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CERTIFIED PUBLIC ACCOUNTANT
ADVANCED LEVEL 1 EXAMINATIONS
A1.3: ADVANCED FINANCIAL REPORTING
DATE: TUESDAY, 26 JULY 2022
MARKING GUIDE AND MODEL ANSWERS

SECTION A

QUESTION ONE: MUSONI GROUP

Marking Guide

Part (a): Application of Equity Method to the accounting for an investment in Joint Venture	Marks
Up to 1 mark is awarded for a well explained accounting principle relating to equity accounting relating to a joint venture (as guided in the main body of the answer guide above) up to a maximum of 10 marks. This includes:	10
(i) A correct definition or reference to a joint venture linked to a joint arrangement in accordance with IFRS 11	
Application of "equity method" under IAS 28 (<i>with a maximum of 2 marks in each of the areas below</i>) including:	
(ii) Initial and subsequent measurement	
(iii) Presentation in the Investor's statement of financial position	
(iv) Presentation in the Investor's statement of profit or loss and other comprehensive income	
<i>Note: Restrict to 1 mark for the point on "a one-line presentation in the financial statements" (regardless of whether the candidate applies correctly to the statement of financial position and/or statement of profit or loss and other comprehensive income)</i>	
(v) Recognition of losses under equity method	
(vi) Treatment of Impairment losses under equity method	
(vii) Transactions between the investor and the joint venture and un-realized profits	
(viii) Treatment of Dividends received from a joint venture	
Part (b): Preparation of the consolidated statement of cash flows	
1 mark is awarded for each correct computed amount for a relevant line presented in the consolidated statement of cash flows (other than the sub/other totals)	20
Up to 2 marks are awarded for every relevant workings with 0.5 marks for each correct figure within the working (This can be presented as either a separate working or as part of line item presented within the consolidated statement of cash flows). 1 mark (is included within the marks for workings) is awarded for a correct explanation regarding to short-term investments (in the current assets) and the corporate bonds (under other investments in the non-current assets) qualifying as "cash equivalents". No other explanations shall be awarded any marks	20
Total marks for Question one	50

Model Answer

Part (a)

Under IFRS 11 “Joint Arrangement”, a joint venture is where the parties in the joint arrangement have rights to the net assets of the joint venture.

In accordance with IAS 28 “Investment in Associates and Joint Ventures” an investment in a joint venture should be accounted for using the “equity method”.

Under the equity method, the investment in a joint venture is initially recognized at cost. Subsequently at each reporting date, the carrying amount of the investment in the joint venture is increased or decreased to recognize the investor's share of the profit or loss and Other Comprehensive Income of the joint venture after the date of acquisition. In addition, the carrying amount of the investment in the joint venture is decreased by the amount of any dividends received and any impairment loss.

A joint venture is **not** consolidated line-by-line but instead, it is presented as a single line item in the investor's financial statements.

Presentation in the Investor's statement of financial position

In the investor's statement of financial position, this is presented as an “investment in a joint venture” in the statement of financial position.

A long-term loan to a joint venture is also included in the carrying amount of the investment rather than presented as a separate financial asset investment.

At acquisition, the cost of the investment is notionally allocated to the fair value of the net assets acquired. Any notional goodwill is **not** recognized as a separate asset; it is subsumed within the carrying amount of the investment. Any excess of fair value over cost is recognized immediately as income (i.e. it increases the investor's share of the joint venture's profit or loss in the period).

Presentation in the Investor's statement of profit or loss and other comprehensive income

In the investor's statement of profit or loss, the investor's share of the joint venture's profit after tax is included in profit or loss as a separate line item.

The investor's share of the associate/joint venture's OCI is included in OCI (split between amounts that may be reclassified to profit or loss and amounts that will not be).

Where an interest is acquired mid-year, results should be time apportioned.

Recognition of losses under equity method

If an investor's share of losses of a joint venture equal or exceeds its interest in the joint venture, the investor discontinues recognizing its share of further losses.

For this purpose, the interest is its carrying amount under the equity method plus any long-term interest which forms part of the investor's net investment (e.g. long-term loans or preference shares).

After the investor's interest is reduced to zero, additional losses are provided for, and a liability is recognized, only to the extent that the investor has incurred legal or constructive obligations or made payments on behalf of the joint venture.

The investment in the joint venture can be reduced to nil but no further (i.e., the investment in joint venture cannot be negative, even if there are post-acquisition losses of the joint venture). Continuing losses of a joint venture is objective evidence that financial interests in the joint venture other than those included in the carrying amount may be impaired.

Treatment of Impairment losses under equity method

The **entire carrying amount** of an investment in the joint venture is tested for impairment by comparing it with its recoverable amount.

After application of the equity method, including recognizing losses, the investor should determine whether there is objective evidence that the investment is impaired. Because goodwill is included in the carrying amount (i.e., it is not separately recognized), it is not tested for impairment separately.

An impairment loss is recognized as an expense in profit or loss and as a reduction to the carrying amount of the investment.

Transactions between the investor and the joint venture and un-realized profits

A group may sell to a joint venture or purchase goods and services from them. This trading will result in the recognition of receivables and payables in the individual company accounts. Such inter-company balances and transactions are **not** eliminated in the consolidated financial statements. In the consolidated statement of financial position, balances with a joint venture are reported separately from other receivables and payables.

A joint venture is **not** part of the group. It is, therefore, appropriate to report amounts owed to the group by the joint venture as assets and amounts owed to the joint venture by the group as liabilities.

