CERTIFIED PUBLIC ACCOUNTANT

ADVANCED LEVEL 1 EXAMINATIONS

A1.3: ADVANCED FINANCIAL REPORTING

DATE: TUESDAY 26, NOVEMBER 2024

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 where necessary.
7. The question paper should not be taken out of the examination room

SECTION A

QUESTION ONE

a) Mutoni Ltd is a company established in Rwanda several years ago. The company growth led directors to diversify investments through acquisition of other companies. Gasabo Ltd is one of their subsidiaries and it has been making losses since acquisition, the directors of Mutoni Ltd are concerned that Gasabo Ltd would worsen the Mutoni Ltd's image if it is included in the group account. They would prefer not to include these losses in the consolidated financial statements and have heard that International Financial Reporting Standards allow the results of subsidiaries to be omitted from group accounts when certain circumstances are satisfied. They indicated that Gasabo Ltd supplies customers that operate mainly in the retail sector, whilst Mutoni Ltd and Giramba Ltd, another subsidiary of Mutoni Ltd, have customers that operate mainly in the manufacturing sector. Therefore, they suggested that incorporating Gasabo Ltd's in the consolidated financial statements would be misleading in such circumstances.

Required:

Draft a memorandum to the directors of Mutoni Ltd that describes the circumstances in which a subsidiary could be excluded from group accounts Appropriate under International Financial Reporting Standards and **Responds to the issues they have raised in the above note**. (4 Marks)

b) H Limited, a public limited entity in Rwanda, operates in the information technology sector. They have made several investments in other companies within the industry, achieving market leadership in the sector.
The following draft financial statements for the year ended 31 October 2022 relate to H Limited and its investment companies:

Statement of profit or loss and other comprehensive income for the year ended 31 October 2022

	H Limited	**S Limited**	**LG Limited**
	FRW "000"	**FRW "000"**	**FRW "000"**
Revenue	8,460	3,880	3,200
Cost of sales	(4,040)	(2,910)	(1,020)
Gross profit	**4,420**	**970**	**2,180**
Investment income	600		
Operating expense			
Distribution costs	(725)	(200)	(220)
Administrative expenses	(1,150)	(350)	(340)
Profit from operations	**3,145**	**420**	**1,620**
Finance costs	(450)	(175)	(320)
Profit before tax	**2,695**	**245**	**1,300**
Income tax expense	(680)	(80)	(440)

Profit for the year	2,015	165	860
Other comprehensive income:			
Gain on property revaluation	70		
Total comprehensive income	**2,085**	**165**	**860**

Additional information:

1) H Ltd acquired 75% of the equity shares in S Ltd on 31 Jan 2012, paying FRW 9.5 million. At the acquisition date, the fair value of the identifiable net assets of S Ltd was FRW 10.9 million which does not include a FRW 600,000 fair value excess on property with a remaining useful life of 30 years, the value excess was not recorded until disposal date. The non-controlling interest was measured using the proportionate method. By 31 January 2022, goodwill was impaired by 50%.

2) On 31 January 2022, H Ltd sold a 65% equity shareholding in S Ltd for FRW 13.2 million. In the 10 years since its acquisition, S Ltd had made profits of FRW 3.9 million and had reported under other comprehensive income of FRW 800,000 relating to debt instruments that were still held at the disposal date. There were no dividends up to disposal date. The fair value of a 10% shareholding in S Ltd at 31 Jan 2022 was FRW 1.9 million and did not change up to 31 October 2022

3) M Limited is the primary competitor of H Limited. On 1 May 2022, both companies acquired 50% of the ordinary share capital of LG Limited, which comprised FRW 200 million shares capital with a nominal value of FRW 10 each. H Limited's acquisition was financed through a combination of cash payments and a share exchange. For each acquired share in LG Limited, H Limited paid FRW 15 in cash and offered a share exchange of 1 H Limited share for every 2 LG Limited shares, with H Limited shares trading at a market price of FRW 20 each at the time. In contrast, M Limited paid FRW 15 per share for its stake but did not issue any shares to LG Limited's shareholders. Each ordinary share in LG Limited carries one voting right

4) Upon the acquisition, H Limited had a contractual right to appoint or remove 60% of the board of LG Limited, with the remaining 40% appointed by M Limited. The 60% members of the board of directors is considered to be the majority. In addition, M Limited and H Limited each appointed one member to LG Limited’s senior management team whereby the senior manager appointed by H Limited is the one who makes the key decisions regarding the development of LG Limited’s new technologies, its principal revenue stream, the market it will operate in and how it is financed. The fair values of LG Limited’s net assets approximated their carrying values at the date of acquisition.

