		1,000

Summary adjustment (in separate and consolidated financial statements):

	Debit (FRW million)	**Credit (FRW million)**
Lease Receivable (3,791 + 379 – 1,000)	3,170	
Cash and Bank (with the lease rental cash-in-transit)	1,000	
Property, plant & equipment (carrying amount of the asset derecognized)		3,200
Profit or Loss (591 + 379)		970

Part (b): Alpha's consolidated statement of financial position as at 30th June 2023 *(rounded in FRW millions)*

Non-current assets	
Property, plant and equipment (87,000 + 73,000 + 36,400 + 12,000+ 6,000 W2 + 7,200 Joint operation) - 3,200 (Finance leased asset (a)(ii))	206,400
Goodwill (W4)	43,940
Lease receivable (a)(ii)	3,170
Sub-total non-current assets	**253,510**
Current assets	
Inventory (27,500 + 16,960 + 7,560 - 500 unrealized profits (W2) - 300 unrealized profits (W6))	51,220
Trade receivables (10,650 + 11,200 + 5,740 - 200 intra group management fees W3)	27,390
Cash (1,700 + 1,080 + 1,300 + 1,000 Finance lease rental (a)(ii))	5,080
Sub-total current assets	**83,690**
Total assets	**337,200**
Equity and Liabilities	
Equity	
Ordinary share capital (Alpha only)	20,000
Retained earnings (W6)	224,840
Non-controlling interests (W5)	42,320
Sub-total equity	**287,160**
Non-current liabilities	
Long-term borrowings (5,600 + 3,760 + 1,860 + 7,200 Joint operation)	18,420

Current liabilities	
Trade payables (13,100 + 12,080 + 6,440)	31,620
Total equity and liabilities	**337,200**

Workings (all in FRW millions)

W1: Group structure (in Alpha's view)	**Bertin**	**Claver**
(i) Group's shareholding in subsidiaries		
Alpha's direct shareholding in Bertin	80%	
Alpha's indirect shareholding in Claver (80% x 75%)		60%
NCI's shareholding in Bertin (balance: 100% - 80%)	20%	
NCI's shareholding (direct & indirect) in Claver (balance: 100% - 60%)		40%

(ii) Date of acquisition (in Alpha's view)	
Acquisition of Bertin	01st July 2021
Acquisition of Claver (Later date: 01st July 2019 Vs 01st July 2021)	01st July 2021

Working 2

Unrealized profit in Alpha 5,000*25/125*1/2=500
Unrealized profit in Claver 6,000*25/125*25%=300

Fair value adjustment - Plant in Bertin

FV increase on acquisition date (01st July 2021) (28,000 - 16,000)	12,000
Less: Extra depreciation (01st July 2021 – 30th June 2023) (12,000 / 4 years x 2 years)	(6,000)
Balance - FV adjustment on Plant in Bertin (on 30 June 2023) (12,000 - 6,000)	**6,000**

Fair value adjustment - Inventory in Bertin

FV increase on acquisition date (01st July 2021) (15,750 - 11,750)	4,000
Less: Transferred to retained earnings (sold all inventory by 30th June 2023)	(4,000)
Balance - FV adjustment on Inventory in Bertin (on 30 June 2023) (4,000 - 4,000)	**-**

Working 3

The management fees were levied by Bertin which means he has debited receivable and credited other income but Claver has not accrued which means he has not recorded it. Therefore, the receivables in Bertin will be eliminated as follows

Dr: Retained earnings	200
Cr: Receivables	200

W4: Consolidated Goodwill

(i) Goodwill in Bertin		
Cost of investment		116,000
Plus: NCI (at its fair value)		28,500
Less: Fair value of net assets		
Ordinary share capital	16,000	
Retained earnings	64,000	
Fair value increase - Inventory (15,750 - 11,750)	4,000	
Fair value increase - Plant (28,000 - 16,000)	12,000	
		(96,000)
Goodwill on acquisition		**48,500**
Less: Goodwill impairment loss *(allocated below)*		(12,000)
Goodwill balance (30 June 2023)		**36,500**
Allocation of impairment loss:		
To Group (in consolidated retained earnings: 80% x 12,000)		9,600
To NCI (20% x 12,000)		2,400

(ii) Goodwill in Claver		
Cost of investment in Claver (Alpha's share: 80% x 36,000)		28,800
Plus: NCI value on acquisition date (40% x net assets of 29,400 in W3)		11,760
Less: Net assets on acquisition date		
Share capital	7,000	
Retained earning	22,400	
Total net asset		**(29,400)**
		43,940

Consolidated Goodwill on 30 June 2023 (36,500 in Bertin + 7,440 in Claver)

W5: Non-controlling interests

	Bertin	Claver
FV of NCIs on acquisition date (in Bertin)	28,500	
Non-controlling interest share for net assets at acquisition in Claver		11,760
Plus: NCI's share in "post-acquisition profit (20% x 31,700) (W6)		
13,300*40% (W6)-Claver	6,340	5,320
Less: Alpha's NCI share in "Bertin's cost of investment in Claver" (20% x 36,000)	(7,200)	
Less: NCI's share of Goodwill impairment in Bertin (20% x 12,000) (W4)	(2,400)	
Totals	**25,240**	**17,080**
Total NCIs on 30 June 2023 (25,240 + 17,080)	**42,320**	