Any unrealized profits are eliminated to the extent of the investor's interest in the joint venture.

However, unrealized losses are not eliminated if the transaction provides evidence of an impairment in the value of the asset which has been transferred.

Treatment of Dividends received from a joint venture

In the consolidated statement of financial position, ensure that dividends payable/receivable are fully accounted for in the separate companies' books and then include the receivable in the consolidated statement of financial position for dividends owed to the *group* from a joint venture. Therefore, do not cancel inter-company balance for dividends.

In the consolidated statement of profit or loss, do **not** include dividends from a joint venture as these are instead credited (reduced from) in the "investment in the joint venture" assets account within the investor's statement of financial position.

The parent's share of the joint venture's profit after tax (hence before dividends) is already included under equity accounting.

Part (b): Mutoni Consolidated statement of cash flows

Cash Flows from Operating activities	FRW Million
Net profit before tax (in P&L)	398
Adjustments for:	
Finance cost	13
Amortization of other intangible assets (Note 2 & W6)	13
Depreciation of PPE (Note 6 and W2)	150
Investment income (in P&L)	(18)
Increase in provision for restructuring costs (Note 2) (20 - 10)	10
Loss on disposal of PPE (in P&L)	5
Profit share from joint venture (in P&L)	(50)
Operating cash flows before changes in working capital	521
Increase in inventories (480 - 453)	(27)
Increase in trade receivables (453 - 360)	(93)
Increase in trade payables (703 - 649)	54
Cash generated from operations	455
Interest paid (20 + 13 - 27)	(6)
Income taxes paid (Note 5) (100 + 127 - 20 for joint venture - 121)	(86)
Net cash from operating activities	363
Cash Flows from Investing activities	
Disposal of 20% shareholding in Katwaza Ltd (cash element) (Note 1)	50
Investment income received (in P&L)	18
Purchase of PPE for cash (W1)	(253)
Sale of PPE for cash (W3)	264
Purchase of investment in Joint venture - cash paid (Note 3)	(17)
Purchase of other intangible assets (W6)	(37)
Net cash from investing activities	25
Cash Flows from Financing activities	
Dividends paid to parent shareholders ((87 (in SOCIE) + 47 (opening balance) - 53 (closing balance))	(81)
Dividends paid to non-controlling interests (W5)	(266)
Repayment of long-term loans (143 - 124)	(19)
Net cash from Financing activities	(366)
Net decrease in cash and cash equivalents in the year	22
Plus: Cash and cash equivalents at start of year (1 July 2020) (Cash balance plus highly liquid investments- see Note below)	118
Cash and cash equivalents at end of year (30 June 2021) (Note 4 & W4) (Cash balance plus highly liquid investments- see Note below)	140

Note on cash & cash equivalents: All short-term investments (in the current assets) and the corporate bonds (under other investments in the non-current assets) qualify as "cash equivalents" as these are highly liquid and mature in not more than 90 days from the reporting dates

Workings (all in FRW million)	
W1: PPE - Cost/valuation	FRW Million
Opening balance (June 2020)	1,400
Loss on property revaluation	(8)
Additional PPE purchased in the year - for cash (Note 6)	253
Less: PPE "cost" transferred to acquire investment in joint venture	(138)
Less: PPE "cost" disposed (difference between total in Note 6 and cost of PPE transferred to joint venture)	(327)
Closing balance (June 2021)	1,180

W2: Accumulated depreciation for PPE	FRW Million
Opening balance (June 2020)	200
Less: PPE "accumulated depreciation" transferred to acquire investment in joint venture	(5)
Less: Accumulated depreciation of PPE disposed of (difference between totals in Note 6 and depreciation of PPE transferred to joint venture)	(58)
Depreciation charge for the year (Note 6)	150
Closing balance (June 2021)	287

W3: Disposal of PPE	FRW Million
Cost/Valuation of PPE disposed of (see W1 above)	327
Less: Accumulated depreciation of PPE disposed of (see W2 above)	(58)
Loss on disposal of PPE (in P&L)	(5)
Balancing figure = Proceeds on disposal of PPE in cash	264

W4: Other Investments	FRW Million
Opening balance (June 2020)	-
Plus: New shares held in Diane plc (in a share exchange) on disposal of Katwaza (Note 1)	200
Investments in corporate bonds (to be classified as "cash equivalents in year ending 30 June 2021" as these mature within 3 months from 30 June 2021 - Note 4)	23
Closing balance (June 2021)	223

W5: Non-controlling interests (in Equity)	FRW Million
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Opening balance (June 2020)	380
NCI share of profits for the year	50
Plus: Transfer of fair value of Katwaza's net assets on part disposal of shareholdings without loss in control (Note 1 & 2)	56
<i>Balancing figure = Dividends paid to NCI in the year</i>	266
Closing balance (June 2021)	220

W6: Goodwill & other intangible assets	FRW Million
Opening balance (June 2020)	96
Less: Amortization of other intangible assets (Note 2)	(13)
<i>Plus: Purchase of other intangible assets (Note 2) - as a balancing figure</i>	37
Closing balance (June 2021)	120

W7: Investment in Joint Venture (Nkusa Ltd)	FRW Million
Opening balance (June 2020)	-
Plus: New investment in Joint venture (Note 3)	150
Profit share from a joint venture (in P&L)	50
Less: Share of income tax expense attributable to Joint venture (Note 5)	(20)
Less: Loss share on property revaluation in a joint venture (SOCIE)	(3)
Closing balance (June 2021)	177

