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: 07 JUNE 2017

INSTRUCTIONS:

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

SECTION (A)

This is a compulsory question

QUESTION ONE

Shema Ltd is a manufacturing company that operates in Nyaruguru district. Shema Ltd also manages a portfolio of investments. It owns investments in Keza Ltd located in Burera district and Safi Ltd located in Rusizi district. The following are trial balances of Shema Ltd, Keza Ltd and Safi Ltd, as at 31 May, 2017:

	Shema Ltd	**Keza Ltd**	**Safi Ltd**
	Frw '000'	Frw '000'	Frw '000'
Issued ordinary share capital	150,000	75,000	30,000
Defined benefit obligation	10,000		
Revenue	554,000	130,500	125,500
Investment income	21,000	9,500	2,500
Gains on property revaluation before tax	70,000	40,000	
Short term borrowings	23,000		
Trade Payables	27,750	14,800	5,550
Retained earnings as at 31 May 2016	18,000	20,000	3,600
	873,750	**289,800**	**167,150**
Cost of goods sold	435,000	136,600	87,000
Freehold land at cost	70,000	22,500	15,000
Buildings at net book value	11,500	25,000	7,300
Plant and machinery at net book value	29,375	40,500	12,875
Motor vehicles at net book value	4,500	9,250	2,888
Operating expenses including depreciation	84,900	10,430	12,015
Administrative costs	20,600	9,870	6,780
Finance costs	5,000	2,000	1,350
Trade receivables	30,625	18,750	6,125
Bank balance	42,410	6,850	8,482
Inventory at 31 May 2017	36,600	7,900	7,320
Investment of in ordinary shares in Keza Ltd at cost	83,000		
Investment of in ordinary shares in Safi Ltd at cost	18,000		
Interim dividend paid	1,500	-	-
Income tax expense	740	150	15
	873,750	**289,800**	**167,150**

Additional information:

1. Shema Ltd acquired 80% of the equity interests of Keza Ltd on 1 June 2015 when the retained earnings balance was Frw 15 million. The purchase consideration comprised cash Frw 83 million and the fair value of the identifiable assets acquired Frw 98 million at that date. The difference in fair value was due to non depreciable land. The fair value of the non-controlling interest (NCI) in Keza Ltd was Frw 20 million on 1 June, 2015 and goodwill had been reviewed annually for impairment and no impairment was deemed necessary.

2. At the time of business combination with Keza Ltd, Shema Ltd included in the fair value of Keza Ltd's identifiable net assets, an unrecognised contingent liability of Frw 9 million in respect of a warranty claim in progress against Keza Ltd. In September, 2016 there was a revision of the estimate of liability to Frw 6 million. The amount has met the criteria to be recognised as a provision in current liabilities in the financial statements of Keza Ltd and the revision of the estimate is deemed to be a measurement period adjustment.

3. Included in the inventory of Shema Ltd at 31 May, 2017 is an amount of Frw 20 million for goods purchased from Keza Ltd before the share disposal in note 4. This inventory had cost Keza Ltd 60% of that figure. The market value of these items of inventory is 75% of the cost to Keza Ltd

4. Shema Ltd disposed of a 35% equity interest in Keza Ltd on 28 February, 2017 for a cash consideration Frw 40 million. The remaining 45% holding had a fair value of Frw 65 million and Shema Ltd exercised significant influence over Keza Ltd following the disposal. Shema Ltd had credited revenue and debited cash for the cash consideration. All gains and losses of Keza Ltd have accrued evenly throughout the year. The disposal is not classified as a separate major line of business or geographical operation.

5. Shema Ltd acquired 60% of the equity interests of Safi Ltd one year after its incorporation on 1 June, 2016. The purchase consideration was Frw 18 million. The fair value of the NCI was calculated as Frw 5 million and goodwill of Frw 8 million was agreed as at this date. The fair value of identifiable net assets of Safi Ltd as at 30 November, 2016 was Frw 20 million. The excess of the fair value of the identifiable net assets at acquisition is due to plant which had a remaining useful life of five years at acquisition date. Due to the losses, an impairment review was undertaken on 31 May, 2017 and it was decided that goodwill had been impaired by 50%. Goodwill impairments are charged to operating expenses

6. The following information relates to Shema Ltd's pension scheme:

	Frw "000"
Plan assets at 1 June 2016	240,000
Defined benefit obligations at 1 June, 2016	250,000
Service cost for the year ended 31 May, 2017	20,000
Discount and return rate at 1 June 2016	10%
Re-measurement loss for the year ended 31 May, 2017	10,000
Past service cost on 1 June, 2016	15,000

The pension adjustments have not been accounted for the year.

