CERTIFIED PUBLIC ACCOUNTANT

ADVANCED LEVEL 1 EXAMINATIONS

A1.3: ADVANCED FINANCIAL REPORTING

WEDNESDAY: 5 JUNE 2019

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

Gitoki Ltd is a public company and operates in the manufacturing sector. Gitoki Ltd manufactures products such as computers, spare parts and accessories but also has a wide portfolio of investment properties. The company has investments in Gatuna Ltd and Rwaka Ltd. The following draft statements of profit or loss and other comprehensive income for the year ended 31 May, 2019 relate to Gitoki Limited, Gatuna Ltd and Rwaka Ltd.

	Gitoki Ltd	Gatuna Ltd	Rwaka Ltd
	Frw 'million'	Frw 'million'	Frw 'million'
Revenue	2,204	2,230	1,985
Cost of sales	(435)	(345)	(293)
Gross profit	1,769	1,885	1,692
Investment income	260	95	-
Administrative expenses	(455)	(464)	(203)
Distribution costs	(302)	(213)	(109)
Other expenses	(216)	(103)	(185)
Operating profit	1,056	1,200	1,195
Finance costs	(24)	(18)	(15)
Profit before tax	1,032	1,182	1,180
Income tax	(256)	(350)	(357)
Profit for the year	776	832	823
Other comprehensive income:			
Gain on revaluation of property, plant & equipment	485	-	-
Total comprehensive income for the year	1,261	832	823

Additional Information:

1. Gitoki Ltd purchased 80% of the ordinary share capital in Gatuna Ltd on 1 June, 2016 for a cash consideration of Frw 100,500 million. On that date, Gatuna Ltd had retained earnings of Frw 11,125 million and the fair value of Gatuna Ltd's non-current assets included in its identifiable net assets was Frw 3,000 million greater than their book value. These non-current assets had a remaining useful life of 5 years at that date. This has not been adjusted in the financial statements by 31 May 2019. Depreciation expenses should be included in administrative expenses.

2. Gitoki Ltd acquired 45% of the ordinary share capital of Rwaka Ltd on 1 June, 2016 for a cash consideration of Frw 10,380 million and exercised significant influence over the financial and operating policy decisions of Rwaka Ltd. At this time, Rwaka Ltd had retained earnings of Frw 980 million and the fair value of Rwaka Ltd's identifiable assets and liabilities were the same as their book value.

3. Gitoki Ltd disposed off a 45% equity interest in Gatuna Ltd on 31 March, 2019 for a cash consideration of Frw 80,840 million and had accounted for the gain or loss in other income. The carrying value of the net assets of Gatuna Ltd at 31 March, 2019 was Frw 30,800 million before any adjustments on consolidation. The carrying value of the investment in Gatuna Ltd was Frw 30,850 million at 31 March, 2019 after the disposal of the equity interest.

4. The equity of the three companies as at 31 May, 2019 was as follows;

	Gitoki Ltd	Gatuna Ltd	Rwaka Ltd
	Frw 'million'	Frw 'million'	Frw 'million'
Share capital (Frw 3,000 nominal)	150,000	90,000	30,000
Share premium	8,500	6,800	5,400
Retained earnings	18,790	13,480	10,018
	177,290	110,280	45,418

5. On 1 September, 2018 Gitoki Ltd acquired a further 20% of the ordinary shares of Rwaka Ltd for a cash consideration of Frw 23,641 million and gained control of the company. The fair value of its identifiable assets and liabilities were the same as their book value.

6. It is the group's policy to value the non-controlling interest at fair value. The market price of a share of Frw 3,000 represents the fair value of the shares held by the non-controlling interest. Revenues and profits accrue evenly throughout the year.

7. All goodwill arising on acquisitions has been tested for impairment. An impairment review was carried out on 31 March, 2019 and it was agreed that the goodwill on acquisition of Gatuna Ltd and Rwaka Ltd be impaired by 10%. Goodwill impairments should be included in other expenses.

8. On 1 March, 2017 the Board of Directors of Gitoki Ltd made a decision to acquire property which was to be used as an office building. On 1 June, 2017 Gitoki Ltd acquired the property at a cost of Frw 450 million. Depreciation is charged on a straight-line basis over the asset's useful life. At that date, the value of the land component of the property was Frw 100 million, and the useful life of the building was estimated at 35 years. On 30 May, 2019 Gitoki Ltd wishes to transfer the property at fair value to investment property at Frw 500 million. This valuation was based upon other similar properties owned by Gitoki Ltd.

9. Gitoki Ltd sells computer accessories and spare parts with a warranty covering customers for the cost of repair of any defects that are discovered within the first two months after purchase. Past experience suggests that 88% of the goods sold will have no defects, 7% will have minor defects and 5% will have major defects. If minor defects were detected in all products sold, the cost of repairs would be Frw 25 million. If major defects were detected in all products sold, the cost would be Frw 100 million.