Movement of transfer within Group reserves	FRW Million
Fair Value of disposal proceeds comprised of:	
Share-holding in Diane plc (at their market value)	200
Cash proceeds	50
	250
Less: Fair value of Katwaza net assets transferred to NCIs (20% of net assets at their fair value on 30 June 2021) (Note 1)	56
Gain on transfer (recognized under "other reserves" in Group Equity)	194

SECTION B

QUESTION TWO: PCB GROUP

Marking Guide

Part (a): Related party disclosure requirements regarding:	Marks
(i) Transactions between PCB, Nkusi Ltd and Kabera Ltd	
1 mark is awarded for each reasonable and valid related party disclosure well developed and specific to the information within the scenario provided in the question (only 0.5 marks for any reasonable disclosure not linked to the information in the scenario)	5
(ii) PCB's Retirement benefit scheme	
1 mark is awarded for each reasonable and valid related party disclosure well developed and specific to the information within the scenario provided in the question (only 0.5 marks for any reasonable disclosure not linked to the information in the scenario)	5
Part (b) Deferred Tax implications	
(i) 1 mark (up to a maximum of 5 marks) is awarded for every valid and reasonable explanation for the IASB's rationale for the recognition of the deferred tax liability for all temporary differences on a "full provision basis". This includes:	5
1 mark for recognizing the need to apply full provision for the recognition of deferred tax in the individual financial statements of an entity	
1 mark for recognizing the need to apply full provision for the recognition of deferred tax in the consolidated financial statements	
(ii) 1 mark for each reason explaining IAS 12 "Income Taxes" requirement to provide for deferred tax on revaluation of assets and fair value adjustments on the date of the business combination (up to maximum of 6 marks)	6
Part (c) Calculation of deferred tax in the PCB Consolidated financial statements on the acquisition of Mutesi Ltd	
Each line is awarded 0.5 marks for a correct calculation of the temporary difference initially picked as separate line items of the net assets of Mutesi Ltd (including a correct total for the net temporary differences) - a maximum of 4 marks	3.5
A correct calculation of the deferred tax (using the net cumulative temporary differences and the tax rate of 30%)	0.5
Total marks for Question two	25

Model Answer

Part (a)

Transactions between PCB, Nkusi Ltd and Kabera Ltd

IAS 24 “Related party Disclosures” does not require the disclosure of related party transactions involving a parent and its subsidiaries as a note in the consolidated financial statements as these are considered intra-group transactions and balances that are eliminated on consolidation.

Therefore, the transactions between PCB and Nkusi Ltd involving the sale of office equipment and lease of a factory building do not require a disclosure note in the PCB consolidated financial statements for the year ended 30 June 2021 as these are eliminated on consolidation as intra-group transactions and balances whether or not these are contracted at normal market rates.

However, IAS 24 requires the disclosure in the separate financial statements of PCB and Nkusi Ltd of the amount of any transactions, including intra-group transactions and any intra-group balances that are eliminated on consolidation arising from the sale of the office equipment and lease of the factory building/

IAS 24 does not address the situation where an entity becomes or ceases to be a subsidiary during the year. However, best practice would seem to indicate that the transactions between related parties will be disclosed to the extent that they are undertaken after 1 April 2021 when Nkusi Ltd was not part of the PCB group.

According to IAS 24, disclosure should be made of transactions between related parties if they were related at any time during the financial period. Therefore, any transactions between PCB and Nkusi Ltd during the period when PCB had significant influence over Nkusi Ltd (from 1 April 2021 to 30 June 2021) will be disclosed as related party transactions in the PCB consolidated financial statements for the year ended 30 June 2021 with the transactions prior to 1 April 2021 eliminated on consolidation.

There is no related party relationship between PCB and Kabera Ltd as the sale of shareholding in Nkusi Ltd by PCB to Kabera Ltd is simply a business transaction unless they have been a subordinating of interests when entering into the transaction due to influence or control (e.g. if both PCB and Kabera Ltd are under same control by another parent company).

PCB's Retirement benefit scheme

In accordance to IAS 24, retirement benefit schemes funded for the benefit of the reporting entity's employees are related parties of the entity and IAS 24 gives an example of the rendering or receipt of services as a situation which could lead to the related party disclosure requirement.

The payment of contributions into the retirement benefit scheme involves the transfer of resources which has a degree of flexibility attached to the arrangement even though IAS 19 "*Employee Benefits*" attempts to regulate the accounting treatment for retirement benefit contributions.

Therefore, under IAS 24, PCB Group's contributions of Frw 15.2 billion paid into the retirement pension scheme for its employees may have to be disclosed in the notes to the financial statements of the PCB Group and this will depend upon the nature of the pension plan and whether or not PCB Group controls the retirement pension scheme.

However, as a requirement in IAS 24, PCB Group must disclose the other transactions (other than the cash contributions) made with the retirement benefit scheme including the transfers of non-current tangible assets of Frw 9.5 billion and a recharge of administrative costs of Frw 2.85 billion.

Under IAS 24, the pension scheme's investment managers will not normally be considered a related party of the reporting sponsoring company and it does not follow that related parties of the pension scheme are also the company's related parties. Hence PCB Group is not considered a related party to the investment manager of the retirement pension scheme implying no related party relationship involving the investment manager will have to be disclosed in the financial statements of PCB Group.

However, a related party relationship will arise if it can be demonstrated that the investment manager of the PCG group retirement benefit scheme is able to exercise significant influence over the financial and operating decisions of PCB Group through his position as non-executive director. Directors under IAS 24 are deemed to be related parties.