7. On 31 May, 2016 Shema Ltd carried an item of plant in its statement of financial position at its revalued amount of Frw 10 million. Depreciation is charged at Frw 1.2 million per year on straight line basis. In November, 2016 the management decided to sell the plant and it was advertised for sale. By 30 November, 2016 the sale was considered to be highly probable and the criterion for the respective accounting Standard was met at this date. At that date, the plant's fair value was Frw 12.5 million and its value in use was Frw 13 million. Costs to sell the asset were estimated at Frw 200,000. On 31 May,

2017 the plant was sold for Frw 12.8 million. The transactions regarding this item of plant are deemed to be material and no entries have been made in the financial statements regarding this plant since 31 May, 2016 as the cash receipts from the sale were not received until June, 2017.

8. Shema Ltd resolved to expand into distribution network and entered into an arrangement with Rukundo Distributors Ltd (RDL) on 1 June, 2016. RDL would provide and maintain the distribution vans and Shema Ltd would take care of the warehouses. RDL is entitled to 5% of sales and 15% of gross profit of the sales involving those distribution vans. Shema Ltd has the sole responsibility for manufacturing, packaging and marketing. However, the agreement provides that key strategic sales and marketing decisions must be agreed jointly. On 1 December, 2016 Shema Ltd and RDL decided to set up a legal entity in the name of Shema Rukundo Ltd (SRL) with equal shares and voting rights. RDL continued to provide distribution vans but without the commission. Shema Ltd continued to manufacture, package and market. The sales and cost of sales during the period to 31 May, 2017 were Frw 45 million and Frw 14 million respectively. The whole of the sales proceeds and the costs of sales were recorded in Shema Ltd's financial statements with no accounting entries made for SRL or amounts due to RDL. Shema Ltd currently funds the operations. Assume that the sales and costs accrued evenly throughout the period and that all transactions relating to SRL had been in cash.

REQUIRED:

(a) Prepare the group consolidated statement of profit or loss and other comprehensive income of Shema Ltd for the year ended 31 May, 2017. (Assume a corporate income tax rate of 30%) **(30 Marks)**

(b) Prepare the group consolidated statement of financial position of Shema Ltd as at 31 May, 2017. **(20 Marks)**

(Total 50 Marks)

SECTION (B)

Attempt two questions from this section

QUESTION TWO

Rwanda enjoys strong economic growth and high rankings in the World Bank's Ease of Doing Business Index. The Government of Rwanda (GOR) has undertaken a series of pro-investment policy reforms intended to improve Rwanda's investment climate and increase clarity and transparency. These policies include indicating that the laws relating to companies are compliant to international standards. This business-friendly reputation has presented a number of investment opportunities and has seen companies like Ndabarinzi Ltd make investments in the communications technology industry. You are the newly recruited accountant of Ndabarinzi Ltd and you have been presented with the following draft statement of profit or loss and other comprehensive income as well as the draft statement of financial position for the year ended 31 May, 2017.

Draft statement of Profit or Loss and other Comprehensive income

	2017	**2016**
	Frw '000'	Frw '000'
Revenue	1,313,730	1,676,000
Cost of sales	(1,053,000)	(1,404,000)
Gross profit	260,730	272,000
Other income	60,000	80,000
Distribution costs	(111,000)	(148,000)
Administrative expenses	(78,600)	(104,800)
Other operating costs	(56,850)	(75,800)
Finance costs	(47,010)	(62,800)
Profit before tax	27,270	(39,400)
Income tax expenses	(96,450)	(61,040)
Profit/ (loss) after tax	(69,180)	(100,440)
Other comprehensive income:		
Gains on property revaluation	28,200	38,400
Re-measurement of defined benefit pension plans	16,890	27,120
Income tax relating to items that will not be reclassified	(7,950)	(22,400)
	37,140	43,120
Items that may be reclassified subsequent to profit/ loss:		
Exchange difference on translating foreign operations	23,040	36,920
Cash flow hedges	(17,250)	(27,160)
Income tax relating to items that may be reclassified	(3,750)	(15,280)
	2,040	(5,520)
Other comprehensive income for the year net of tax	39,180	37,600
Total comprehensive income for the year	**(30,000)**	**(62,840)**

Draft statement of Financial Position

Assets:	2017	2016
Non-current assets:	Frw '000'	Frw '000'
Plant, property and equipment	1,500,000	2,000,000
Investments	210,000	280,000
	1,710,000	2,280,000
Current assets:		
Inventories	90,000	120,000
Trade receivables	120,000	160,000
Cash and cash equivalents	150,000	40,000
Total current assets	360,000	320,000
Total assets	2,070,000	2,600,000
Equity and Liabilities:		
Share capital	1,200,000	1,600,000
Retained earnings	(487,000)	(450,000)
	713,000	1,150,000