5) On 01 June 2022, LG Limited sold goods worth FRW 400,000 to H Limited. LG Limited reports a gross profit margin of 25% on all its sales. The 20% of these goods remained in the inventory of H Limited as at 31 October 2022.

6) None of the group companies paid dividends during the year ended 31 October 2022.

7) S Limited had not issued any ordinary shares since its shares were acquired by H Limited.

Required:

i) Calculate the gains or losses on disposal of S LTD that will be recognized in the group retained earnings as at as at 31 October 2022 (12 Marks)

ii) Consolidated statement of profit or loss and other comprehensive income for H Group for the year ended 31 October 2022. (16 Marks)

Guidance:

Show all workings and explanation where necessary.
Where workings are separated from the main answer, provide adequate references for the workings within the answer

c) ABD BANK Rwanda Co has interests in a number of subsidiaries and associate companies. In order to raise funds to expand into a new overseas market ABD BANK management sold half of its 30% shareholding in Liam Co on 30 September 2019 for cash consideration of FRW 1.6 million, the fair value of retained investment was equal to the consideration received when selling 15%. The shares had been acquired on 1 October 2014 for FRW 2 million and gave ABD BANK Co significant influence over Liam Co. This significant influence was lost on the sale of the 15% shareholding. Between 1 October 2014 and 30 September 2019 Liam Co made profits of FRW 1.2 million but paid no dividends.

Required:

Explain the treatment of change in the shareholding and compute the gains or losses on disposal of 15% (6 Marks)

d) The draft consolidated statement of profit or loss for the year ended 30 June 2023 of SIGOMA is as follows:

	FRW "000"
Revenue	3,700
Cost of sales	(3,069)
Gross profit	**631**
Operating expenses	(275)
Dividend from subsidiary	24
Dividend from associate	18
Profit before tax	**398**
Income tax	(140)
Profit for the year	**258**
Profit allocated to	

	FRW "000"
Non-controlling interest	64.5
Owners of the parent	193.5
	258

The draft statement was prepared by adding together the income and expenses of SIGOMA and its 75% owned subsidiary, MUKWANO, and allocating 25% of group profit after tax of FRW 258,000 to the non-controlling interest in MUKWANO.

Below are the items which were not included in the consolidated statement of profit or loss for the year ended 30 June 2023

1) The interest in MUKWANO has been held for a number of years and the non-controlling interest was measured at fair value at acquisition. Goodwill of FRW 160,000 was recognised at acquisition and half of this was impaired prior to the current financial year. A further FRW 30,000 was written off after an impairment review conducted in April 2023 but was not included in the financial statements for the year ended 30 June 2023

2) SIGOMA also holds a 30% interest in MURIGO Ltd, which gives them significant influence over MURIGO Ltd. The investment in MURIGO Ltd was acquired on 1 November 2022. SIGOMA has no other investments.

3) During the year, SIGOMA bought goods from MUKWANO for FRW 144,000 and at the year-end it still held a quarter of these goods in the inventory. MUKWANO's mark-up was 20% on cost. SIGOMA also bought goods from MURIGO Ltd between November 2022 and 30 June 2023 at a margin of 25% on sales price. These goods cost SIGOMA FRW 128,000 and a half of it were unsold by SIGOMA at the year end

4) During the year ended 30 June 2023, MUKWANO reported profits of FRW 66,000 and MURIGO Ltd FRW 120,000

Required

Prepare a corrected consolidated statement of profit or loss of SIGOMA for the year ending 30 June 2023 (12 Marks)

(Total: (50 Marks)

SECTION B

QUESTION TWO

a) Rutsiro limited has a financial year that ends at 31st December. The company decided to sell two properties on 1st December 2023 that were considered to be surplus to the requirements of the company and which were both measured at cost.

The first property (described as property A) was available and advertised for immediate sale in its current condition. This property had a carrying amount of FRW 60 million as at 1st December 2023. The property was being actively marketed at a realistic selling price of FRW 70 million. The agent responsible for its sale has advised that a sale should be achievable within three months after 1st December 2023. The agent charges a commission of 5% on the selling price.