If the Investment manager is considered a related party based on his role as a non-executive director of the PCB group, then the fees paid to the investment manager of Frw 23,750,000 for professional services rendered to PCB Group should be disclosed in the PCB Group financial statements despite these being immaterial in monetary terms to PCB Group.

Materiality is looked at in the context of its significance to the other related party in which case it is possible that the fees of Frw 23,750,000 will be material to the investment manager.

In addition, in accordance with IAS 24, PCB Group must disclose key management personnel compensation in their totals and by category of the management personnel. Therefore, any amounts included in the contributions paid of Frw 15.2 billion into the retirement benefit scheme relating to members of PCB Group senior management personnel (including executive directors) should be disclosed in the notes to the financial statements of PCB Group for the year ended 30 June 2021.

Part (b)

(i) Why a full provision method is applied in IAS 12 for recognition of deferred tax

When an entity recognizes an asset, it is inherent that the carrying amount of the asset will be recovered in the form of economic benefits in the future periods. If the carrying amount of the recognized asset exceeds its tax base then the amount of the taxable economic benefits will exceed the amount allowed for tax purposes. This will then result into a taxable temporary difference which will result in a future tax liability hence it is probable that economic benefits will flow from the entity in form of tax payments in future as a result of the related asset.

Therefore, IAS 12 “Income Taxes” requires the recognition of all deferred tax liabilities with certain exceptions while the partial provision would not meet this criterion. There are further problems associated with the partial provision as below:

- The partial provision method is dependent upon future events and the intentions of management which means deferred tax liabilities will only be recognized based on the future plans of the company for that asset that creates the temporary differences. This is contrary to the conceptual framework for financial reporting which defines assets and liabilities in relation to past events (not future events) and states that management’s intentions alone do not give rise to assets and liabilities
- There are variations in practice in the application of the partial provision method for example over the fair value adjustments made in the “purchase method” of accounting applied in the consolidation of group financial statements where the method allows some companies to provide for deferred tax on the fair value adjustments while other companies do not.
- The partial provision method is not internationally acceptable and it is applied in a small number of countries while the global trend has moved to the “full provision” of deferred tax particularly countries that adopt a conceptual framework similar to the IASB’s conceptual framework for financial reporting. PCB Group operates with subsidiaries, associates and joint ventures based in countries that comply to IFRSs and hence these countries will require entities under the PCB Group to prepare their financial statements using the IFRSs with deferred tax liabilities recognized on a full provision basis. This will also certainly be the requirement for the financial statements for the PCB Group as a requirement

of the stock market regulations recognized in Rwanda as Rwanda adopts IFRSs in the preparation of financial statements.

Part (b) (ii)

The matter to consider is whether fair value adjustments in the purchase method of accounting as applied in the consolidation of financial statements give rise to deferred tax where the full provision should be applied. There are arguments that the full provision for deferred tax should not be provided on fair value adjustments arising on the consolidation of a subsidiary because these adjustments are made as a consolidation entry only and not required in the individual financial statements of the subsidiary. In addition, these fair value adjustments in practice are rarely taxable or tax deductible which implies they are permanent differences rather than temporary differences and hence do not affect the tax burden of either the subsidiary or the group.

It is further argued that providing for deferred tax on fair value adjustments is not an allocation of an expense but can be used as a smoothing device to smoothen the profits of the group.

Finally, among the arguments against recognition of deferred tax is the concept that the difference between the carrying value of the net assets acquired and their fair values is “Goodwill” and since goodwill is a mere residual subsuming all differences including the temporary differences no deferred tax is therefore required.

The arguments in favor of recognition of deferred tax are conceptual by nature. If the net assets of the acquired subsidiary are shown in the group accounts at fair value, then this will affect the post-acquisition earnings of the group. For example, an increase in the inventory value by (say) Frw 100m will result in a profit being reduced by Frw 100m in the post-acquisition period. Therefore, it seems consistent to exclude the tax on these profits from the post-acquisition period also.

Additionally, since an acquisition gives rise to no tax effect, the effective tax rate in the profit or loss should not be distorted as a result of the acquisition of the subsidiary.

Other arguments in favor of providing for deferred tax in the consolidated financial statements, argue that deferred tax should be provided on assets purchased in an acquisition of a subsidiary as a “valuation adjustment”. If the asset had been purchased in an arm’s length transaction (for example inventory), then the cost of purchasing the asset would have been totally tax deductible.

As this is not the case, then the asset is worth less to the company because it is not tax deductible. Therefore, deferred tax should be provided as an adjustment to reflect the reduction in the true value of the asset.

The revaluation of a non-current asset can be seen as creating a further temporary difference because it reflects an adjustment of depreciation which is itself a temporary difference. The revaluation is not seen as a reversal of previous depreciation but rather that simply the remaining life of the asset will be measured at a different amount in the consolidated accounts. The additional depreciation charge due to the fair value adjustment has no tax equivalent and it would be incorrect to make any tax adjustments in regard to the additional depreciation charge. Consequently, there are no deferred tax implications arising on the additional depreciation created by the revaluation of the non-current asset. For the fair value adjustments, it can be argued that deferred tax is a valuation adjustment and while a revaluation does not directly give rise to a tax liability, the tax status of the revalued asset is not the same as the tax status of an asset carried at historical cost and therefore a provision for deferred tax should be made in order to reflect the true after-tax value of the revalued asset.

