CERTIFIED ACCOUNTING TECHNICIAN (CAT)

STAGE 3 EXAMINATION

S3.1 FINANCIAL ACCOUNTING

DATE: MONDAY, 27 NOVEMBER 2023

MARKING GUIDE AND MODEL ANSWERS

MARKING GUIDE

SECTION A

Question Number	CORRECT ANSWER	MARKS
1	C	2
2	A	2
3	D	2
4	B	2
5	D	2
6	C	2
7	D	2
8	C	2
9	B	2
10	A	2
TOTAL		20 MARKS

Model Answer

QUESTION ONE

The correct answer is C

The correct answer is **C**. This is because financial accounting information uses historical information rather than futuristic information. On the other hand, management accounting information are for both historical records and future planning tool.

Option A, B, D are not correct because they represent a true characteristic of financial accounting information:

- Financial accounting information detail the performance of an organization over a certain period and the position of the entity at the end of that period.
- Financial accounting information present a future picture of the company's long-term operations.
- There is a mandatory requirement for financial accountants of limited liability company to produce external reports.

QUESTION TWO

The correct answer is A

The Objectives of IFRS Foundation is not the enforcement of International Financial Reporting Standard in most countries.

Options B, C, D are correct because the objective of the IFRS foundation is the following:

- Development of International Financial Reporting Standard through the IASB.
- Convergence of International Financial Reporting Standard and accounting standards.
- Promoting the use and application of International Financial Reporting Standard.
- Taking account of the financial reporting needs of emerging economies and small- and medium-sized entities (SMEs).

QUESTION THREE

The correct answer is D

A significant growth in the level of competition faced by the company is a sign that the entity may be pushed out of the market by competitors in the next 12 months, and hence cease trading in which case the entity may need to prepare their financial statement on a break-up basis instead of going concern basis.

Option A, B, C: They are all indicators of the improvement of the company's performance in the next 12 month, and which means that entity should prepare its financial statement on a going concern basis.

A A significant increase in demand for the company's products in the past 12 months: indicate that this could be the same in the next 12 months.

B A significant increase in advance payments made to suppliers with some suppliers increasing the credit of the entity: indicate that the has more cash at its disposal and the entity is paying suppliers in advance.

C A significant increase in the cash flow forecast of the entity and showing a significantly improving position within the next 12 months: indicate that the entity will continue operation in the next 12 month.

QUESTION FOUR

The correct answer is B

In accordance with IAS 37, a contingent asset must be recognized in the financial statement only when it is virtually certain that future economic benefits will flow to the entity.

The following option are not correct because:

Option A: When the flow of economic benefit associated with the asset is remote the contingent asset should neither be recorded in financial statement nor be disclosed in the notes to the financial statement.

Option C: When the flow of economic benefit associated with the asset is probable the contingent asset should be disclosed in the notes to the financial statement but recognised in the financial statements.

Option D: When the flow of economic benefit associated with the asset is possible the contingent asset should neither be recorded in financial statement nor be disclosed in the notes to the financial statement.

QUESTION FIVE

The correct answer is D

The advantages of issuing right issue are the following:

(i) Keeping reserves available for future dividends.

(ii) Raising cash for the company.

Option A, B, C are not correct because they contain the following:

(iii) No raising of cash for the company while increasing share capital is an advantage of issuing bonus issue and,

(iv) No dilution of current shareholders' holdings even when they don't take up the right issue is not correct because the right issue dilutes the shareholders' holdings when they don't take up the issue.

QUESTION SIX

The correct answer is C

This the correct answer because the external users of financial statement are customers, suppliers, and lenders.

Option A, B, D are not correct because they contain managers, yet managers are internal users of financial statement or do not contain all the available external users.

QUESTION SEVEN

The correct answer is D

Profitability ratios include asset turnover ratio, net profit margin, gross profit margin, and return on capital employed.

Option A, B, C are not correct because:

Option A: Quick ratio belongs to liquidity ratio.
Option B: Debt ratio belongs to leverage ratios.
Option C: Interest cover belongs to leverage ratios.

QUESTION EIGHT

The correct answer is C

The revenues generally come from taxes or through the exercise of coercive power in public sector. Instead, the revenues generally come from donations, membership fees, and contributions instead of sales in Not-for-profit entities in private sector.

