ICPAR
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CERTIFIED PUBLIC ACCOUNTANT

INTERMEDIATE LEVEL EXAMINATIONS

I1.2: FINANCIAL REPORTING

DATE: TUESDAY 28, MAY 2024

INSTRUCTIONS:

1. **Time Allowed: 3 hours 15 minutes** (15 minutes reading and 3 hours writing).
2. This examination has **two** sections**: A & B.**
3. Section **A** has **three compulsory questions** while Section **B** has **two questions, one question** to be attempted.
4. In summary attempt **four questions, three questions** in section **A** and **one** in section **B**.
5. Marks allocated to each question are shown at the end of the question.
6. Show all your workings where applicable.
7. The question paper should not be taken out of the examination room.

SECTION A

QUESTION ONE

a) Fancy Ltd, a company is a local company in Rwanda that sells pesticides used farmers in the agriculture sector. Fancy Ltd is trying to improve its liquidity and profitability and therefore the company has engaged in the following transactions during the year ended 31st December 2023.

Vehicles: Fancy Ltd had a fleet of vehicles purchased and capitalized at FRW 200 million on 1st January 2014 with useful life of 20 years. These fleet of vehicles were assessed to be surplus to the requirements of the company and therefore on 30th June 2023, the company sold the vehicles for FRW 150 million. It is company's policy to depreciate all assets using straight line method evenly over the useful life of the asset including in the year of disposal.

Huye building: On 1st January 2001, Fancy Ltd purchased a building in Huye at a cost of FRW 750 million with a useful life of 50 years and immediately used it as its office building in Huye. Later, on 1st July 2023, vacated the building and immediately leased it on an operating lease agreement for an annual rental income of FRW 50 million. The annual rental income was received in advance on 1st July 2023. Fancy Ltd applies the fair value model for its investment properties in accordance with IAS 40 Investment properties. The fair value of the building in Huye was equal to its carrying amount in the accounting records on 1st July 2023. The fair value of the building on 31st December 2023 was determined to be FRW 520 million.

Required:

i) Show the accounting entry required to recognize the computed gain/loss on disposal of the vehicles in the financial statements of Fancy Ltd for the year ended 31st December 2023. (2 marks)

ii) Show the accounting entries required to account for the change in use of the Huye building on 1st July 2023 and to account for the fair value adjustment of the building on 31st December 2023. (3 marks)

iii) Show the accounting entries required for the rent received for the Huye building on 1st July 2023 and the subsequent entries required on 31st December 2023 to account for the rental income. (2 Marks)

b) The information given below was extracted from the financial statements of Fancy Ltd at 31st December 2023.

	31-Dec-2023
	FRW 000
Property, plant and equipment - Carrying amount	1,200,000
Trade receivable	300,000
Provision for a liability	(50,000)

During the year ended 31st December 2023, Property plant and equipment registered a revaluation gain of FRW 40 million. As at 31st December 2022, Fancy Ltd had a deferred tax liability balance of FRW 250 million.

The tax written down value (tax base) of the property, plant and equipment as at 31st December 2023 was FRW 490 million while the tax base of the trade receivable was nil. The provision is allowed for tax when the associated expense is paid. The rate of tax is 30%.

Required:

Compute the deferred tax as at 31st December 2023 and show the accounting entries to record the deferred tax that arose in the year ended 31st December 2023 (6 Marks)

c) In the year ended 31st December 2023, Fancy Ltd commenced large-scale plantation farms in the Southern province which in accordance with IAS 41 *Agriculture* qualifies as an investment in biological assets. The management of Fancy Ltd are unsure of how the company's biological assets should be treated in the financial statements for the year ended 31st December 2023.

Required:

As a Financial Reporting student on the ICPAR course, **briefly explain to the management of Fancy Ltd, IAS 41's requirements for:**

(i) The criteria applied to recognize biological assets; (2 marks)

(ii) The initial and subsequent measurement for the company's biological assets (3 marks)

(iii) Any TWO disclosures needed in the notes to the financial statements (2 marks)

Note: You are NOT required to explain specific principles regarding "presentation" for the biological assets **(Total: 20 Marks)**

QUESTION TWO

Below are the separate financial statements of Muhanga Ltd, Guma Ltd and Eagle Ltd which operate in the same industry.