W6: Consolidated retained earnings (at 30 June 2023)			
	Alpha	**Bertin**	**Claver**
All of Alpha - per question	204,150	106,400	35,700
At Acquisition		(64,000)	(22,400)
Less: Unrealized profits (Alpha's sales to Claver) (6,000 x unsold goods of 25% x profit element of 25/125)	(300)		
Extra depreciation on Fair value adjustment in bertin-12,000/4*2		(6,000)	
Fair value adjustment on inventory as it was sold		(4,000)	
Unrealized profit on stock FRW 5,000*25/125*1/2		(500)	
Management fees levied by Bertin to Claver		(200)	

Less: Goodwill impairment loss (9,600 in Bertin + 3,720 in Claver) (W4)	(13,320)		
Plus: Net income on finance lease (gain on asset derecognition of 591 + Finance income of 379)	970		
Totals	**191,500**	**31,700**	**13,300**
Group's share (in %)	100%	80%	60%
Group's share (in amount)	**191,500**	**25,360**	**7,980**
Consolidated retained earnings (191,500 + 25,360 + 7,980)	**224,840**		

SECTION B

QUESTION TWO

Marking Guide: Nexus

Part (a): Situation 1: Decommissioning Liability

(a) (i): Required appropriate accounting treatment

Award 1 mark for every correct reference to an accounting treatment and 1 mark for every correct application of the accounting treatment to the specific information provided in the scenario under *Situation 1 on Decommissioning Liability* **(maximum of 4 marks)**	4
Award 0.5 marks for each correct figure picked in the financial statements (except totals / sub-totals) and 0.5 marks for every correct calculation done (either in a separate working or on the face of the financial statements) - **(maximum of 4 marks)**	4
(a) (ii): Decommissioning liability - inconsistent treatment with the IASB's Framework	
Award 1 mark for any valid reference to the IASB's Framework and 1 mark for any correct explanation of the inconsistence between the IFRS accounting treatment for a decommissioning liability and the Framework **(maximum of 2 marks)**	2
Total marks for part (a)	**10**

Part (b): Situation 2: Deferred taxes

(b) (i): Required appropriate accounting treatment - Deferred taxes

Award 1 mark for every correct reference to an accounting treatment and 1 mark for every correct application of the accounting treatment to the specific information provided in the scenario under *Situation 1 on Decommissioning Liability* **(maximum of 3 marks)**	3
Award 0.5 marks for each correct figure picked in the financial statements (except totals / sub-totals) and 0.5 marks for every correct calculation done (either in a separate working or on the face of the financial statements) - **(maximum of 3 marks)**	3
(b) (ii): Deferred taxes - inconsistent treatment with the IASB's Framework	
Award 1 mark for any valid reference to the IASB's Framework and 1 mark for any correct explanation of the inconsistence between the IFRS accounting treatment for a deferred taxes and the Framework **(maximum of 2 marks)**	2
Total marks for part (b)	**8**

Part (c) IFRS 17 steps to apply in accounting for the insurance contract in the financial statements of Nexus

Award up to 1 mark for every well-developed point that provides an "overview" or a "highlight" of guides from IFRS 17 for Nexus to "recognize" and "disclose" a group of insurance contracts in the financial statements of a company (the order of the points given in the student's answer DOES NOT matter).

In addition:

- Award 1 mark for any valid point where the student's answer goes deeper into the IFRS 17 initial and subsequent recognition requirements as long as the point is linked to the case of Nexus;
- Award up to 1 mark (maximum) where a reasonable introduction is made 7

Total marks for part (c) **7**

Total Marks for Question Two **25**

Model Answer: Nexus

Part (a): Accounting situations

Situation 1

(i) The required accounting treatment

Under IAS 37 *Provisions, contingent liabilities and assets*, a provision is a liability of uncertain timing or amount. A provision is recognised when:

- An entity has a present obligation (legal or constructive) as a result of a past event
- It is probable that an outflow of resources embodying economic benefits will be required to settle the obligation
- A reliable estimate can be made of the amount of the obligation

Nexus should recognize a provision on the initial recognition of the gas extraction facility for the discounted cost of the removal of the extraction facility due to the following reasons:

- The installation of the facility creates an obligating event.
- The operating license given by the Government of Rwanda creates a legal obligation for Nexus to dismantle the plant which is likely to occur.
- The costs of removal will have to be incurred irrespective of the future operations of the company and cannot be avoided
- A transfer of economic benefits (i.e., costs of removal) will be required to settle the obligation
- A reasonable estimate of the obligation can be made although it is difficult to estimate an actual cost which will be incurred in 20 years' time.