Option A, B, D are not correct because they are true characteristics of Not-for-profit entities in private sector which are the following:

- The primary objective is to sell and goods and services to many individuals rather making profit for the owners of the entity.
- There is an absence of shares of that can be sold, redeemed, or transferred (i.e., many NGOs are limited liability by guarantee not by shares).
- Revenues generally come from donations, membership fees, and contributions instead of sales.
- There is a wide group of stakeholders to consider which may include the public at large

QUESTION NINE

The correct answer is B

Objectives of a good accounting system are timeliness, reliability, and cost effectiveness. Relevance is not part.

Option A, C, D are not correct because they contain relevance (iii) which a characteristic of a good information but not a good accounting system and that is why it is the correct answer.

QUESTION 10

The correct answer is A

All the available controls are applicable for the entity to prevent fraud:

- Segregation of duties.
- Review of controls and regular checks on control activities.
- Locking away confidential files and ensuring office security.
- Password protection, access limitations and integration of systems.

Option B, C, D, are not correct because they don't contain all the above/available and applicable controls to prevent fraud.

SECTION B

QUESTION 11
Marking Guide:

Sub-question (a)	Marks
(i)	
Explanation of cost model	1.5
Explanation of revaluation model	1.5
Maximum marks to be awarded:	**3**
(ii)	
Explanation of fair value as per IFRS 13	2
Sub-question (b)	
The fact that land is not depreciated	1
Initial entries for revaluation surplus in 2015:	
Dr Land	0.5
Cr Equity/OCI	0.5
Entries for impairment in 2022:	
Dr Equity/OCI (reversal)	1
Dr Impairment Loss in P/L	1
Cr Land	1
Maximum marks to be awarded	**5**
Total Marks	**10 Marks**

Model Answer:

a)

(i) Cost Model: The cost model measures the asset by carrying it to its cost less any depreciation and any accumulated impairment loss. The component of a cost of an asset include: the purchase price, import duties, directly attributable costs, and initial estimate cost for dismantling and removing the asset and restoring the site on which it is located.

Revaluation Model: Carry the asset at a revalued amount, being the fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses.

(ii) Fair Value: As per IFRS 13, this is the price that would be received to sell an asset or paid to transfer a liability in an orderly market transaction between market participants at the measurement date.

b) (i) Although land is to be sold after 20 years for capital appreciation, it does not mean that it will be depreciated over that period of time. Land is never depreciated.

(ii)	Initial Cost	45,000,000		
	Value of the Asset 31 December 2015	100,000,000		

Entries to pass:

	Dr	Cr
Land (PPE)	**55,000,000**	
Revaluation surplus (Equity through OCI)		**55,000,000**

(iii)	Value of the Asset 31 December 2022	**30,000,000**		

Entries to pass:

	Dr	Cr
Revaluation surplus (Equity through OCI)	**55,000,000**	
Impairment loss	**15,000,000**	
Land (PPE)		**70,000,000**

QUESTION 12

Marking Guide:

Sub-question (a)	Mark
Capitalized rate / weighted average rate	1
Capitalized borrowing cost	1
Total borrowing cost before capitalization or expensing	1
Total borrowing cost expensed in the P/L	1
Profit Before Tax	1
Maximum marks to be awarded	**5**
Sub-question (b)	
For each point identified award 0.5 marks, and 0.5 marks for explanation to a maximum of 5 points:	
Probable	1
Intention	1
Resource	1
Ability	1
Technical feasibility	1
Expenditure	1
Maximum marks to be awarded	**5**
Total Marks	**10**

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Model Answer:

a)

The total borrowing cost before capitalization:

= (18%*20,000,000,000) + (12%*30,000,000,000) +(10%*10,000,000,000) = 8,200,000,000

Capitalization rate:

= (18%*20/60) + (12%*30/60) + (10%*10/60) = 14%

Capitalized Borrowing Cost: Applies only

= (14%*1,500,000,000 + 14%*900,000,000*2/12) = 231,000,000

Borrowing cost expensed in P/L:

= 8,200,000,000 – 231,000,000 = 7,969,000,000

Profit Before Tax (PBIT – Finance cost) will be:

= 20,000,000,000 - 7,969,000,000 = 12,031,000,000

b)

When deciding whether Research and development costs should be capitalised or expensed, it is important to assess each of the capitalisation criteria as all of them must be met in order to recognise an intangible asset for development costs (the criteria are summarised in a word PIRATE):

P- Will the asset generate **Probable** future economic benefits? We can see from the scenario that the new software is expected to result in a profit making of over FRW 15 million per year. Therefore, it meets this criterion.