Part (c): Calculation of “Deferred tax liability” in the consolidated financial statements of the PCB Group arising on the acquisition of Mutesi Ltd on 30 June 2021:

	Fair Value	Tax Base	Taxable Temporary Difference
	FRW000	FRW000	FRW000
Buildings	450,000	90,000	360,000
Plant & Equipment	36,000	13,500	22,500
Inventory	111,600	102,600	9,000
Trade receivables	99,000	99,000	-
Retirement benefit liability	(54,000)	-	(54,000)
Current Liabilities	(94,500)	(94,500)	-
	548,100	210,600	337,500
Deferred tax liability (in FRW000): 30% x 337,500			101,250

QUESTION THREE: MUHANGA PLC

Marking Guide

Part (a): Reportable segments and segmental information for Muhanga plc under IFRS 8 “Operating Segments”	
Up to 1 mark is awarded for each element of the definition of an "operating segment “made correctly in accordance with IFRS 8 "Operating Segments" (up to a maximum of 2 marks)	2
Up to 1 mark is awarded for each element of the criteria for determining the quantitative threshold of a reportable segment in accordance with IFRS 8 "Operating Segment" (up to a maximum of 2 marks)	2
In addition to marks allocated above, there will be up to 1 mark for any relevant and valid discussion (excluding the calculations) of the principles in IFRS 8 “Operating Segments” for the determination of a company’s reportable operating segments and the application of these accounting principles by Muhanga plc to determine its reportable segments on 30 June 2021 after the sale of Ngabo Ltd and the purchase of the radio station (to a maximum of 6 marks)	6
There will be 0.5 marks awarded for each correct line making up an appendix of a separate computation of the quantitative threshold benchmarks for Muhanga plc "after the sale of Ngabo Ltd" with a computational assessment of the segments as reportable segments (these assessment can either be combined within the same appendix/schedule of the computations or can be separated from the main computation) - a maximum of 5 marks including a conclusion of the segments that are reportable segments based on quantitative measurements	5
Part (b): Preparation of the individual entity’s statements of financial position after the proposed reorganization plan	
Award 0.5 marks for "each line item" (not the sub/other totals) correctly making up the statement of financial position taking into account the accounting impact of the re-organization plan (separately for each of the three companies including Muhanga plc, Innocent Ltd and Gatera Ltd) including the accounting treatment with a correct "double-entry accounting" for every required adjustment arising from the re-organization plan. All these will be up to a maximum of 10 marks	10
Total marks for Question three	25

Model Answer

Part (a): Reportable segments and segmental information for Muhanga plc under IFRS 8 “Operating Segments”

IFRS 8 “Operating Segments” defines an operating segment as a component of an entity:

- That engages in business activities from which it may earn revenues and incur expenses including revenues and expenses relating to transactions with other components of the same entity; and
- Whose operating results are reviewed regularly by the entity’s chief operating decision makers to make decisions about resources to be allocated to the segment and to assess its performance; and
- For which discrete financial information is available

IFRS 8 requires an entity to report financial and descriptive information about its reportable segments aligned to the internal reports provided by the chief operating decision makers in form of disclosure information to enable users to evaluate the nature and financial effects of the types of business activities in which the entity engages and the economic environments in which it operates.

Reportable segments are operating segments that meet specified quantitative threshold criteria:

- The reported revenue, from both external customers and inter-segment sales or transfers, is 10% or more of the combined revenue, internal and external, of all operating segments; or
- The absolute measure of its reported profit or loss is 10% or more of the greater, in absolute amount of (i) the combined reported profit of all operating segments that did not report a loss, and (ii) the combined reported loss of all operating segments that reported a loss; or
- Its assets are 10% or more of the combined assets of all operating segments.

If the total external revenue reported by operating segments constitutes less than 75% of the entity’s revenue, additional operating segments must be identified as reportable segments even if they do not meet the quantitative thresholds until at least 75% of the entity’s revenue is included in reportable segments. There is no precise limit to the number of segments that can be disclosed.

In the case of Muhanga plc, the clustering of the subsidiaries into segments prior to the purchase of the radio station is satisfactory as long as the subsidiaries are similar in terms of the factors defined for business segments i.e. satisfies the definition criteria for operating segments under IFRS 8.

Form the analysis in the “appendix” below, after the sale of Ngabo Ltd, all the remaining segments except Bosco Ltd satisfy the 10% threshold tests and hence these are reportable segments. In addition, the revenue from external sales for the qualifying reportable segments at 97% of the total external sales pass the 75% test

as required by IFRS 8. Therefore, Muhanga plc is required to provide segmental information in its financial statements as required by IFRS 8.

In addition, although the property letting segment of Muhanga plc does not earn most of its revenue from sales to external customers (Frw 585 million are sales inter-segmental sales compared to Frw 540 million as external sales), it will still be reported as a separate segment as it passes the 10% quantitative threshold.

On the sale of Ngabo Ltd, the vehicle leasing segment becomes quite small. In the assessment of the quantitative thresholds, Bosco Ltd the remaining subsidiary operating the vehicle leasing segment will fail the 10% threshold tests in respect of revenue, profit/loss and assets based on the remaining segments. Therefore, on the basis of the 10% thresholds, Bosco Ltd and the vehicle leasing segment will be excluded as a reportable segment and only shown.

However, IFRS 8 allows Muhanga plc to disclose a business segment separately despite not meeting the 10% quantitative threshold as long as it is reported internally and it is a distinguishable component of Muhanga plc providing products and services which are subject to risks and rewards. Hence Bosco Ltd and therefore the vehicle leasing component could be a reportable segment although because of its relatively small size, consideration could be made of aggregating the vehicle segments (sales and leasing) as long as they report to the same chief operating decision maker within Muhanga plc.