The costs to be incurred will be treated as part of the initial cost of the plant (as an asset in the property, plant and equipment) and this will be depreciated over its production life of twenty (20) years. However, the costs related to the damage caused by the extraction should not be included in the provision, until the gas is extracted which in this case would be 20% of the total discounted provision. The accounting treatment for the provision of the decommissioning liability would be:

Nexus Statement of financial position at 31st Dec 2023 (extracts)

	FRW million
Assets	
Non-current assets	
Property, plant & equipment:	
Plant - construction cost	2,000
Plus: Provision for decommissioning *(W1)*	400
Initial cost (2,000m + 400m)	**2,400**
Less: Depreciation charge for year-ended 31 Dec 2023 (W3)	(120)
Carrying value (on 31 Dec 2023) (2400m – 120m)	**2,280**
Liabilities	
Non-current liabilities	
Provision for decommissioning (for the plant on 1 Jan 2023) (W1)	400
Plus: Unwinding of discount (by 31 Dec 2023) (W2)	20
Adjusted carrying amount for provision for decommissioning plant (400m + 20m)	**420**
Plus: Decommissioning provision - damage rectification (W1)	13.3
Provision for decommissioning (at 31 Dec 2023) 420m + 5m	**425**

Nexus Profit or loss for the year-ended at 31 Dec 2023 (extracts)

Depreciation charge (W3)	120
Plus: Decommissioning provision - damage rectification (W1)	5
Plus: Unwinding of discount on decommissioning plant (finance cost by 31 Dec 2023) (W2)	22
	145

Workings

	FRW million
W1: Allocation of Restoration cost of FRW 500 million:	
(i) To capitalize (initial cost of plant asset on 01st Jan 2023): 80% x FRW 500m	400
(ii) To Profit or loss (as a provision for damage costs for year ended 31st Dec 2023): ((20% x FRW 500 m) / 20 years	5
W2: Unwinding of discount (decommissioning of plant by 31st Dec 2023) (5% x FRW 500m)	25
W3: Depreciation charge - Plant (on 31st Dec 2023) (2,000m + 400m) / 20 years	120

(ii) Decommissioning liability - inconsistent treatment with the IASB's Framework

IAS 37 *Provisions, contingent liabilities and assets* and IAS 16 *Property, plant and equipment* requires Nexus to recognize a full discounted liability for the decommissioning cost of the plant extraction facility in Gisenyi. The accounting treatment as discussed above requires the corresponding debit entry to be recognized as an asset and added to the initial cost of the plant asset on 01st January 2023.

The challenge with the accounting treatment above is that the recognized asset struggles to satisfy the definition of an asset in the IASB's Framework which defines an asset as "an economic resource controlled by an entity arising from a past event". It is difficult to assess how the future cost to pay for a decommissioning provision will qualify as an asset in accordance with the definition of an asset in the Framework as the expected dismantling cost fails to qualify as "an economic resource" for the company since this cost cannot be evidence of future economic resources expected to flow to the entity.

In addition, the accounting treatment for IAS 16 for a subsequent depreciation charge recognized as an "operating expense" and IAS 37's requirement to unwind the discount recognized as a "finance cost" will also fail to satisfy the fundamental qualitative characteristics of "relevant information" and "faithful representation" that are required for the financial information to assist users make economic decisions.

(b) Situation 2

(i) Deferred taxes - the required accounting treatment

Nexus should recognize a provision for deferred tax in its financial statements on 31 December 2023 in accordance with IAS 12 *Income Taxes* as computed below:

Deferred tax implications - Factory building

	FRW million
Carrying amount (Building on 31st Dec 2023)	
Purchase cost (01st Jan 2023)	1,000
Less: Grant related to asset (1 Jan 2023)	(200)
Net initial cost (01st Jan 2023) (1,000 - 200)	**800**
Less: Depreciation charge for building (FRW 800m / 10 years)	(80)
Carrying amount (Building at 31st Dec 2023) (800 - 80)	**720**
Tax base (Building at 31st Dec 2023) (FRW 1,000m x 60%)	600
Taxable temporary difference (building at 31st Dec 2023) (720 - 600)	**120**
Plus: Other taxable temporary differences (on 31st Dec 2023)	300
Total taxable temporary differences (120 + 300)	**420**

Deferred tax implications - Warranty provision

	FRW million
Warranty provision (liability at 31st Dec 2023)	400
Tax base (warranty provision)	-
Deductible temporary difference (re warranty provision) (400 - 0)	**400**
Plus: Un-used tax losses (at 31st Dec 2023)	700
Total deductible temporary differences (400 + 700)	**1,100**

Net temporary differences (at 31st Dec 2023)

	FRW million
Total deductible temporary differences	1,100
Less: total taxable temporary differences	(420)
Net deductible temporary differences (1,100 - 420)	**680**

Deferred tax asset (31st Dec 2023)

	FRW million
Net deductible temporary differences	680
Company tax rate	30%
Deferred tax asset (31st Dec 2023) 680m x 30%	**204**

If Nexus can prove that suitable taxable profits will be available in the future or that tax planning opportunities are available to create suitable taxable profits, then a deferred tax asset of FRW 204 million can be recognized within the current assets at 31st December 2023.

(ii) Deferred taxes – inconsistent treatment with the IASB's Framework

As discussed above, IAS 12 Income taxes requires the entity to recognize a deferred tax liability for all the taxable temporary differences and a deferred tax asset for all the deductible temporary differences that exist at the reporting date. This treatment may not be consistent with the IASB's Framework definition and recognition criteria for a liability and an asset.