Non-current liabilities:		
Long-term borrowing	480,000	400,000
Deferred tax	180,000	160,000
Long-term provisions	267,000	356,000
	927,000	916,000
Current liabilities:		
Trade payables	120,000	160,000
Short term borrowing	49,000	28,000
Current portion of long-term borrowing	90,000	120,000
Current tax payable	135,000	180,000
Short-term provision	36,000	46,000
Total current liabilities	430,000	534,000
Total liabilities	1,357,000	1,450,000
Total equity and liabilities	**2,070,000**	**2,600,000**

Critically appraise and restate the draft financial statements, supported with suitable workings where necessary, for each of the following scenarios in accordance with the respective regulation and standards for financial reporting.

(a) The draft financial statements were prepared under the historical cost convention, modified to include the valuation of certain properties. The company uses budgets in its risk management strategy. Inventory, which principally consist of communication equipment for sale and hire are valued at the lower of cost and net realisable value. Depreciation was provided on all non-current assets other than freehold land at rates calculated to write off the cost less residual value of each asset evenly over its expected useful life. Depreciation is not provided on investment properties. There were 100,000 7% issued and fully paid preference shares and 400,000 issued ordinary shares for each of the years ended 31 May, 2017 and 2016. The company has 4 directors, of which two were appointed half way through the year ended 31 May, 2017. The directors have no interest in the share capital of the company. The emoluments of directors together with the audit fees are included in the distribution costs. There was no resolution regarding the independent auditors. All employment costs are included under administrative expenses.

REQUIRED:

You are requested to critically appraise the draft financial statements of Ndabarinzi Ltd with reference to the disclosure requirements of the law relating to companies and advise management on any modification that will ensure compliance. **(8 Marks)**

(b) Included in the share capital are 100,000 7% preference shares of Frw 3,000 each. The 7% preference dividends are two years in arrears. The balance is 400,000 ordinary shares of Frw 3,000 each that is 75% paid. The company formulated an approval scheme of reorganisation, to take effect on 1 May, 2017 in which the ordinary share capital is to be written down to 25% and converted into new ordinary shares of Frw 3,000 each fully paid. The preference shareholders are to receive 50,000 ordinary shares of Frw 3,000 per share, fully paid at par, in exchange for their issued preference shares plus 4,000 ordinary shares of Frw 3,000 fully paid in full and final settlement of the arrears of preference dividends. The creditors for trade payables have agreed to take 40,000 new ordinary shares of Frw 3,000 each fully paid at par and the adverse balance on retained earnings is to be written off. The valuation report indicates that property, plant and equipment are to be written down by Frw 260 million and a provision for bad debts is to be raised at Frw 3 million.

REQUIRED:

Management would like you to restate the draft financial statements by incorporating all the reorganization adjustments and evaluate the professional judgement and ethical sensitivity for the reorganization decision. **(8 Marks)**

(c) During the top management meeting, you were informed that Ndabarinzi Ltd had incurred significant expenditure in compliance with the corporate social responsibility policy. The company paid Frw 1 million in installing energy efficient lights in the neighboring community. The company is yet to pay Frw 300,000 to Ntarugera Ltd that had been contracted to install the energy efficient lights. Prior to this Ndabarinzi Ltd had secured a cash grant of Frw 5 million for the energy efficient lights project. Ndabarinzi Ltd also provided free internet infrastructure to the community that cost Frw 1.5 million before the attributable indirect taxes of Frw 90,000.

REQUIRED:

You are requested to recognise the above transactions in the draft financial statements, justify the adjustments made, and provide the respective notes to financial statements in compliance with reporting standards. **(9 Marks)**

(Total 25 Marks)

QUESTION THREE

Mparo Ltd is a public limited company, specialising in the production and trading of construction materials. The following information is available about the company for the year ended 31 May, 2017.