REQUIRED:

(a) Demonstrate, with suitable calculations, how the sale of the 45% interest in Gatuna Ltd by Gitoki Ltd, should be dealt with in the group statement of profit or loss and other comprehensive income for the year ended 31 May, 2019. **(5 Marks)**

(b) Prepare a consolidated statement of profit or loss and other comprehensive income of the Gitoki Ltd group, for the year ended 31 May, 2019. (Include all the notes to the financial statements as far as the information provided allows). **(35 Marks)**

(c) Gitoki Ltd sells computer accessories and spare parts as part of a combined contract which includes a standard one-year warranty term and maintenance services for a five-year period. Gitoki Ltd also offers the option of a five-year extension to the warranty for an additional fee which is paid at the time of the initial sale. The sales price for the combined contract is Frw 360 million and the customer will pay an additional fee of Frw 80 million for the extended warranty. If sold separately, the selling price of the computer accessories would be Frw 320 million and the selling price of the one-year warranty and five-year maintenance service contract would be Frw 90 million. The extended warranty has a separate selling price of Frw 10 million.

REQUIRED:

Write a memo to the Board of Gitoki Ltd, showing how the above transaction should be accounted for under IFRS 15: Revenue from Contracts with Customers. **(10 Marks)**

(Total 50 Marks)

SECTION B

QUESTION TWO

(a) Kalisa Enterprises Ltd (KEL) commenced trading on 1 April 2010. Prices have been changing over the years and the Accountant is convinced that current cost accounting (CCA) adjusted financial statements will illustrate the effects of changing price levels for the benefit of Directors. He decides to prepare the following statement of financial position for the year ended 31 March, 2019 after taking into account general price level changes.

Assets:	Frw 'million'
Non-current assets:	
Property, plant & equipment	17,268
Investment property	1,200
Intangible assets	833
	19,301
Current assets:	
Inventories	1,488
Trade receivables	1,000
Cash & cash equivalents	350
	2,838
Total assets	22,139
Equity & liabilities:	
Share capital	3,000
Retained earnings	3,750
Current cost reserve	11,989
Total equity	18,739
Non-current liabilities:	
Long-term borrowings	2,000
Total non-current liabilities	2,000
Current liabilities:	
Trade & other payables	900
Tax payable	500
Total current liabilities	1,400
Total liabilities	3,400
Total equity & liabilities	22,139

Additional information:

1. The details of property, plant and equipment (PPE) are as follows

    (a) 7 % of PPE relates to land which is valued at fair value at the end of each reporting period. The land was purchased on 1 April 2010.

    (b) One piece of machinery which accounts for 14% of the PPE was revalued on 31 March, 2018. This machinery was acquired on 1 April, 2015 and is depreciated at 10% per annum on straight-line basis.

    (c) The rest of the PPE comprise buildings which were acquired on 1 April, 2010 and are depreciated at 2% per annum.

2. Intangible assets were acquired on the 1 June, 2018 and are amortized on a straight-line basis over their useful life of 10 years.

3. The company policy is to revalue investment property on an annual basis. The investment property was acquired on 17 July, 2017.

4. As a matter of company practice, inventories are purchased in bulk on the last day of each reporting period. The closing inventories were purchased as follows:

   (a) 6% was purchased on 31 March, 2016
   (b) 24% was purchased on 31 March, 2017
   (c) The remainder was purchased on 31 March, 2018

5. The general price indices provided by the Bureau of Statistics were as follows.

1 April, 2010	110
1 April, 2015	250
31 March, 2016	270
31 March, 2017	300
17 July, 2017	320
31 March, 2018	370
1 June,2018	420
31 March, 2019	500

REQUIRED:
Redraft the company`s statement of financial position under historical cost accounting. (Round off your figures to the nearest million.)

(15 Marks)

(b) KEL recently recruited a fresh graduate to join the department responsible for financial reporting. The Director of Finance has sent him the following information which should be incorporated in the company's annual financial report after a meeting they had in the office of the director.