The Framework defines a liability as "a present obligation arising from a past event". This Framework emphasizes the concept of a "constructive obligation" in supporting the definition and recognition of a liability where implies that this is an obligation that the entity cannot avoid and hence must result into an outflow of its economic resources to settle the obligation. However, a deferred tax liability can be avoided by the entity if for example the entity makes future losses and with suitable tax planning strategies this may never result in taxable amounts.

In addition, a deferred tax asset is dependent upon the certainty of future profits or tax planning opportunities. Recognizing the deferred tax asset may not satisfy the Framework's definition of an asset being "a current economic resource controlled by entity arising from a past event". It can be argued that a deferred tax asset does not confer any "right" to future economic benefits as future profits are never certain as it is evident that the economic environment under Nexus operates from has always been very unpredictable.

Part (c): Seven steps applied in the recognition of insurance contacts in the insurer's financial statements.

Introduction

The International Accounting Standards Board (IASB) issued IFRS 17 Insurance Contracts in May 2017 replacing IFRS 4 Insurance Contracts and had an initial effective date of 01st January 2021, which date was later extended to 01st January 2023.

The requirements of IFRS 17 focus on the transactions rather than the insurance entity, specifically on insurance contracts and not insurance entities. In this case, IFRS 17 will apply to the group of insurance contracts managed by Nexus that share similar risks and characteristics (e.g., third-party motor insurance).

IFRS 17 is applied by the insurance company (the "insurer") and not by the customer purchasing an insurance policy (the "policyholder").

Guides to be applied by Nexus in recognizing a group of insurance contracts in the financial statements:

Nexus will be required to apply IFRS 17 Insurance Contracts from the year ended 31 December 2024 to **recognize** the transactions under insurance contracts with its customers for the motor insurance contracts and make disclosures for groups of insurance contracts in their financial statements following the IFRS 17 specific guidance below:

- Nexus shall have to identify insurance contracts that qualify for recognition under IFRS 17 as those contracts under which the company has accepted to take on a significant insurance risk from another party (the policyholder of the motor insurance contracts) in which case, Nexus will be obliged to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder.

- The company shall then separate any specified embedded derivatives, distinct investment components and distinct performance obligations from the existing insurance contracts.

- The company will have to classify / allocate the insurance contracts into groups on the basis that recognition and measurement of the insurance contracts is separate for each group of insurance contracts – for example a group of motor comprehensive insurance to individual car owners of small-sized cars located in Kigali city shall be separately measured and recognized from other groups of insurance contracts.

- Nexus will recognize and measure (initially and subsequently at each reporting date) each group of insurance contracts at:

- A risk-adjusted present value of the future cash flows (i.e., the fulfilment cash flows) that incorporates all of the available information about the fulfilment cashflows in a way that is consistent with observable market information; *plus / minus:*
- An amount representing the un-earned profit in the group of contracts (i.e., the contractual service margin)

- Nexus will recognize the profit from a group of insurance contracts over the period the company provides insurance contract services to its customers for the motor insurance contracts, and as the entity is released from the risk. If a group of insurance contracts is or becomes loss-making (i.e., a group of onerous contracts), Nexus should recognize the loss immediately.

- Nexus shall present separately in its profit or loss the insurance revenue (that excludes the receipt of any investment component), insurance service expenses (that excludes the repayment of any investment components) and insurance finance income or expenses.

- Lastly Nexus shall disclose information in the notes to the financial statements to enable the users of the financial statements (such as the company's shareholders on the basis that Nexus is a listed company) to assess the effect that the insurance contracts within the scope of IFRS 17 have on itsfinancial position, financial performance and cash flows.

QUESTION THREE

Marking Guide: Kigali Soap Industries Limited (KSIL)

Part (a): Accounting treatment for the shared-based payment in the financial statements of KSIL regarding the two pension schemes including

The SMT scheme

Award 1 mark for explaining the IFRS 2 requirement to use the grant date fair value of FRW 20,000 per share option as a fixed value throughout the vesting period for the "equity-based share-based payment arrangement"	1
Award up to 1 mark for each correct share-based expense per year (includes a calculation mark of 0,5 marks per correct calculation) and 1 mark for the equity value in the statement of financial position (a maximum of 6 marks)	6
The Producers scheme	
Award 1 mark for explaining the IFRS 2 requirement to apply the fair value at each reporting date to measure the liability arising from the "cash-based share-based payment arrangement"	1
Award up to 1 mark for each correct share-based expense per year (includes a calculation mark of 0,5 marks per correct calculation) and 1 mark for the liability value in the statement of financial position (a maximum of 6 marks)	6
Total marks for part (a)	**14**

Part (b) Events after the end of the reporting period

Award 1 mark for every correct / valid reference to a relevant accounting treatment (as per IFRS) and 1 mark for every correct application of the accounting treatment to the specific information given in the scenario. This includes:	
(i) Legal claim by an employee	4
(ii) In-complete revenue contract with a customer	4
(iii) Fraud (materials theft by the storekeeper)	3
Total marks for part (b)	**11**
Total Marks for Question Three	**25**

Model Answer: Kigali Soap Industries Limited (KSIL)

Part (a): The share-based expense to charge to the profit or loss and the statement of financial position for each year

The "SMT Scheme"

The movement in the fair value of the share options is not relevant since the expense to the profit or loss is based on the fair value of the share options on the grant date of 01st January 2022 which is FRW 20,000 per share option.