1. During the year, Mparo Ltd purchased Shs 60,000,000 of specialist raw materials from a Ugandan company. The purchase took place and was recognised in the financial statements on 2 January, 2017 when the exchange rate was Shs 3.20: Frw 1.00. The supplier has provided Mparo Ltd with 6 months interest-free credit. At the reporting date of 31 May, 2017 the exchange rate was Shs 3.00: Frw 1.00. As at 31 May, 2017, 60% of the materials purchased were still in Mparo Ltd's inventory. The directors of Mparo Ltd are unsure how to deal with the transaction in the financial statements. **(5 Marks)**

2. Mparo Ltd normally adopts newly issued or amended international financial reporting standards (IFRS) at the earliest opportunity. In its current financial statements under financing activities, it has shown an increase in long-term borrowings to Frw 140 million and an increase in the capital element of finance lease liabilities to Frw 17 million. At 1 June, 2016 Mparo Ltd had shown in its financial statements long-term borrowings of Frw 50 million and the capital element of lease liabilities at Frw 5 million. During the financial year, Mparo Ltd has taken out a long-term loan with a financial institution of Frw 55 million and had acquired AMA Ltd, a listed company, for Frw 150 million on 1 June, 2016. AMA Ltd had a long-term loan of Frw 35 million at acquisition. Further, Mparo Ltd had taken out finance lease liabilities totaling Frw 15 million and had paid Frw 3 million off the capital element of the lease liabilities. Mparo Ltd showed interest paid on lease liabilities of Frw 5 million in operating activities.

Finally, Mparo Ltd had an overdraft with the bank of Frw 2 million. The directors need the notes to the statement of cash flows, which would be required under the amendments to IAS 7; Statement of Cash Flows, which sets out the components of financing activities. **(5 Marks)**

3. At the reporting date on 31 May, 2017, Mparo Ltd's liquidity position was quite poor and company was at risk of breaching certain loan covenants that were due in the near future. The Directors do not wish to disclose this arguing that any further disclosure would be excessive and confusing to users of their published financial information. **(2 Marks)**

4. Mparo Ltd operates a defined benefit scheme for its employees. In June 2016, the net pension liability recognised in the statement of financial position was Frw 18 million, excluding an unrecognised actuarial gain of Frw 15 million, which Mparo Ltd wishes to spread over the remaining working lives of the employees. The scheme was revised on 1 June, 2016. This resulted in the benefits being enhanced for some members of the plan and because benefits do not vest for these members for five years, Mparo Ltd wishes to spread the increased cost over that period. However, part of the scheme was to be closed, without any redundancy of employees. Mparo Ltd requires advice on the financial reporting of the above scheme. **(5 Marks)**

REQUIRED:

(a) Advise Mparo Ltd on the financial reporting requirements for each of the above scenarios with help of suitable computations and with reference to relevant Standards.

(b) There has been significant divergence in practice over recognition of revenue mainly because International Financial Reporting Standards (IFRS) have contained limited guidance in certain areas. The International Accounting Standards Board (IASB) as a result of the joint project with the US Financial Accounting Standards Board (FASB) issued IFRS 15: Revenue from Contracts with Customers in 2014 to replace the previous international financial reporting standards relating to revenue.

REQUIRED:

Critically appraise the current standards on revenue recognition and demonstrate the expected improvements by IFRS 15 to the financial reporting of revenue. **(5 Marks)**

(c) Rwanda has already adopted International Public Sector Accounting Standards (IPSAS) to improve the quality of financial information reported by its public sector departments and agencies. Two main sources of finance for these public sector organisations are taxes and grants.

REQUIRED:

With reference to the relevant IPSAS(s), discuss the reporting requirements with regard to taxes and grants in public sector organizations. **(3 Marks)**

(Total 25 Marks)

QUESTION FOUR

(a) Ganza Ltd is a listed company operating in the transport industry. In the year ended 31 May, 2017 it made a profit after tax of Frw 35 million. There were no discontinued operations. At 1 June, 2016 Ganza Ltd had 70 million ordinary shares and 30 million preference shares in issue. The preference shares were correctly presented in equity within the statement of financial position. In the year ended 31 May, 2017 Ganza Ltd declared and paid a dividend of 12 cents per share to the ordinary shareholders and 6 cents per share to the preference shareholders.

On 1 September, 2016 Ganza Ltd made a fully subscribed rights issue of two ordinary shares for every seven held at Frw 1.35 per share. The fair value of an ordinary share at 1 September, 2016 was Frw 1.80.

Throughout the financial year Ganza Ltd had 20 million convertible loan notes on which interest of 5 cents per note was payable annually in arrears. The carrying amount of the liability element of the loan notes at 1 June, 2016 was Frw 23 million and the effective rate of interest was 7%. The rate of income tax applicable to Ganza Ltd is 20%. The notes are convertible into ordinary shares from 1 June, 2018 at the option of the note holder. The conversion terms are one ordinary share for every loan note held.

REQUIRED:

Advise the management of Ganza Ltd on the effect of current year performance on the market price of the shares of the company based on relevant computations and standards.