It is likely that the radio station should not be included in the insurance segment as it is unlikely that they will exhibit similar financial performance or economic characteristics. It is likely that most of the revenue from the radio station will be external and as it passes the 10% threshold test for segment assets (at 13% of combined assets as seen in appendix below), it should be shown as a separate segment in future financial statements.

Appendix		
All figures rounded to FRW 000		
Quantitative threshold benchmarks "after the sale of Ngabo Ltd" as picked from the figures provided:	FRW 000	%
(1) Total combined revenue (external & inter-segmental revenue)	2,133,000	
(2) Absolute measure of reported profits and losses		
(i) Total reported profit - segments that did not report a loss	135,000	
(ii) Total reported loss - segments that reported a loss	153,000	
(3) Total combined assets (including assets in Radio station)	2,151,000	
Assessment of the reportable segments including:	Amount	%
	FRW 000	
Vehicle Leasing: Bosco Ltd		

- Segment revenue (external & internal)	72,000	3%
- Absolute measure of segment reported loss	9,000	7%
- Segment assets	72,000	3%
Vehicle sales: Gatera Ltd		
- Segment revenue (external & internal)	315,000	15%
Vehicle sales: Innocent Ltd		
- Segment revenue (external & internal)	225,000	11%
- Absolute measure of segment reported loss	36,000	27%
Property Letting		
- Segment revenue (external & internal)	1,125,000	53%
Insurance		
- Segment revenue (external & internal)	396,000	19%
Radio station (separately from the Insurance segment)		
- Segment assets	270,000	13%
Reported revenue from external sources - for reportable segments passing the 10% threshold (assess the 75% requirement) - all except for Ngabo (sold) and Bosco (is below threshold)	1,395,000	97%

(b) Statements of Financial Position at 30 June 2021 (after making provisions for the re-organization)

	Muhanga plc	Gatera Ltd	Innocent Ltd
	FRW 000	FRW 000	FRW 000
Non-current assets			
Tangible non-current assets at depreciated cost/valuation (Note 3)	54,000,000	16,650,000	3,150,000
Cost of Investment in Gatera	11,700,000		
Cost of Investment in Innocent (Note 1)	-	8,820,000	
Loan asset (Note 2)	8,820,000		
Current assets (Notes 1, 2, 3 & 4)	16,200,000	2,070,000	11,430,000
Total Assets	90,720,000	27,540,000	14,580,000
Equity and Liabilities			
Equity and Reserves			
Share capital	12,600,000	6,300,000	3,150,000
Retained earnings (Notes 1, 3 & 4)	70,020,000	17,550,000	900,000

	82,620,000	23,850,000	4,050,000
Non-current liabilities			
Long-term loan (Note 2 & 3)	450,000	540,000	9,360,000
Current Liabilities			
Trade payables	7,650,000	900,000	1,170,000
Dividend payable (Note 4)		2,250,000	
Total Equity and Liabilities	90,720,000	27,540,000	14,580,000

(1) Gatera Ltd's purchase of shareholding in Innocent Ltd	FRW 000	FRW 000
<i>(i) In Gatera's financial statements</i>		
Debit: Investment in Innocent Ltd (at Fair Value of purchase consideration)	8,820,000	
Credit: Cash (under current assets)		8,820,000
<i>(ii) In Muhanga's financial statements</i>		
Debit: Cash (under current assets)	8,820,000	
Credit: Investment in Innocent Ltd (derecognize at the carrying value)		8,550,000
Credit: Retained Earnings (profit on disposal of investment in Subsidiary Innocent Ltd - as the difference)		270,000
(2) Muhangi plc's long-term loan to Innocent Ltd		
<i>(i) In Muhanga's financial statements</i>		
Debit: Investment in Loan assets (Loan receivable)	8,820,000	
Credit: Cash (under current assets)		8,820,000
<i>(ii) In Innocent's financial statements</i>		
Debit: Cash (under current assets)	8,820,000	
Credit: Long-term Loan		8,820,000
(3) Transfer of Land from Innocent Ltd to Gatera Ltd		
<i>(i) In Gatera's financial statements (as the buyer of the land)</i>		
Debit: Tangible non-current assets (recognize purchased "Land")	1,350,000	

Credit: Long-term loan (for mortgage taken over by Gatera Ltd)	540,000
Credit: Cash (under current assets) - for difference paid in cash	810,000
<i>(ii) In Innocent's financial statements (as the seller of the land)</i>	
Debit: Long-term loan (for mortgage transferred to Gatera Ltd)	540,000
Debit: Cash (under current assets) - for difference received in cash	810,000
Credit: Tangible non-current assets (derecognize sold "Land at carrying value)	900,000
Credit: Retained earnings (profit on sale of land)	450,000
(4) Dividends payable by Gatera Ltd to Muhanga plc	
<i>(i) In Gatera's financial statements</i>	
Debit: Retained earnings	2,250,000
Credit: Dividend payable (under current liabilities)	2,250,000
<i>(ii) In Muhanga's financial statements</i>	
Debit: Dividend receivable (under current assets)	2,250,000
Credit: Retained earnings	2,250,000

QUESTION FOUR

Marking Guide

PUBLIC SECTOR ACCOUNTING FOR EMPLOYEE BENEFITS (USING IPSAS 39 "EMPLOYEE BENEFITS")