In Year 1 of the SMT scheme (i.e., year-ended 31st December 2021)

The expense to be charged to the profit or loss and credit to equity is (FRW 20,000 x 45 employees expected to complete the vesting period x 200 share options each x 1/3 years) FRW 60,000,000

In Year 2 of the SMT scheme (i.e., year-ended 31st December 2022)

The cumulative balance the share-based instrument based on the updated assumptions regarding leavers on 31 December 2022 is (FRW 20,000 x 48 employees expected to complete the vesting period x 200 share options each x 2/3 years) FRW 128,000,000.

Therefore, the expense charged to the profit or loss for the year is (128m – 60m) FRW 68,000,000.

The amount recognized in the statement of financial position is the cumulative amount of the share-based instrument recognized to-date in the profit or loss of FRW 128,000,000 – and this is recognized in a "separate reserve in equity" as at 31 December 2022.

In Year 3 of the SMT scheme (i.e., year-ended 31st December 2023)

The final cumulative cost of the "SMT scheme" at the vesting date (31st December 2023) is based on the actual number of employees after adjusting for the actual leavers on 31st December 2023 which is (FRW 20,000 x 47 employees expected to complete the vesting period x 200 share options each) FRW 188,000,000.

Therefore, the expense charged to the profit or loss for the year is (188 million – 128 million) FRW 60,000,000.

The amount recognized in the statement of financial position is the cumulative amount of the share-based instrument recognized to-date in the profit or loss of FRW 188,000,000 – and this is recognized in a "separate reserve in equity" as at 31st December 2023.

The "Producers Scheme"

In Year 1 of the Producers scheme (i.e., year-ended 31st December 2021)

The expense to be charged to the profit or loss and as a credit to liabilities is (2 SARs each employee x 470 employees expected to complete the vesting period x FRW 156,000 i.e., the fair value of the SARs on 31 December 2021 x 1/3 years) FRW 48,880,000.

In Year 2 of the Producers scheme (i.e., year-ended 31st December 2022)

The cumulative balance in the liabilities is based on the updated assumptions regarding leavers which is (2 SARs each employee x 480 employees expected to complete the vesting period x FRW 162,000 i.e., the fair value of the SARs on 31st December 2022 x 2/3 years) FRW 103,680,000.

Therefore, the expense to profit or loss for the year ended 31st December 2022 is (103,680,000–48,880,000) FRW 54,800,000.

The amount recognized in the statement of financial position is the cumulative amount of the share-based instrument recognized to-date in the profit or loss of FRW 103,680,000– and this is recognized in the "non-current liabilities" as at 31st December 2022.

In Year 3 of the Producers scheme (i.e., year-ended 31st December 2023)

The final cumulative cost of the "Producers scheme" at the vesting date (31st December 2023) is (2 SARs each employee x 476 employees who completed the vesting period on 31 December 2023 x FRW 180,000 i.e., the fair value of the SARs on vesting date) FRW 171,360,000.

Therefore, the expense to profit or loss for the year ended 31st December 2023 is (171,360,000 - 103,680,000) FRW 67,680,000.

The amount recognized in the statement of financial position is the cumulative amount of the share-based instrument recognized to-date in the profit or loss of FRW 171,360,000 – and since the employees are expected to be paid their cash bonus on 30 April 2024 (in four months from 31st December 2023), the liability is recognized in the "current liabilities" as at 31st December 2023.

Part (b): Events after the end of the accounting period

(i) Legal claim by an employee

KSIL has correctly treated the outstanding legal claim by the employee as a contingent liability in its financial statements for the year ended 31st December 2023.

According to IAS 10 *Events after the end of a reporting period,* the settlement of a court case after the end of the reporting period may confirm the existence of an obligation at the year end and this would have a valid case for an adjusting event. If this was the case for KSIL, then this would require an adjustment by removing the contingent liability disclosure in the notes to the financial statements and instead the obligation for the legal claim would be recognized in the financial statements depending on the most likely outcome of the case in accordance *with IAS 37 Provisions, contingent liabilities and assets*.

However, on a more detailed analysis, the circumstances of the employee's legal claim against KSIL are different of those in the recently concluded court case of the other company. Therefore, the recent court case of an injury in the other company does not appear to have any effect on the likelihood of KSIL losing the case. This implies that KSIL cannot use the recently concluded court case of an injury in the other company to conclude that "it is highly probable that KSIL will also lose the legal case charged by the employee" and therefore this is only "a possibility that KSIL can lose the court case".

The only impact the recently concluded legal case of an injury of the other company to KSIL's situation is an impact on the potential amount of settlement for the employee's legal claim against KSIL. Under IAS 10, this then requires an "update of the amount to disclosure in the contingent liability"

Therefore, the only required change to the financial statements of KSIL would be to update the disclosure note on the contingent liability to reflect that the "possible liability" has increased from FRW 150 million to FRW 175 million.

(ii) In-complete revenue contract with a customer

Under IAS 10 *Events after the end of the reporting period*, in a normal case, the effect of a price increase of materials after the reporting period would be reported in the financial statements of the accounting period in which the change in price takes place. This would have implied that KSIL would not adjust the financial statements for the year ended 31 December 2023 as the change in the price of the materials took place in February 2024 and hence this would have been classified as a non-adjusting event.

