INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS OF RWANDA

Driving Sustainable Performance

Associate of IFAC

CERTIFIED PUBLIC ACCOUNTANT

ADVANCED LEVEL 1 EXAMINATIONS

A1.3: ADVANCED FINANCIAL REPORTING

WEDNESDAY: 9 JUNE 2015

INSTRUCTIONS:

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

SECTION A

QUESTION ONE

Higa, a public limited company, operates in the manufacturing sector. Higa has investments in two other companies. The draft statements of financial position at 31 October 2014 are as follows:

Assets:	**Higa**	**Kubaho**	**Komera**
Non-current assets	Frw (million)	Frw (million)	Frw (million)
Property, plant and equipment	7,200	5,500	6500
Investments in subsidiaries			
Kubaho	6,250		
Komera	1,550	6,350	
Financial assets	1,600	105	705
	3,320	2,391	1,441
Current assets	4,475	3,405	750
Total assets	**21,075**	**15,360**	**7,955**
Equity and liabilities:			
Share capital	8,750	6,050	4,000
Retained earnings	6,200	4,650	1,750
Other components of equity	625	400	475
Non-current liabilities	4,925	3,825	750
Current liabilities	575	435	980
Total equity and liabilities	**21,075**	**15,360**	**7,955**

The following information is relevant to the preparation of the group financial statements:

(1) On 1 November 2012, Higa acquired 10% of the equity interests of Komera for a cash consideration of Frw. 1,300 million and Kubaho acquired 70% of the equity interests of Komera for a cash consideration of Frw. 6,350 million. At 1 November 2012, the identifiable net assets of Komera had a fair value of Frw. 4,950 million, retained earnings were Frw. 950 million and other components of equity were Frw. 260 million. At 1 November 2013, the identifiable net assets of Komera had a fair value of Frw. 5,750 million, retained earnings were Frw. 1,200 million and other components of equity were Frw. 350 million. The excess in fair value is due to non-depreciable land.

The fair value of the 10% holding of Higa in Komera was Frw. 1,400 million at 31 October 2013 and Frw.1,550 million at 31 October 2014. The fair value of Kubaho's interest in Komera had not changed since acquisition.

(2) On 1 November 2013, Higa acquired 60% of the equity interests of Kubaho, a public limited company. The purchase consideration comprised cash of Frw. 6,250 million. On 1 November 2013, the fair value of the identifiable net assets acquired was Frw. 9,750 million and retained earnings of Kubaho were Frw. 3,250 million and other components of equity were Frw. 275 million. The excess in fair value is due to non- depreciable land.

It is the group's policy to measure the non-controlling interest at acquisition at its proportionate share of the fair value of the subsidiary's net assets.

(3) Goodwill of Kubaho and Komera was impairment tested at 31 October 2014. There was no impairment relating to Komera. The recoverable amount of the net assets of Kubaho was Frw. 10,440 million. There was no impairment of the net assets of Kubaho before this date and any impairment loss has been determined to relate to goodwill and property, plant and equipment.

(4 Higa has made a loan of Frw. 250 million to another entity.

The loan was made on 1 November 2013 and is repayable on maturity in three years' time. Interest is to be charged one year in arrears at 3%, but Higa assesses that an unsubsidised rate for such a loan would have been 6%. The only accounting entries which have been made for the year ended 31 October 2014 are the cash entries for the loan and interest received which have resulted in a balance of Frw. 242.5 million being shown as a financial asset.

(5) On 1 November 2012, Higa acquired office building at a cost of Frw. 450 million with a 30-year estimated useful life. During the year, the property market in the area slumped and the fair value of the accommodation fell to Frw.75 million at 31 October 2013 and this was reflected in the financial statements. However, the market recovered unexpectedly quickly due to the announcement of major government investment in the area's transport infrastructure. On 31 October 2014, the valuer advised Higa that the offices should now be valued at Frw. 525 million. Higa has charged depreciation for the year but has not taken account of the upward valuation of the offices. Higa uses the revaluation model and records any valuation change when advised to do so.

(6) Higa has announced two major restructuring plans. The first plan is to reduce its capacity by the closure of some of its smaller factories, which have already been identified. This will lead to the redundancy of 800 employees, who have all individually been selected and communicated with. The costs of this plan are Frw. 45 million in redundancy costs, Frw. 20 million in retraining costs and Frw. 25 million in lease termination costs.

The second plan is to re-organise the finance and information technology department over a one-year period but it does not commence for two years. The plan results in 20% of finance staff losing their jobs during the restructuring. The costs of this plan are Frw. 50 million in redundancy costs, Frw. 30 million in retraining costs and Frw. 35 million in equipment lease termination costs. No entries have been made in the financial statements for the above plans.