	Quantity used or produced	
Item	2019	2018
Energy use	3,500 Kwh	4,000 Kwh
Water use	100,000 cubic meters	250,000 cubic meters
Materials	3 kg to produce one unit	4 kg to produce one unit
Waste products	5,000 kg	5,500 kg
Turnover	Frw 500 million	Frw 400 million

During the meeting, the director emphasised the need to comply with the regulatory framework for financial reporting in Rwanda. He kept wondering why he was being given non-financial information for inclusion in the annual financial reports. He has approached you as head of department for guidance

REQUIRED:

(i) Discuss the regulatory financial reporting framework in Rwanda. **(5 marks)**

(ii) Assess KEL's environmental performance based on the information provided above. Include possible reasons for the results. **(5 marks)**

(Total 25 Marks)

QUESTION THREE

(a) Gatuna Ltd complies with International Standards in preparing its financial statements. In line with this, the company carries out impairment tests on all its assets in accordance with International Accounting Standard (IAS) 36: Impairment of Assets. Mr. Jean Nizeyimana, who is the accountant responsible for financial reporting, is a certified public accountant (CPA) and reports to the Head of Finance, Mr. Michael Habimana who is also a CPA. Mr. Habimana has a domineering personality.

The valuation information received last year showed that the fair value of the assets was 1% less than their carrying amount (with no single asset being more than 3% different). The company did not report the fair value of the assets on the grounds that the carrying amount was not materially different from the fair value. This year's valuation shows a continued decline in the fair value of the assets, which is now 5% less than their carrying amount with some assets now being 15% below their carrying amount.

Mr. Nizeyimana has emailed Mr. Habimana draft financial statements in which he has recognised the fair value of the assets in accordance with IAS 36. Mr. Habimana immediately responded and instructed Mr. Nizeyimana to report the assets using their carrying amount as the fair value of the assets is only 5% different from their carrying amount and besides, the fair value would water down the performance of the branch.

REQUIRED:

Discuss the courses of action Mr. Nizeyimana should take **(10 Marks)**

(b) Marie Ange Ltd (MAL) is a family founded business that started its operations over two decades ago and was listed in 2009 on the stock exchange market. However, over the last five years, the company has been experiencing falling performance and got delisted on 1 April, 2018. The company decided to adopt the International Financial Reporting Standards for Small and Medium-size Entities (IFRS for the SMEs) to prepare its financial statements from the financial year ended 31 March, 2019. Their draft statement of financial position prepared in accordance with the full International Financial Reporting Standards (IFRS) during the year ended 31 March 2019 is as follows.

Assets:	Frw ‘million’
Non-current assets:	
Property, plant & equipment	5,400
Investment property	400
Intangible assets	900
	6,700
Current assets:	
Inventories	400
Trade receivables	700
Cash & cash equivalents	250
	1,350
Total assets	8,050
Equity & liabilities:	Frw ‘million’
Share capital	2,000
Retained earnings	2,178
Revaluation reserve	272
Total equity	4,450
Non-current liabilities:	
Long-term borrowings	2,000
total non-current liabilities	2,000
Current liabilities:	
Trade & other payables	1,100
Tax payable	500
Total current liabilities	1,600
Total liabilities	3,600
Total equity and liabilities	8,050

Additional information:

1. MAL completed construction of a building where its head office is headquartered by the start of the financial year ended on 31 March, 2010 at a cost of Frw 1,000 million. Due to staff reduction in the financial year ended 31 March, 2018 the company rented a half of the block from which it gets a substantial amount in rent. The building is depreciated at 2% on a straight-line basis. The fair value of the building less cost to sell was Frw 1.200 million and Frw 1,230 million on 31 March, 2018 and 2019 respectively.
2. MAL purchased specialised machinery on 1 April, 2014 for Frw 700 million. The useful life of this machinery is 20 years. The machinery was revalued on 31 March, 2017 to Frw 867 million. The machinery is depreciated on a straight-line basis over its useful life.
3. The company, in attempt to develop unique software to apply in the distribution of its products overseas, spent Frw 20 million up to November 2017 on research and development. In December 2017, the company confirmed that the development of the software was feasible and had enough resources to complete the development. The company spent a further Frw 500 million and Frw 400 million from December 2017 to March 2018 and during the financial year ended 31 March 2019 respectively.

4. The Government of Rwanda, in appreciation of the company`s effort to produce its goods using technologies that protect the environment, gave the company a grant of Frw 700 million which was used to purchase and operate a plant which was purchased and installed in the northern part of the country at the beginning of the financial year ended 31 March 2016. The plant cost Frw 650 million and the balance to be used for paying a specialist to operate the machinery for five years from the date of installation. The useful life of the plant is 25 years and is depreciated over its useful life on a straight-line basis. The company policy is to recognise government grants over the useful lives of assets purchased or over the period expenses from government grants are incurred.
5. The company uses the cost model for valuation of buildings and investment property. Accrued governments grants are included in trade and other payables.

REQUIRED:

From the information provided, redraft the company`s statement of financial position as at 31 March, 2019 in accordance with IFRS for SMEs. **(15 Marks)**

(Total 25 Marks)

Hint: Show your workings.