Part (a) (i): Accounting treatment for “State plans” and “Insured Benefits” related to retirement benefit plans under IPSAS 39 "Employee Benefits"	Marks
Up to 1 mark is awarded for a correct explanation of the accounting treatment of the “State plans” and “Insured Benefits” related to retirement benefit plans within the financial statements of the reporting entity (up to a maximum of 5 marks). The maximum marks here include:	5
Up to 1 mark for correctly explaining how a retirement benefit plan qualifies to be classified as a "defined contribution plan" in accordance with IPSAS 39; and/or	
Up to 1 mark for correctly explaining how a retirement benefit plan qualifies to be classified as a "defined benefit plan" in accordance with IPSAS 39; and/or	
Part (a) (ii): Key accounting issues in the determining the method of accounting for retirement benefits in respect of defined benefit plans in accordance with IPSAS 39 "Employee Benefits"	
For each correctly explained issue, award up to 1 mark (but a 0.5 mark if the student only identifies the issue without any explanation of why it is an issue to consider) and award 1 mark for a correct approach provided by IPSAS 39 – giving a total of 2 marks per issue with its related IPSAS 39 approach. In line with the question, marking will be restricted to ONLY the five (5) best explained issues by the student (giving a maximum of 10 marks for part (a) (ii)).	10
Part (b): Key disclosures to be made by the Republic of Rwanda with their justification regarding public debt that should be reported in the government’s annual financial statements	
There are 2 marks for each well explained disclosure (up to a maximum of 10 marks) broken down for each point to include:	10
Up to 1 mark for each valid disclosure that is well explained (marks should be allocated to a maximum of 5 disclosures)	
Up to 1 mark for the correct justification of the disclosure (marks should be allocated to a maximum of justification for 5 disclosures)	
Total marks for Question four	25

Model Answer

Part (a) (i)

IPSAS 39 “Employee Benefits” accounting for State plans and Insured Benefits

State plans – classification in the financial statements

State plans are established by legislation to cover all entities (or all entities in a particular category, for example, a specific industry) and are operated by national, state, or local government or by another body (for example, an agency created specifically for this purpose).

Entities covered by state plans account for those plans as either defined contribution or defined benefit plans. The accounting treatment depends upon whether the entity has a legal or constructive obligation to pay future benefits. If an entity’s only obligation is to pay the contributions as they fall due, and the entity has no obligation to pay future benefits, it accounts for that state plan as a defined contribution plan.

A state plan may be classified as a defined contribution plan by a controlled entity. However, it is a rebuttable presumption that the state plan will be characterized as a defined benefit plan by the controlling entity. Where that presumption is rebutted the state plan is accounted for as a defined contribution plan.

Insured Benefits – classification in the financial statements

In an arrangement of “Insured Benefits”, an entity will pay insurance premiums to fund a post-employment benefit plan.

The entity shall treat such a plan as a defined contribution plan unless the entity will have (either directly or indirectly through the plan) a legal or constructive obligation either:

- 1) To pay the employee benefits directly when they fall due; or
- 2) To pay further amounts if the insurer does not pay all future employee benefits relating to employee service in the current and prior periods.

If the entity retains such a legal or constructive obligation, the entity shall treat the plan as a defined benefit plan. The entity:

- 1) Accounts for a qualifying insurance policy as a plan asset; and
- 2) Recognizes other insurance policies as reimbursement rights.

Part (a) (ii)

The following key issues are important in determining the method of accounting for retirement benefits in respect of defined benefit plans and how IPSAS 39 “Employee Benefits” addresses these issues:

1. The accounting objective: the issue is whether the accounting objective should be to view employee benefits as an operating expense and seek to provide for the projected cost over the years of employment thus applying the matching concept and focusing on the reporting entity’s statement of surplus or deficit or to concentrate on the statement of financial position and use the current values of the retirement plan.

IPSAS 39 approach: IPSAS 39 concentrates on a statement of financial position approach in accounting for employee benefits and focuses on the use of current values. The surplus or deficit in the defined retirement benefits fund is determined annually with assets being measured at their fair values at the reporting date while the fund liabilities are measured on an actuarial basis using the projected unit credit method. The net amount is presented in the employer's statement of financial position as an asset or liability.

2. The determination of the expense: the issue is to determine what method to be used by the entity in the recognition and measurement of the employee benefit expense. The question is whether the entity should use a cash basis or accrual basis or a method based upon a funding objective whereby assets are built up in the scheme.

IPSAS 39 approach: the accounting standard applies the use of accrual accounting in the determination of the employee benefit expenses in the surplus or deficit with the employee expenses recognized when the entity receives the employee services during the reporting period and the service costs are measured using the projected unit credit method.

3. Recognition of the plan assets: the question arises as to whether the plan assets should be recognized on the employer's statement of financial position as if the assets "belong" to the company. This premise is often questionable in law and in terms of economic reality.

IPSAS 39 approach: Plan assets in a defined retirement benefit scheme should be recognized as plan assets on the employer's statement of financial position as these are resources set aside by the entity to use in the settlement of its present obligations towards the employees' retirement plan. Though the plan assets may be managed through a separate entity, these are economic resources available to the entity to settle the employee retirement obligations when they fall due.

4. Valuation of the plan assets: The issue to address is the value that the plan assets should be measured with in the financial statements of the entity at the reporting date with a view of whether to use the historical cost measure or the fair value measure.

IPSAS 39 approach: the accounting standard requires the application of the fair value measure for the plan assets in the financial statements of the employer at the reporting date taking into account the investment return earned on the plan assets at the reporting date.