Statements of financial position as at 31st December 2023

	Muhanga Ltd FRW million	**Guma Ltd FRW million**	**Eagle Ltd FRW million**
Property, plant and equipment	25,500	13,900	20,960
Investments	27,600	-	-
Current assets			
Inventory	12,500	2,400	3,000
Cash	4,500	12,400	2,400
Receivables	750	810	940
Total Asset	**70,850**	**29,510**	**27,300**
Equity			
Share capital of FRW 1 each	15,000	5,000	6,000
Share premium	3,000	2,300	1,500
Retained earnings	25,000	12,000	14,300
Non-current liabilities:			
20% loan notes	3,000	-	-
Current liabilities			
Trade and account payable	9,500	4,500	5,500
Tax payable	15,350	5,710	
Total equity and liabilities	**70,850**	**29,510**	**27,300**

Additional information

(1) On 1st September 2023, Muhanga Ltd acquired 80% of the equity share capital of Guma Ltd. The consideration consisted of two elements:

- **(i)** A share exchange of three shares in Muhanga Ltd for every five shares acquired in Guma Ltd when on that date, the market prices were FRW 5 each for Muhanga and FRW 4 each for Guma; and
- **(ii)** An immediate cash payment of FRW 24,000 million was made for the investment acquired in Guma Ltd.

The share issue has not yet been recorded by Muhanga Ltd, but the cash payment has been recorded.

(2) At the date of acquisition, the fair values of Guma Ltd's assets were equal to their carrying amounts, with the exception of an item of property which had a fair value of FRW1,200 million below its carrying amount. The effect of the fair value adjustment led to a reduction of the depreciation charge (in the cost of sales) of FRW 200 million in the post-acquisition period. Guma Ltd has not incorporated the fair value adjustment into its separate financial statements.

(3) On 1st July 2023, Muhanga Ltd acquired 2,400 million ordinary shares in Eagle Ltd at a price of FRW 1.5 per share.

(4) Sales from Guma Ltd to Muhanga Ltd in the post-acquisition period were FRW 12,000 million making a profit margin of 25% on these sales. At year-end, Muhanga Ltd had FRW 2,000 million at an invoice price of these inventories supplied by Guma Ltd.

(5) In December 2023, Muhanga Ltd sold goods to Eagle Ltd for FRW 4,000 million including a profit margin of 20%. All these goods remained unsold by Eagle Ltd as at 31st December 2023.

(6) Muhanga Ltd's policy is to value the non-controlling interests at fair value at the date of acquisition. For this purpose, Guma Ltd's share price at that date can be deemed to be representative of the fair value of the shares held by the non-controlling interest.

(7) Goodwill was tested at the end of the year, and 10% of the Goodwill related to the acquisition of Guma Ltd was impaired.

(8) The summarized statements of profit or loss for the year ended 31st December 2023 for the three companies are shown below:

	Muhanga Ltd	**Guma Ltd**	**Eagle Ltd**
	FRW million	**FRW million**	**FRW million**
Operating profit before tax	13,900	5,400	9,000
Income tax	(3,900)	(1,500)	(2,200)
Profit for the year	10,000	3,900	6,800

Required:

Prepare the consolidated statement of financial position for Muhanga Group as at 31st December 2023 **(30 marks)**

Note: Show all the workings appropriately and all monetary figures must have been rounded off to the nearest FRW millions (with NO decimal places)

QUESTION THREE

a) In accordance with IAS 2, inventory should be valued at the lower of cost and net realisable value (NRV) and this is in line with the general rule for valuing assets whereby all assets should not be carried at an amount greater than the amount expected to be realised from the sale or use of that asset.

Required:

In terms of "inventory", **outline any TWO examples that may cause the inventory's net realisable value (NRV) to be lower than its cost?** (2 Marks)

b) On 1st January 2023, Tura Heza Ltd entered into a 5-year lease agreement with another company to lease construction machines. The terms of the lease include paying FRW 70,000,000 each year with the first instalment paid on the first day of the lease term when the machines are taken out. On the date of the lease agreement, legal fees of FRW 5,000,000 was paid by Tura Heza Ltd to the lawyer for legal support services towards the lease contract. Tura Heza Ltd's incremental borrowing rate is 12% annually and the related compound discount factor applicable is 3.037.

Required

In accordance with IFRS 16 *Leases*, **Prepare calculations for the amounts of the right-of-use asset and the lease liability balances on initial recognition and subsequently at the end of each of the five years** (8 Marks)

c) Investment in associate is usually evidenced by having significant influence. This form of investment is always above a simple investment but less than investment in subsidiary.

Required

i) Explain the term significant influence in accordance with IAS 28 *Investment in Associates and Joint Ventures* (2 Marks)

ii) In addition to holding a certain percentage of voting ordinary shares, **mention any other THREE sources of evidence that can demonstrate the existence of an investor's significant influence over the other company (the associate)** (3 Marks)

d) Muhabura Ltd bought land on 1 January 2022 at a cost of FRW 45,000,000 with a plan to leave it vacant and benefit from its capital appreciation and then sell the asset after 20 years. For this purpose, the company applies a fair value model to account for the property at each reporting date. In the year ended 31 December 2022, the asset was fair valued to FRW 54,000,000. On 31 December 2023, after the Government of Rwanda fixed prices on all lands in the area where the Muhabura Ltd.'s land is located, the asset of Muhabura Ltd was fair valued at FRW 40,000,000.