I- Does the business **Intend** to complete the intangible asset and use or sell it. Muhima Ltd has every intention of completing the new software and using it in their production process. Therefore, it meets this criterion.

R- The availability of adequate technical, financial, and other **Resources** to complete the development and to use or sell the intangible asset. Currently, Muhima Ltd all their source of funds have been exhausted and therefore this criterion is not met as the financial resources are not available.

A - Is the business **Able** to use or sell the intangible asset. The new software will be used in place of the current software, and management is sure that once this is done quality of work done for customers will increase. Therefore, this criterion is met.

T- The **Technical feasibility** of completing the intangible asset so that it will be available for use or sale. Muhima Ltd has demonstrated that the software is viable and the future expected benefits. Therefore, this criterion is met.
E- Is the business able to reliably measure the **Expenditure** attributable to the intangible asset during its development. The software is expected to cost total of FRW 77 million, of which they have spent FRW 30 million. The costs are known and measurable, therefore this criterion is met.

Although most of the criteria are met, there is currently not sufficient financial resources to complete the project and therefore the full FRW 30 million must be expensed as the project is still under the research phase.

QUESTION 13

Marking Guide

	Marks
Sub-question (a)	Marks
For a provision:	
A present obligation exists	1
Probable that transfer of economic benefit will occur	1
Reliable estimate of costs	1
Contingent Liability: Possible that transfer of economic benefit will occur	1
Contingent Asset: Probable that economic benefit will flow to the entity	1
Subtotal	**5**
Sub-question (b)	
Statement of Profit or Loss:	
Gross Profit	0.5
Gain on Disposal	1
Provision	1
Depreciation	1
Bad Debt	1
Rental Income	1
Depreciation for the current year	1
Finance cost	1
Loss before tax	0.5
Net Loss	1
Workings:	
Disclosure of contingent asset	1
Closing carrying amount of Nyabugogo Building	1
Cease depreciation for the investment property	1
6 months depreciation of Nyabugogo Building	1
6 months depreciation of Gisiment Building	1
Reversal of Nyabugogo building annual depreciation	0.5
Reversal of Gisiment building annual depreciation	0.5
Subtotal	**15**
Total	**20**

Model Answer:

a)

As per IAS 37, a provision should be recognised in the financial statement when the following conditions exist:

- The entity has a present obligation (the obligation can be legal or constructive),
- It is probable (above 50% chance) that a transfer of economic benefit will be required to settle it,
- and the cost can be measured reliably.

A contingent liability should be disclosed in the notes when the entity has a present obligation (the obligation can be legal or constructive), cost can be measured reliably, but it is **possible** (less than 50%) that a transfer of economic benefit will be required to settle it.

A contingent asset should only be disclosed in the notes only when it is **probable** that the economic benefit associated with the asset will flow to the entity.

b)

Muyange Ltd Statement of Profit or Loss for the year ended 31 December 2022.	**FRW "000"**
Sales	70,000,000
Cost of sales	(45,900,000)
Gross profit	**24,100,000**
Gain on PPE disposal	2,250,000
Provision	(2,000,000)
Depreciation	250,000
Bad Debt	(1,700,000)
Rental Income	120,000
Operating expenses	(16,000,000)
Administrative expenses	(9,000,000)
Finance cost	(4,400,000)
Loss before tax	(6,380,000)
Tax expense	(1,000,000)
Net loss	**(7,380,000)**

Workings:

1. Provision

As per IAS 37 for a provision to be recognized in the financial statement:

- A present obligation exists as ordered by the court
- Probable that transfer of economic benefit will occur as confirmed by the lawyer
- Reliable estimate of costs amounting to FRW 2 billion.