(7) The following information relates to the group pension plan of Higa:

	1 November 2013 (Frw. million)	**31 October 2014 (Frw. million)**
Fair value of plan assets	140	145
Actuarial value of defined benefit obligation	150	175

The contributions for the period received by the fund were Frw. 10 million and the employee benefits paid in the year amounted to Frw. 15 million. The discount rate to be used in any calculation is 5%. The current service cost for the period based on actuarial calculations is Frw. 5 million. The above figures have not been taken into account for the year ended 31 October 2014 except for the contributions paid which have been entered in cash and the defined benefit obligation.

REQUIRED:

Group Consolidated Statement of Financial Position of Higa as at 31 October 2014. **(35 Marks)**

(b) It is the Higa group's policy to measure the non-controlling interest (NCI) at acquisition at its proportionate share of the fair value of the subsidiary's net assets. The directors of Higa have used this policy for several years and do not know the implications, if any, of changing the policy to that of accounting for the NCI at fair value. The fair value of the NCI of Kubaho at 1 November 2013 was Frw. 4,000 million. The fair value of the NCI of Komera, based upon the effective shareholdings, was Frw. 2,500 million at 1 November 2012 and Frw. 2,890 million at 1 November 2013.

REQUIRED:

Explain to the directors, with suitable calculations, the impact on the financial statements if goodwill was calculated using the fair value of the NCI. **(9 Marks)**

(c)The directors of Higa have strong views on the usefulness of financial statements after their move to international financial reporting standards (IFRSs).They feel that IFRSs implement a fair value model nevertheless that IFRSs are failing users of financial statements as they do not reflect the financial value of an entity.

REQUIRED:

Discuss the directors' views above as regards the use of fair value in IFRSs and the fact that IFRSs do not reflect the financial value of an entity. **(6 Marks)**

(Total 50 Marks)

SECTION B

Attempt two questions from this section

QUESTION TWO

KISARO a public limited company operates many of its activities overseas. The directors have asked for advice on the correct accounting treatment of several aspects of KISARO's overseas operations. KISARO's functional currency is the Rwandan Franc (Frw).

REQUIRED:

Advise the directors of KISARO on their various requests below, showing suitable calculations where necessary:

(a) KISARO has created a new subsidiary, which is incorporated in the same country as KISARO. The subsidiary has issued 80 million Shillings of equity capital to KISARO, which paid for these shares in Shilings. The subsidiary has also raised 8,000,000 Shillings of equity capital from external sources and has deposited the whole of the capital with a bank in an overseas country whose currency is the Shilling. The capital is to be invested in Shillings denominated bonds. The subsidiary has a small number of staff and its operating expenses, which are low, are incurred in Rwandan franc. The profits are under the control of KISARO. Any income from the investment is either passed on to KISARO in the form of a dividend or reinvested under instruction from KISARO. The subsidiary does not make any decisions as to where to place the investments.

REQUIRED:

Advice on how to determine the functional currency of the subsidiary. **(7 Marks)**

(b) KISARO has a foreign branch which has the same functional currency as KISARO. The branch's taxable profits are determined in Shillings. On 1 May 2013, the branch acquired a property for 480 million Shillings. The property had an expected useful life of 12 years with a zero residual value. The asset is written off for tax purposes over eight years. KISARO Ltd and the subsidiary are in the different tax jurisdictions but both pay tax at 30%. The foreign branch uses the cost model for valuing its property and measures the tax base at the exchange rate at the reporting date.

REQUIRED:

Provide an explanation (including a calculation) as to why a deferred tax charge relating to the asset arises in the group financial statements for the year ended 30 April 2014 and the impact on the financial statements if the tax base had been translated at the historical rate. **(7 Marks)**

c) On 1 May 2013, KISARO purchased 70% of a multi-national group whose functional currency was the shilling. The purchase consideration was Frw 8,000 million. At acquisition, the net assets at cost were 80,000 million Shillings. The fair values of the net assets were 88,000 million Shillings and the fair value of the non-controlling interest was 20,000 million Shillings. KISARO uses the full goodwill method.

REQUIRED:

Explain how to deal with goodwill arising on the above acquisition in the group financial statements for the year ended 30 April 2014. **(6 Marks)**

(d) KISARO took out a foreign currency loan of 400 million Shillings at a fixed interest rate of 8% on 1 May 2013. The interest is paid at the end of each year. The loan will be repaid after two years on 30 April 2015. The interest rate is the current market rate for similar two-year fixed interest loans.

REQUIRED:

Advice KISARO on how to account for the loan and interest in the financial statements for the year ended 30 April 2014. **(5 Marks)**

Additional information

KISARO has a financial statement year end of 30 April 2014 and the average currency exchange rate for the year is not materially different from the actual rate.

Exchange rates	Frw 1=Shillings
1 May 2013	10
30 April 2014	12
Average exchange rate for year ended 30 April 2014	11.2

(Total 25 Marks)

QUESTION THREE

(a) Cyerekezo Ltd owns the following properties at 1 April 2013:

Property A: An office building used by Cyerekezo Ltd for administrative purposes with a depreciated historical cost of Frw 2 million. At 1 April 2013 it had a remaining life of 20 years. After a reorganization on 1 October 2013, the property was rent to a third party and reclassified as an investment property applying Cyerekezo Ltd's policy of the fair value model. An independent valuer assessed the property to have a fair value of Frw 2·3 million at 1 October 2013, which had risen to Frw 2·34 million at 31 March 2014.