5. Measurement of plan liabilities: the issue is how to measure the plan liabilities in the employer's financial statements as these involve complexity and are subjective with a consideration of whether to apply the present valuation techniques or the current cost method.

IPSAS 39 approach: the accounting standard requires the plan liabilities to be measured at their present values on the reporting date in the employer's financial statements with the use of the projected unit credit method where a discount rate equivalent to the entity's high corporate bonds is applied in the determination of the present value for the plan liabilities. The present value is unwound at each subsequent reporting date to determine the finance costs to be recognized in the surplus or deficit of the entity's financial statements.

6. Frequency of actuarial valuations: the potential problems for companies is the onerous nature of the actuarial valuations and the impracticality for preparers of financial statements and therefore a question arises as to the frequency of conducting the actuarial valuations for the defined retirement benefit schemes.

IPSAS 39 approach: the accounting standard requires the actuarial valuations to be conducted at least annually and at the end of the reporting period to determine any actuarial differences that need to be recognized in the entity's financial statements. Due to the complexity of the valuation process, the actuarial valuations should be conducted with the professional support of an actuary.

7. Recognition of actuarial gains and losses: the question arises as to whether these gains and losses should be recognized in the entity's surplus or deficit or within the net assets and in addition whether such gains or losses should be spread over the service lives of the employees taking into account the volatility of the company's financial performance that may arise in the financial statements as a result of actuarial gains and losses.

IPSAS 39 approach: The actuarial gains and losses are recognized directly within the net assets of the company rather than in the company's surplus or deficit. This is done to restrict any volatility on the company's net surplus or deficit in the reporting period that would be caused by the actuarial gains and losses yet these differences arise directly from the company's primary economic activities conducted during the accounting period.

Consequently, the actuarial gains and losses are recognized in full within the net assets in the reporting periods in which they arise (rather than spreading them over the employees' service period) and the accumulated actuarial gains and losses are not released to the surplus or deficit in the subsequent accounting periods even when the retirement liabilities are settled by the company.

8. Plan amendments: the issue is how to account for implications of plan amendments in the financial performance statement of surplus or deficit where a past service cost emerges in regard to a decision to improve or award additional "new" benefits to employees for the past periods. In addition, the question to address is the measurement of the past cost arising from the plan amendment.

IPSAS 39 approach: the accounting standard requires the full recognition of the past service costs arising from plan amendments in the company's surplus or deficit immediately when the obligation arises. The obligation is measured using the projected unit credit method and included within the liabilities in the statement of financial position as an adjustment to the pension liabilities.

Note: Credit should be given where other valid issues are correctly raised and explained by the students for example the "measurement of the net finance cost"; "the discount rate to apply"; "settlement and/or curtailment of the retirement benefit scheme" etc

Part (b) - Disclosure of public debt in the government financial statements

The following disclosures relating to public debt in the government financial statements are important:

- The "TOTAL AMOUNT DUE" of the public debt showing the gross amount borrowed and amount paid in the accounting period and the portion thereof represented by borrowing of separate public entities of the government. This helps evaluate the level of debt borrowed and balance held by each public sector within the total borrowings of the country.

- Amount of debt held in foreign currencies and the exchange rates used in the valuation of the debt. This helps assess the level of volatility of the debt denominated in foreign currencies compared to debt in local currency due to effects of changes in exchange rates.
- New borrowings in the financial year. This will help to determine the types of lenders, terms of the issues and loan agreements and the impact on the forecast cash flows expected from the amounts of future loan repayments.
- Types and terms of loan and other instruments where types will include issued broken down between various major classifications such as treasury bills, notes and government bonds while terms will include information relating to maturities, callable features etc. This will help in assessing the impact on the future cash flows and assets of the country in respect of the timing of the settlement within a short, medium and long-term period
- The bases of measurement and any changes since the prior financial year report. The use of different measurement bases can produce significantly different results for example the market value of the bonds can fluctuate widely with changes in interest rates. This helps determine the impact of the change in the measure of the debt on the financial position of the public sector and/or the country.
- Principal repayments of the debt made during the reporting period and the means used to finance the principal repayments. This will help assess the sustainability of repayment of the principal repayments over the remaining duration of the loan.
- Restructured debt including results of any public debt re-negotiations that occurred during the reporting period. This will help to evaluate the impact on country debt policy regarding the terms and conditions of the renegotiated debt.
- Disclosure of the debt service costs which will include interest payments, other administrative and commission costs paid during the reporting period. These will help assess the impact of cost of the public debt on the cash flows of the government as these tend to be routine and fixed cash outflows.
- Risk assessment. Information would be provided to describe potential vulnerabilities to fluctuations in interest rates, currency values, or other factors that affect repayment costs. Debt pegged to floating interest rates would be disclosed where applicable. Such Information will help assess actions taken by the government in derivatives markets, such as interest rate and currency swap agreements, in order to limit such vulnerabilities.
- Significant legal requirements and restrictions should be appropriately disclosed. This can include among others constitutional and other legal limits on the amount of public debt or debt service costs; limits on the uses of proceeds of borrowed funds; regulations specifying who may borrow on behalf of a public body; laws outlining the public bodies which are responsible for public debt incurred by others; and requirements regarding the currency in which public debt may be held or the lenders who are to be used. This information will help to assess the level to which the government has satisfied the legal requirements and restrictions relating to the debt and any potential penalties for non-compliance.

END OF MARKING GUIDE AND MODEL ANSWERS