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The resulting entries:

Dr P/L	2,000,000	
Cr Provision (other payables)		2,000,000

2. Contingent Asset

A contingent asset should be recognized in the financial statement only when it is virtually certain that future economic benefit will flow to the entity.

As this is not the case for Muyange Ltd, then the amount of FRW 2.5 billion will only be disclosed in the notes.

3. Gain on disposal

Initial cost	10,000,000	
Accumulated depreciation (FRW 10 billion*8/20)	(4,000,000)	
Opening Carrying Amount		**6,000,000**

Reversal of depreciation for the year:

Depreciation for the year (FRW 10 billion/20 years)	500,000	

The resulting entries:

Dr Accumulated depreciation	500,000	
Cr Operating Expenses		**500,000**

Recognition of 6 months depreciation:

Depreciation for six months (FRW 500 million*6/12)	250,000	

The resulting entries:

Dr Operating Expenses	250,000	
Cr Accumulated depreciation		**250,000**

Carrying amount at the date of sale:

Opening Carrying Amount	6,000,000	
Depreciation charge for 6 months	(250,000)	
Closing Carrying amount		**5,750,000**

Gain on disposal:

Procced	8,000,000	
Carrying amount	5,750,000	
Gain on disposal		**2,250,000**

The resulting entries:

Dr Cash	8,000,000	
Cr Nyabugogo building		5,750,000

Cr gain on disposal (P/L) **2,250,000**

4. Investment property

As the asset is now going to be used to generate rental income, it will shift from IAS 16 to IAS 40 (investment property) and depreciation will cease immediately.

Reversal of depreciation for the year:

Depreciation for the year (FRW 20 billion/20 years)		**1,000,000**

The resulting entries:

Dr Accumulated depreciation	1,000,000	
Cr Operating Expenses		**1,000,000**

Recognition of 6 months depreciation:

Depreciation for six months (FRW 1,000 million*6/12)	500,000	

The resulting entries:

Dr Operating Expenses	500,000	
Cr Accumulated depreciation		**500,000**

Recognition of 6 months rental income (20million*6)

Dr Receivable / Cash	120,000	
Cr Rental Income		**120,000**

5. Bad debt

As per IFRS 10 (events after reporting), the customer declared bankrupt is an adjusting event.

The resulting entries:

Dr Operating Expenses	1,700,000	
Cr Trade Receivables		**1,700,000**

6. Finance cost

Loan	20,000,000	
Interest rate	12%	
Interest expense		**2,400,000**

The resulting entries:

Dr Finance cost	2,400,000	
Cr Interest payable		**2,400,000**

QUESTION 14

Marking Guide:

Sub-question (a)	
For each point identified award 1 marks, and 1 mark for explanation to a maximum of 5 points:	
Customers	2
Suppliers	2
Government	2
Lenders	2
Competitors	2
Subtotal	**10**
Sub-question (b)	
For each point identified award 1 marks, and 1 mark for explanation to a maximum of 5 points:	
Misappropriation of assets	2
Misstatement of the financial statements	2
Financial	2
Reputation	2
Employee morale	2
Subtotal	**10**
Total Marks	**20**

Model Answer:

a) Key external stakeholders for Company Y are likely to include some or all of the following:

- **Customers:** To ensure that the company is solvent, and they have some comfort that Company Y will be able to supply their product.
- **Suppliers:** Especially any significant or new suppliers who will be assessing Company Y for creditworthiness.
- **The Government:** For example, Rwandan Revenue Authority (RRA) and the Office of the Registrar General) will need to ensure that the financial statements are filed on time.
- **Lenders:** Such as the bank due to the need for a loan, the lender will monitor Company Y's solvency to ensure it is able to pay off its debts.
- **Competitors:** They can access information about Company Y as they can view the statutory financial statements from the Office of the Registrar General. Although for a small company like Company Y the information be limited to a statement of financial position, and small companies like Kivu Ltd would want to minimise the amount of information a competitor would be able to view, provided they adhere to financial reporting regulations.

- **Regulatory Bodies:** These bodies may be interested in the performance of the organisation, and if a complaint is made against the company, there may need to make further investigation and inquiry.

b)

(i) With respect to the accounting system the types of fraud which are important are the following:

- **Misappropriation of assets:** which is theft, teeming and lading, payment of false employees or suppliers.
- **Misstatement of the financial statements:** which is the overstatement of assets or profit, or the understatement of profit, losses, or liabilities.