However, KSIL's method of recognizing profit using the "cost basis" to determine the percentage of completion requires an estimate on 31 December 2023 of the most likely future costs of the contract. The estimated cost is then used to directly determine the amount of profit that should be recognized by KSIL for the year ended 31 December 2023.

Therefore, the information indicating that the total estimated costs of the contract have increased should be taken as providing additional evidence of conditions that existed at the year-end (31st December 2023). This is then "an adjusting event" which requires KSIL to recalculate the profit to be recognized on the contract with the government hospital.

Based on the information provided, the original estimate of the recognized profit at 31st December 2023 of FRW 1,200 million would be half (50%) of the estimated total profit of FRW 2,400 million (i.e., FRW 3,000 million / FRW 6,000 million giving a percentage of completion of 50%).

The increase in the costs of the materials by an additional FRW 1,500 million implies that the revised estimated total profits will reduce to FRW 900 million (i.e., FRW 2,400 million – FRW 1,500 million additional costs). The revised total costs will be FRW 7,500 million (i.e., FRW 6,000 million + FRW 1,500 million).

Therefore, KSIL will recalculate the profit to be recognized on the contract as FRW 360 million (900m x 3,000m/7,500m) with appropriate adjustments to the other figures within the financial statements.

(iii) Fraud (materials theft by the storekeeper)

In accordance with IAS 10 *Events after the end of the reporting period*, the theft of the materials by the storekeeper of KSIL qualifies as an adjusting event to the company's financial statements for the year ended 31st December 2023.

Based on the information provided, it is evident that to some extent, the figures already reported in the financial statements of KSIL for the year ended 31 December 2023, have presumably been recognized as "cost of sales" amounting to FRW 420 million as a "cost of materials issued out of the stores" to be part of the cost of the goods sold. However, this is a wrong presentation in the financial statements for this loss to the company.

Since, the fraud is considered to be material, FRW 420 million should be removed from the cost of sales and included as an operating expense (perhaps as a separate line presentation) in the profit or loss. This will affect the gross profit amount, the ratio for gross profit margin but will not affect the operating profit figure and the ratio for the operating profit margin.

The additional loss relating to the theft of materials that took place after 31st December 2023 of (480 million – 420 million) FRW 60 million shall be considered as a "non-adjusting event" in accordance with IAS 10 and disclosed in the notes to the financial statements if considered material in its own right.

QUESTION FOUR

Marking Guide: Rwamine, Kenmine & Tazmine	
(a) Opening statement of financial position for Tazmine at 01st January 2023	
Generally, award 0.5 marks for each correct figure used either in the workings or figure presented on the face of statement of financial position (excluding totals / sub-totals) - maximum 5 marks	5
Award 1 mark for every correct / valid reference to a relevant accounting treatment (as per IFRS) and 1 mark for every correct application of the accounting treatment to the needed "accounting adjustment" based on the specific information given in the scenario. This includes:	
Discussion of Rwamine's net assets contributed to the joint venture (Tazmine Ltd)	
Mining site – cost of dismantling the site (this includes 0.5 marks for every correct calculation used to support the required accounting adjustment)	2
Impairment test for mining site – as a cash generating unit (this includes 0.5 marks for every correct calculation used to support the required accounting adjustment - e.g. 0.5 marks per year for the value-in-use for the CGU, fair value less costs of disposal etc.)	4
Trade receivable from Dime Ltd (this includes 0.5 marks for every correct calculation used to support the required accounting adjustment)	3
Termination of the contract with Dime Ltd	1
Discussion of Kenmine's net assets contributed to the joint venture (Tazmine Ltd)	
Termination of the sales agent contract	2
Sales contract with a new customer in France	3
	2
Total marks for part (a)	**0**
(b) Advantages of producing a separate environmental report for Rwamine and Kenmine	
Award up to 1 mark for every well explained advantage of an environmental report - specific to Rwamine and Kenmine (maximum of 5 marks)	5
Total marks for part (b)	**5**
Total Marks for Question Four: 25 marks	

Model Answer: Rwamine, Kenmine & Tazmine

(a) Tazmine's statement of financial position at 01st January 2023 (in FRW million)

	Rwamine's contribution		**Kenmine's contribution**		**Revised (Total)**
	Original	**Adjustment**	**Original**	**Adjustment**	
Assets					
Non-current assets					
Property, plant & equipment	9,000	+ 3,960 (note 1)	10,000		22,960
Intangible assets	3,000	- 3,000 (note 4)	2,000	- 500 (note 5) + 1,500 (note 6)	3,000
Total non-current assets	**12,000**		**12,000**		**25,960**
Current assets					
Inventory	-		3,000		3,000
Trade receivables	7,000	- 3,226 (note 3)	-		3,774
Cash	1,000		5,000		6,000
Total current assets	**8,000**		**8,000**		**12,774**
Total assets	**20,000**		**20,000**		**38,734**
Equity and Liabilities					
Equity					
Ordinary share capital	20,000		20,000		40,000
Other reserves		- 3,226 (note 3) - 3,000 (note 4)		- 500 (note 5)	(6,726)
Total equity	**20,000**		**20,000**		**33,274**
Liabilities					

Deferred income				+ 1,500 (note 6)	1,500
Decommissioning / dismantling liability		+ 3,960 (note 1)			3,960
Total equity and liabilities	**20,000**		**20,000**		**38,734**

Notes on Discussion of Rwamine's net assets contributed to the joint venture (Tazmine Ltd)

Note 1: Mining site – cost of dismantling the site

In accordance with IAS 37 *Provisions, contingent liabilities and assets*, a provision for a liability is recognized where an entity has a present obligation arising from an obligating event for which the entity cannot avoid and this should arise from a past event.