Required:

With clear workings, and in accordance with the applicable International Financial Reporting Standards, **briefly explain the accounting treatment for the fair value adjustments on the land and show the accounting entries in the financial statements of Muhabura Ltd for the year ended 31 December 2022 and 31 December 2023.** (6 Marks)

e) Muhima Ltd is a company that provides marketing services but has been experiencing losses for so long. The company is developing new software to replace old system, the new software will cost FRW 77 million. In regard to this software, the company incurred research and development costs amounting to FRW 30 million. Management is sure that once the old software is replaced, the quality service to customers will increase and the company will start making a profit of at least FRW 15 million per year. Management is sure that their market share will increase as well. Muhima Ltd has demonstrated the intention to finish the development, however, they have exhausted all their current source of funds, and for that reason they don't know when the project will be completed.

Required:

Explain the reference criteria for recognition of research and development costs as per IAS 38 and advise Muhima Ltd the appropriate accounting treatment of the research and development cost of FRW 30 million incurred in relation to the software as per IAS 38

(9 Marks)

(Total: 30 Marks)

SECTION B

QUESTION FOUR

a) Ingenzi Wine Ltd is a private company based in the special economic zone. The company has been considering the accounting treatment of its intangible assets in the financial statements for the year ended 31st March 2024

(i) On 1st October 2023, Ingenzi Wine Ltd acquired the entire (100%) shareholding of Munezero Beer Ltd, a small company that specializes in wine research and development. The purchase consideration was a share exchange arrangement valued at FRW 40 million on 1st October 2023. On the date of acquisition, the fair value of Munezero Beer Ltd.'s net assets were FRW 25 million (excluding any items referred to below).

Munezero Beer Ltd owns a patent for an established successful wine that has a remaining life of eight years. A firm of specialized valuers, Universal Advisors Ltd has estimated the current market value of the patent to be FRW 10 million; however, the company is awaiting the outcome of the drink trials test where the wine has been tested for different customers. If this trial is successful, the value of wine will be estimated at FRW 16 million.

(ii) Ingenzi Wine Ltd has developed and patented a new wine which has been approved for drink use. The costs of developing the wine were FRW 14 million. This new wine is on high demand in Rwanda and can be sold when management decides to do so.

(iii) In the current accounting period, Ingenzi Wine Ltd has spent FRW 3 million sending its staff on specialized training courses. While these courses have been expensive, they have led to a marked improvement in production quality, and staff now need less supervision. This, in turn, has led to increased revenue and cost reductions. The directors of Ingenzi Wine Ltd believe these benefits will continue for at least three years and wish to treat the training costs as an asset.

Required:

Advise Ingenzi Wine Group Ltd on how the matters above should be treated in the consolidated financial statements for the year ended 31st March 2024 (10 Marks)

b) Ingenzi Wine Ltd started constructing a modern tower building where they wish to relocate group head offices. The building is estimated to cost FRW 48 billion to complete. On 01st January 2024, the regional bank approved a 10% loan to finance 80% of the building estimated costs of FRW 48 billion for a 5-year term. The remaining 20% finance will be funded by a green building fund, which is a government institution that provides grants. The construction process of the building started immediately after obtaining approval of the loan. However, 40% of the capital funds borrowed from the bank for the construction costs was reinvested in a commercial bank to attract a return of 4% per annum. Until 31 March 2024, 40% of the loan was still held as short-term investment. The year ends 31st March.

Required

(i) In accordance with IAS 23 Borrowing Costs, **briefly explain when capitalization of borrowing costs must commence** (3 Marks)

(ii) **Show how the above loan will be recorded and its associated borrowing costs in accordance with IAS 23 Borrowing Costs for the year ended 31 March 2024** (7 Marks)

(Total: 20 Marks)

QUESTION FIVE

a) Recently most companies are fully adopting an integrated reporting framework to show shareholders and other stakeholders that the company takes all the surrounding risks seriously and not just financial risks.

Required

Explain the concept of integrated reporting (IR) and explore how an integrated report covering any FIVE capital types that would provide insights for the shareholders and other stakeholders in a company. (12 Marks)

b) Financial information to be useful to users need to have fundamental and enhancing characteristics. The conceptual framework states that qualitative characteristics are the attributes that make financial information most useful to users.

Required:

(i) Clearly differentiate what the conceptual framework means by the concepts of fundamental qualitative characteristics from enhancing qualitative characteristics. (2 Marks)

(ii) Explain each characteristic under fundamental qualitative and enhancing qualitative. (6 Marks)

(Total 20 Marks)

End of question paper

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