(ii) Fraud has the following types of impact on a company:

- **Financial** - loss of funds or other assets. This in turn affects the company's profitability and the owner's investment in it. It can also affect the company's share price.
- **Reputation** - exposure to fraud can affect the company's reputation in the eyes of internal and external stakeholders. This in turn could lead to a loss of business.
- **Employee morale** - the trust of existing employees could be damaged. Future recruitment and retention of staff might also be affected.

QUESTION 15

Marking Guide:

Consolidated Statement of Financial Position:	Marks
Land	0.5
Property, Plant, and Equipment	0.5
Other assets	0.5
Goodwill (W4)	1
Current assets	
Inventories (19,000+7,000 – 23 (W6))	1
Trade receivables and other receivables	0.5
Cash at bank	0.5
Equity and liabilities	
Equity	0.5
Retained earnings (W5)	1
Non-controlling interests (W6)	1
Short-term Loan	0.5
Trade payables	0.5
Workings:	
Available shares (6,000,000/1000)	1
Acquired percentage	1
Fair value per share	1
Non-controlling interest (NCI) At Acquisition	1
Goodwill	2
Net Asset Acquired	1
Duhaze Ltd post acquisition profit	1
Rwamagara Ltd.'s share of post-acquisition profit	1
Rwamagara Ltd consolidated profit	1
NCI share of post-acquisition retained earnings	1
Unrealised profit	1
Total	**20**

Model Answer:

a)

Rwamagara Ltd Consolidated Statement of Financial Position for the year ended 31 December 2022.	**FRW "000"**
Non-current assets	
Land	13,200,000
Property, Plant, and Equipment	27,200,000
Other assets	18,000,000
Goodwill (W4)	16,500,000
	74,900,000
Current assets	
Inventories (19,000,000+700,000 – 23,000 (W7))	19,677,000
Trade receivables and other receivables	6,100,000
Cash at bank	10,400,000
	36,177,000
	111,077,000
Equity and liabilities	
Equity	26,000,000
Retained earnings (W5)	3,401,600
Non-controlling interests (W6)	3,275,400
Total equity	**32,677,000**
Non-current liabilities	
Long-term Loan	**44,200,000**
Current liabilities	
Short-term Loan	4,200,000
Trade payables	30,000,000
	34,200,000
Total liabilities	**78,400,000**
	111,077,000

Workings:

1. Group Structure

Acquired Shares in Duhaze Ltd	4,800
Available shares (6,000,000/1000)	6,000
Acquired percentage	80%
Retained Earnings at Acquisition	500,000

2. Fair value per share

The shares of Duhaze Ltd were acquired at the current fair value:

Acquired shares	4,800
Proceed	20,000,000
Fair value per share	**2,500**

3. Non-controlling interest (NCI) At Acquisition:

Acquired Shares in Duhaze Ltd	4,800
Available shares (6,000,000/1000)	6,000
Remaining shares (20%)	**1,200**

It is the company policy to measure Non-Controlling Interest (NCI) at fair value:

NCI (1,200*2,500)	**3,000,000**

4. Goodwill

Consideration transferred		20,000,000
Non-controlling Interest (NCI)		3,000,000
Share capital	6,000,000	
Retained earnings at acquisition	500,000	
Net assets acquired:		**(6,500,000)**
Goodwill		**16,500,000**

5. *Retained earnings*

	Rwamagara Ltd	***Duhaze Ltd***
Retained earnings:	2,300,000	1,900,000
Retained earnings at acquisition		(500,000)
Unrealised profit (W7)		(23,000)
Duhaze Ltd post acquisition profit		1,377,000
Rwamagara Ltd.'s share of post-acquisition profit 80% x 1,377,000	1,101,600	
	3,401,600	

6. Non-controlling interests

NCI at acquisition (W3)	3,000,000
NCI share of post-acquisition retained earnings 20% x 1,377,000	275,400
	3,275,400

7. Unrealised Profit

Sales from Duhaze Ltd to Rwamagara Ltd	
230,000,000 x 25/125*50%	**23,000,000**

END OF MARKING GUIDE AND MODEL ANSWERS.