Property B: Another office building sub-let to a subsidiary of Cyerekezo Ltd. At 1 April 2013, it had a fair value of Frw 1·5 million which had risen to Frw 1·65 million at 31 March 2014.

REQUIRED:

Prepare extracts from Cyerekezo Ltd statement of profit or loss and other comprehensive income and statement of financial position for the year ended 31 March 2014 in respect of the above properties. In the case of property B only, state how it would be classified in Cyerekezo Ltd's consolidated statement of financial position.

Note: Ignore deferred tax. **(5 Marks)**

(b) (i) Komeza Ltd acquired an item of plant at a cost of Frw 800,000 on 1 April 2012 that is used to produce and package pharmaceutical pills. The plant had an estimated residual value of Frw 50,000 and an estimated life of five years, neither of which has changed. Komeza Ltd uses straight-line depreciation. On 31 March 2014, Komeza Ltd was informed by a major customer (who buys products produced by the plant) that it would no longer be placing orders with Komeza Ltd. Even before this information was known, Komeza Ltd had been having difficulty finding work for this plant. It now estimates that net cash inflows earned from the plant for the next three years will be:

Year ended:	Frw "000"
31 March 2015	220
31 March 2016	180
31 March 2017	170

On 31 March 2017, the plant is still expected to be sold for its estimated realizable value.

Komeza Ltd has confirmed that there is no market in which to sell the plant at 31 March 2014.

Komeza Ltd's cost of capital is 10% and the following values should be used:

Value of Frw 1 at:	Frw
End of year 1	0·91
End of year 2	0·83
End of year 3	0·75

(ii) Komeza Ltd owned a 100% subsidiary, Puma Ltd that is treated as a cash generating unit. On 31 March 2014, there was an industrial accident (a gas explosion) that caused damage to some of Puma Ltd's plant. The assets of Puma Ltd immediately before the accident were:

	Frw "000"
Goodwill	1,800
Patent	1,200
Factory building	4,000
Plant	3,500
Receivables and cash	1,500
	12,000

As a result of the accident, the recoverable amount of Puma Ltd is Frw 6·7 million

The explosion destroyed (to the point of no further use) an item of plant that had a carrying amount of Frw 500,000.

Puma Ltd has an open offer from a competitor of Frw 1 million for its patent. The receivables and cash are already stated at their fair values less costs to sell (net realizable values).

REQUIRED:

Calculate the carrying amounts of the assets in (i) and (ii) above at 31 March 2014 after applying any impairment losses. Calculations should be to the nearest Frw 1,000. **(20 Marks)**

(Total 25 Marks)

QUESTION FOUR

The following figures have been calculated from the financial statements (including comparatives) of Kora Ltd for the year ended 30 September 2014:

Increase in profit after taxation	80%
Increase in (Basic) earnings per share	5%
Increase in diluted earnings per share	2%

REQUIRED:

Explain why the above three measures of earnings (profit) growth for the same company (Kora Ltd) over the same period give apparently differing impressions. **(6 Marks)**

(b) The profit after tax for Kora Ltd for the year ended 30 September 2014 was Frw 15 million. At 1 October 2013 the company had in issue 36 million equity shares and Frw 10 million 8% convertible loan note. The loan note will mature in 2015 and will be redeemed at par or converted to equity shares on the basis of 25 shares for each Frw 100 of loan note at the loan-note holders' option. On 1 January 2014 Kora Ltd made a fully subscribed rights issue of one new share for every four shares held at a price of Frw 280 each. The market price of the equity shares of Kora Ltd immediately before the issue was Frw 380. The earnings per share (EPS) reported for the year ended 30 September 2013 was Frw 350. Kora Ltd's income tax rate is 25%.

REQUIRED:

Calculate the (basic) EPS figure for Kora Ltd (including comparatives) and the diluted EPS that would be disclosed for the year ended 30 September 2014. **(10 Marks)**

b) Gasanza Ltd entered into an agreement with a finance company, to lease transmission equipment for a four year period. Under the terms of the agreement, the machine was to be made available to Gasanza Ltd on 1 January 2011, when an immediate payment of Frw 2,550,000 was made, to be followed by seven semi-annual payments of an equivalent amount.

The fair market price of the machine on 1 January 2011 was Frw 16,320,000. The estimated life of this type of machine was established to be four years. The implicit rate of interest in the transaction was 6.94% payable semi-annually and the corporate tax rate applicable 30%.

Gasanza has a policy of depreciating machines of this type over a four year period on the straight line basis. Assume the lease is to be capitalized.

REQUIRED:

Show how the above transactions will be reflected in the income statements of Gasanza Ltd for each of the four years ending 31 December 2011, 2012, 2013 and 2014. **(9 Marks)**

(Total 25 Marks)

End of question paper