QUESTION FOUR

Mack Limited (ML) is a listed company, incorporated several years ago. It deals in a variety of products, imported from different countries with a relative stable price with its competitors. You are the newly appointed managing director at ML. During your first meeting with the chairman Board of Directors, he brought the following to your attention: the Board received significant adverse comments about ML's management. According to the final audit carried out by Risen & Co, it was confirmed that ML's Board is not providing sufficient risk oversight, there are significant conflicts of interest in complex, volatile and difficult to measure areas; poor governance and tone at the top, as the former CEO always ignored signs from the strategic management function and never provided the Board with strategic issues and policy matters on a timely basis.

During the meeting with Rwanda Private Sector Foundation (PSF), the directors of ML were reminded of the need to comply with the PSF Code of Corporate Governance and also disclose explicitly the risk assessment measures in the financial reports of the company.

Required:

Write a memo to the Board of Directors of ML, discussing the effect of good corporate governance on corporate behaviour.

(5 Marks)

(b) ML's financial statements are prepared to 31 March, in accordance International Financial Reporting Standards (IFRSs) and other local regulations.

(i) During the year ended 31 March, 2019 ML bought some goods from Europe on 30 March. The invoice value of the goods was United States dollar (USD) 40,000 and is due for settlement in equal installments on 30 May and 31 July. The exchange rates were as follows:

Date	USD 1 = Frw
30 March	904.76
30 May	905.74
30 June	905.86
31 July	906.01

(ii) On 1 April, 2018 the fair value of ML's defined benefit plan assets were valued at Frw 2,200,000 and the present value of the defined benefit obligation was Frw 2,500,000. On 30 September 2018, the plan received contributions from the employer of Frw 980,000 and paid out benefits of Frw 380,000. The current service cost for the year was Frw 720,000 and a discount rate of 6% is to be applied to the net liability or asset. After these transactions, the fair value of ML's plan assets at 30 September, 2018 was Frw 3,000,000. The present value of the defined benefit obligation was Frw 3,107,200.

(iii) On 1 April, 2018 ML made a decision to issue 250,000 5% convertible bonds at their face value of Frw 100,000 each. The bonds will be redeemed on 1 April, 2023. Each bond is convertible at the option of the holder at any time during the five-year period. Interest on the bond will be paid annually in arrears. The prevailing market interest rate for similar debt without conversion options at the date of issue was 6%.

REQUIRED:

Advise the management of ML on the accounting treatment of the above transactions (i - iii) in accordance with the relevant international financial reporting standards.

(10 Marks)

(c) ML is also considering purchasing an interest in its competitor Raks Limited (RL). The Managing Director of ML has obtained the following most recent statements of financial position and statements of profit or loss of RL.

Summarised statements of financial position as at December 31;

	2018	2017
Assets:	Frw '000'	Frw '000'
Non-current assets:		
Property, plant & equipment	3,380,000	2,672,000
Investment properties	5,645,030	4,233,600
Motor vehicles	1,160,000	1,200,000
	10,185,030	8,105,600
Current assets:		
Inventories	840,000	724,700
Trade & other receivables	1,800,000	1,360,000
Prepayments	458,000	1,045,000
Cash & short-term deposits	88,970	600,000
	3,186,970	3,729,700
Total assets	13,372,000	11,835,300
Equity & liabilities:		
Equity:		
Ordinary share capital Frw 50,000 per share	2,400,000	2,400,000
Share premium	1,145,000	1,145,000
Retained earnings	1,940,000	674,900
Other equity reserves	2,350,200	950,200
	7,835,200	5,170,100
	2018	2017
Liabilities:	Frw '000'	Frw '000'
Non-current liabilities:		
Loans and borrowings	3,000,000	2,500,000
Provisions	766,800	900,000
10% bonds	400,000	1,200,000
	4,166,800	4,600,000
Current liabilities:		
Bank overdrafts	400,000	920,000
Accruals	250,000	345,200
Trade & other payables	720,000	800,000
	1,370,000	2,065,200
Total equity and liabilities	13,372,000	11,835,300

Summarised statements of profit or loss for the year ended December 31;

	2018	2017
	Frw'000'	**Frw'000'**
Revenue	4,300,000	3,024,000
Cost of sales	(2,860,000)	(2,296,000)
Gross profit	1,440,000	728,000
Investment income	260,000	195,000
Operating expenses	(680,000)	(540,000)
Operating profit	1,020,000	383,000
Finance costs	(240,000)	(180,000)
Profit before tax	780,000	203,000
Income tax	(256,000)	(123,000)
Profit for the year	524,000	80,000

REQUIRED:

Write a report to the finance director of ML, analysing the financial performance of Raks Limited (RL) and show relevant ratio calculations as an appendix to the report. **(10 marks)**

(Total 25 marks)