In terms of the mining site which already exists in Dodoma, Tanzania and there is an existing legal obligation to dismantle the site after its useful life of four (4) years, the entity will have no alternative but to dismantle the mining site at the end of its useful life (on 31st December 2026). Therefore, a provision for a dismantling / decommissioning liability should be recognized on 01st January 2023 as the entity has a present legal obligation to dismantle the mining site.

Further, IAS 16 Property, plant and equipment requires where a decommissioning liability relates to a capitalization of an asset to have the cost of the dismantling be recognized as part of the initial measure of the PPE. Therefore, the provision for the dismantling / decommissioning liability shall be added to the property, plant and equipment of Tazmine on 01st January 2023.

On 01st January 2023, the present value of the dismantling / decommissioning liability is computed as (FRW 5,000 million x 0.792) FRW 3,960 million and this shall be recognized as an increase to the liabilities (as a provision for dismantling costs) and also an increase to the property, plant & equipment asset.

Note 2: Impairment test for mining site – as a cash generating unit

IAS 36 *Impairment of assets*, sets out the events that might indicate that an asset is impaired. These circumstances include external events such as the decline in the market value of an asset and internal events such as the reduction in cash flows to be generated from an asset or cash generating unit. The loss of the only customer (Dime) of the cash-generating unit (the "mining site") is an indication of the possible impairment of the cash generating unit. Therefore, the mining site of Tazmine based in Dodoma, Tanzania will have to be impairment tested on 01st January 2023.

Under IAS 36, on the assessment of an impairment loss, the recoverable amount of the cash generating unit has to be assessed where the recoverable amount is the higher of the fair value less costs of disposal and the value in use. In the case of the mining site in Dodoma, the recoverable amount will have to be determined and compared to the value given to the asset on the setting up of the joint venture. In this case, the recoverable amount is the higher of the cash generating unit's fair value less costs of disposal and its value in use.

The fair value less costs of disposal will be FRW 15,000 million which is the offer for the sale of the mining site of FRW 16,000 million less the costs of disposal of FRW 1,000.

The value in use is the discounted value of the future cash flows expected to arise from the cash-generating unit. In calculating the value in use for the cash generating unit, the present value for the dismantling costs of the mining of FRW 3,960 million shall be included as a cash outflow on the basis that the net cash flows initially provided had not included this cost.

The value in use for the cash-generating unit (the mining site) based on the future expected cash flows and a discount rate of 6% on 01st January 2023 is FRW 20,984 million (Working below).

The fair value less costs of disposal for the cash-generating unit (the mining site) based on the offer price provided by an interested buyer of the mining site reduced by the costs of disposal on 01st January 2023 is (16,000m – 1,000m) FRW 15,000 million.

Therefore, the recoverable amount of the cash-generating unit (the mining site) on 01st January 2023 is the higher amount of FRW 20,984 million (i.e., the value in use since this is higher than the fair value less costs of disposal of FRW 15,000 million).

On the basis that the carrying amount of the cash-generating unit (the mining site) on 01st January 2023 of FRW 20,000 million (i.e., the net assets contributed to the joint venture by Rwamine) is less than the recoverable amount of FRW 20,984 million, the mining site is not impaired and hence no impairment loss should be recognized.

Working: Value in use of CGU - mining site (01st Jan 2023)

	Year 1 (31 Dec 2023)	**Year 2 (31 Dec 2024)**	**Year 3 (31 Dec 2025)**	**Year 4 (31 Dec 2026)**	**Total**
Net cash inflows	6,000	7,000	8,000	8,000	
Discount rate (6%)	0.943	0.890	0.840	0.792	
Present value	**5,660**	**6,230**	**6,717**	**6,337**	**24,944**
Less Present value of dismantling cost (5,000 x 0.792)					(3,960)
Present value for CGU (i.e., value-in-use) on 01st Jan 2023					**20,984**

Note 3: Trade receivable from Dime Ltd

IFRS 9 *Financial instruments*, requires an entity to assess at each reporting date whether a financial asset is impaired. In the case of the joint venture, the trade receivable of FRW 7,000 million is likely to be impaired as the customer (Dime Ltd) is declared bankrupt and undergoing a liquidation process.

IFRS 9 applies a simple measurement method for the impairment measurement for a trade receivable (unlike the expected credit loss approach for the other financial assets) where the recoverable amount for the trade receivable is calculated as the present value of the estimated future cash flows. Normally, cash receipts from a trade receivable are not discounted except where the cash flows are expected to be received in more than twelve (12) months from the reporting date.