(NB: The EPS figure originally reported in 2016 was Frw 0.525.) **(4 Marks)**

(b) On 1 June, 2015 Ganza Ltd granted options to 500 employees to subscribe for 400 shares each in Ganza Ltd on 31 May, 2019 provided the employees still worked for Ganza Ltd at that time. On 1 June, 2015 the fair value of each option was Frw 1·50.

In the year ended 31 May, 2016 ten of these employees left Ganza Ltd and at 31 May, 2016 Ganza Ltd expected that 20 more employees would leave in the three-year period from 1 June, 2016 to 31 May, 2019. Ganza Ltd's results for the year ended 31 May, 2016 were below expectations and at 31 May, 2016 the fair value of each option had fallen to 25 cents. Therefore, on 1 June, 2016 Ganza Ltd amended the exercise price of the original options. This amendment caused the fair value of these options to rise from 25 cents to Frw 1·45.

During the year ended 31 May, 2017 five of the employees left and at 31 May, 2017 Ganza Ltd expected that ten more would leave in the two-year period from 1 June, 2017 to 31 May, 2019. The results of Ganza Ltd for the year ended 31 May, 2017 were much improved and at 31 May, 2017 the fair value of a re-priced option was Frw 1·60.

REQUIRED:

Prepare financial statement extracts for the year ended 31 May, 2016 and 2017 to demonstrate the reporting requirements of the above transactions based on the relevant standards. **(6 Marks)**

(c) Ganza Ltd identified the following operating segments in its annual financial statements for the year ended 31 May 2017:

1. Segment 1 local bus operations
2. Segment 2 inter-city bus operations
3. Segment 3 road constructions

The company disclosed two reportable segments; segments 1 and 2 were aggregated into a single reportable operating segment. Operating segments 1 and 2 have been aggregated on the basis of their similar business characteristics, and the nature of their products and services.

In the local bus operation market, it is the local transport authority, which awards the contract and pays Ganza Ltd for its services, the contracts are awarded following a competitive tender process, and the ticket prices paid by passengers are set by and paid to the transport authority.

In the inter-city bus operation market, ticket prices are set by Ganza Ltd and the passengers pay Ganza Ltd for the service provided.

REQUIRED:

Analyse the reporting requirements of the above transactions and advise Ganza Ltd on their disclosure in the financial statements for the year ending 31 May, 2017. **(3 Marks)**

(d) Additionally the directors of Ganza Ltd have requested for your advice on the financial reporting requirements of the following issues:

(i) Ganza Ltd commenced construction on a bus terminal on 1 February, 2017 and this continued until its completion, which was after the year end of 31 May, 2017. The direct costs were Frw 20 million in February 2017 and then Frw 50 million in each month until the year end. Ganza Ltd has not taken out any specific borrowings to finance the construction of the Bus terminal, but it has incurred finance costs on its general borrowings during the period, which could have been avoided if the bus terminal had not been constructed. Ganza Ltd has calculated that the weighted average cost of borrowings for the period 1 March to 31 May, 2017 on an annualised basis amounted to 9% per annum. **(4 Marks)**

(ii) Ganza Ltd wishes to create a credible investment property portfolio with a view to determining if any property may be considered surplus to the functional objectives and requirements of the company. The following portfolio of property is owned by Ganza Ltd.

1. Several plots of land. Some of the land is owned by Ganza Ltd for capital appreciation and this may be sold at any time in the future. Other plots of land have no current purpose, as Ganza Ltd has not determined whether it will use the land to provide services such as Bus terminals or for short-term sale.

2. Ganza Ltd supplements its income by buying and selling property. Part of the inventory, which is not held for sale, is to provide housing to its employees at below market rental. The rent paid by employees' covers the cost of maintenance of the property.

(4 Marks)

(iii) Ganza Ltd acquired a property for Frw 4 million and annual depreciation of Frw 300,000 is charged on the straight-line basis. At the end of the previous financial year of 31 May, 2016 when accumulated depreciation was Frw 1 million, a further amount relating to an impairment loss of Frw 350,000 was recognised, which resulted in the property being valued at its estimated value in use. On 1 November, 2016 as a consequence of a proposed move to new premises, the property was classified as held for sale. At the time of classification as held for sale, the fair value less costs to sell was Frw 2·4 million. At the date of the published interim financial statements on 1 January, 2017 the property market had improved and the fair value less costs to sell was reassessed at Frw 2·52 million and at the year end on 31 May, 2017 it had improved even further, so that the fair value less costs to sell was Frw 2·95 million. The property was sold on 5 June, 2017 for Frw 3 million. **(4 Marks)**

REQUIRED:

Write a report to the directors of Ganza Ltd discussing the financial reporting requirements for transactions (i) to (iii) above based on the relevant Standards.

End of question paper

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