In the case of the trade receivable (in terms of Dime Ltd i.e., the customer undergoing liquidation), the amount expected from the liquidation administrators of FRW 5,000 million will not likely be received for a year (12 months) and the most likely expected amount is 80%. Therefore, the present value of the trade receivable from Dime Ltd using a discount rate of 6% in one year from 1 January 2023 is (5,000 x 80% x 0.943) FRW 3,774 million.

Therefore, an impairment loss on the trade receivable of (Carrying amount of FRW 7,000 less Recoverable amount of FRW 3,774) FRW 3,226 million should be recognized on 01st January 2023 in accordance with IFRS 9 by reducing the trade receivables and as a loss in the reserves (in equity).

Note 4: Termination of the contract with Dime Ltd

Further in accordance with IAS 36 Impairment of assets, the intangible asset representing "the contract with Dime" of FRW 3,000 million shall be fully impaired to NIL as the contract with Dime has been terminated and hence it is worthless.

An impairment loss of FRW 3,000 million should be recognized by writing down the intangible assets to nil on 01st January 2023 and as a loss in the reserves (in equity).

Notes on Discussion of Kenmine's net assets contributed to the joint venture (Tazmine Ltd)

Note 5: Termination of the sales agent contract

The termination cost of the contract with the sales agent entity cannot be treated as an intangible asset. Such a contract termination is considered to be similar to a termination of an employment contract of a staff. The termination of the sales agent contract in this case represents a compensation for the loss of future income for the sales agent. Therefore, it must be removed from the statement of financial position of Tazmine.

Under IAS 38 Intangible assets, an intangible asset is only recognized where it is probable that future economic benefits will flow to the entity and the cost can be measured reliably. In the case of the compensation cost for the terminated contract with the sales agent, the second condition is satisfied but the first condition (future economic benefits flowing to the entity) is not satisfied. This is because the cost of gaining future customers for Tazmine cannot linked to this compensation cost.

The required adjustment is therefore to remove the compensation cost of FRW 500 million from the intangible assets and recognize this as an expense in the profit or loss which shall reduce the reserves in equity of Tazmine on 01st January 2023.

Note 6: Sales contract with a new customer in France

IFRS 15 Revenue from contracts with customers contains a concept of a "separable distinct performance obligations" as an arrangement where a contract may contain two or more distinct performance obligations which are therefore in substance separate and separately identifiable. In other words, the distinct performance obligations can operate independently from each other.

In the case of the contract with a new customer in France, the contract has two performance obligations including the obligation to supply diamonds at their fair value to the customer and also an obligation not to sell diamonds to any company in France.

IFRS 15 specifies that where the performance obligations are satisfied over time, then revenue from such a contract is recognized in the financial statements over time as the performance obligations are being satisfied.

The contract with the new customer in France has not been fulfilled as yet and therefore the amount of FRW 1,500 million received from the customer as a deposit (in advance) should not be recognized in the profit or loss in full amount on 01st January 2023.

The requirement not to supply diamonds to any company in France is an obligation that will have to be satisfied over a period of four (4) years and therefore, the recognition of the receipt of FRW 1,500 million should be spread over the four (4) year period.

The deposit of FRW 1,500 million should initially be recognized as "deferred income" in the liabilities on 01st January 2023 and not as an offset from the intangible assets. This requires an adjustment to the financial statements by increasing the intangible assets and the deferred income (in the liabilities) by FRW 1,500 million on 01st January 2023.

In addition, the revenue from the sale of diamonds to the new customer in France shall be recognized in the financial statements as and when the sale of the goods is done according to the revenue recognition requirements in IFRS 15.

(b) Advantages of an environmental report to Rwamine and Kenmine

An environmental report allows an organization to communicate with different stakeholders. For both Rwamine and Kenmine, the benefits that come with an environmental report include:

- Through the report, the companies will be evaluating environmental performance which will help them highlight inefficiencies in operations which helps them improve management systems. This helps the companies identify opportunities to reduce the resource use, waste and operating costs.
- The report will help communicate the efforts being made by the companies to improve the social and environmental performance and this fosters community support for the business of the companies enhancing their reputation as good corporate citizens. At the moment the two companies are suffering with a poor reputation in this area.

- They will be able to report the efforts taken to improve the companies' environmental, social and economic performance which will lead to increased consumer confidence in the mineral products sold by the two companies.
- The commitment to report on the current environmental impact and identifying ways to improve environmental performance will improve relationships with the environmental regulators and may reduce the potential threat of litigations and penalties which the two companies are threaten with.
- Since investors, financial analysts and other key stakeholders constantly ask about the sustainability of a company's operations, a highly quality environmental report will present the strategies being taken by the two companies to reduce risks making the two companies attractive to investors.
- Disclosing the company's environmental, social and economic best practices can give a competitive market edge. Currently the corporate image of the two companies is poor and this has partly contributed to the loss of market share to the competitors.
- The global trend towards improved corporate sustainability is growing and access to international markets requires increasing transparency in reporting the impact of the companies' mining activities to the environment which will help improve the corporate image of the two companies.
- Large-sized customers are increasingly requiring their suppliers to submit performance information in order to satisfy the expectations of their own shareholders and regulators. Disclosing such information in an environmental report can make the two companies more attractive to the large-sized customers which will increase their market share.

END OF MARKING GUIDE AND MODEL ANSWERS