The second property (described as property B) required some essential repairing works which are to be done before it can be in a condition ready for sale. These repair works are scheduled for January 2024 and are estimated to cost FRW 12 million. The carrying amount of this property is FRW 45 million as at 31st December 2023. The agent has advised that the property will realistically be sold for FRW 55 million once the repair works are completed and a commission of 5% will also be applicable. Both properties will not be able to generate any income after 31st December 2023 except through the sale.

Required:

Explain how these properties will be recognised and the amounts at which they will be measured at in the financial statements of Rutsiro limited for the year ended 31st December 2023. (8 Marks)

b) Kanombe limited is a company operating in the construction industry and has its head office at Musanze. The company financial year ends at 31st December. On 1st January 2019, Kanombe acquired a property for FRW 30 million which was immediately put on lease to Kirehe Limited under an operating lease. The annual rental agreed was FRW 3 million.

On 31st December 2022, the fair value of the property was determined to be FRW 36 million. According to the terms of the lease agreement, Kirehe limited was able to cancel the lease if a prior notice of six months was given in writing to Kanombe limited. Kirehe limited stopped using the property and gave a notice on 1st January 2023 and vacated the property on 30th June 2023. On 1st July 2023, Kanombe was able to immediately convert this property into ten flats of equal size that the company intends to sell in the ordinary course of business.

Kanombe limited spent FRW 7 million to undertake the conversion works between January 2023 and June 2023. It is estimated by the directors that a further FRW 5 million will be needed to complete the project and once completed, each flat can be sold at FRW 6 million. Kanombe uses the fair value method to measure the property in compliance with IFRS standards.

Required:

With the use of relevant calculations, **discuss how the properties before and after the conversion will be recognised and measured in the financial statements for Kanombe limited for the year ended 31st December 2023.** (7 Marks)

c) On 1st November 2023, Kimironko limited purchased a machine from a supplier in Daresalaam, Tanzania; whose currency is Tanzania shillings (Tsh.). The price agreed for the purchase of the machine was Tsh 1,200,000 payable on 31st January 2024. This asset was modified to make it suitable to the requirements of Kimironko limited at a cost of FRW 45,000 in November 2023 and was brought to use on 1st December 2023. Directors of Kimironko limited estimate that the useful life of the machine will be 5 years from the date of first use. The relevant exchange rates were as follows:

1st November 2023	Tsh 2.5 to FRW 1
1st December 2023	Tsh 2.0 to FRW 1
31st December 2023	Tsh 2.4 to FRW 1
31st January 2024	Tsh 2.1 to FRW 1

Required:

With the use of relevant calculations, **Explain how the purchase of this machine will be recognised and measured in the financial statements of Kimironko limited for the year ended 31st December 2023.** (10 Marks)

Total Marks: (25 Marks)

QUESTION THREE

Kicukiro limited is a public company that is listed on Rwanda stock exchange. The following transactions relate to the company on various occasions during the financial year ending 31st December 2023:

1) On 1st January 2023, Kicukiro received a grant from the ministry of health to facilitate the acquisition of specialised machines that it uses in its research activities in the pharmaceutical field. The grant represented 20% of the cost of the machine which had a total cost of FRW 10,000,000. The expected life of this machine is expected to be four years with nil residual value. The ministry of health uses IPSAS modified accruals in accounting but Kicukiro limited uses IFRS. The expected profit of Kicukiro before accounting for depreciation of the machine are expected to be FRW 5,000,000 per year during the life of the machine.

2) On 1st July 2023, Kicukiro acquired Kirehe limited which specialises in undertaking research and development for pharmaceutical products. The consideration to acquire this company comprised a share exchange and was valued at FRW 40,000,000 The fair value of the net assets of Kirehe was FRW 18 million, which did not include the patent mentioned in this case. Kirehe owns a patent for an established successful drug with a remaining useful life

of 8 years that was independently valued by experts to be worth FRW 12 million. Kirehe limited is however waiting for the results of clinical trials for tests conducted on the same drug but for treatment of a different disease. If trials are successful, it is estimated that the value of the patent will be FRW 15 million. The financial statements of Kirehe also include FRW 2.5 million that was incurred on research for a client.

3) Kicukiro has developed a patented new drug that has now been given approval by the ministry of health for clinical trial. The cost incurred to develop the drug was FRW 16 million and on the basis of initial assessments of its early success, it is estimated to have a market value of FRW 20 million.

4) On 1st July 2022, Kicukiro commenced a project aimed at development of a more efficient process. Expenses incurred in the project amounted to FRW 4 million and these were charged to the statement of profit or loss in the year ended 31st December 2023. Additional costs of FRW 2.5 million were incurred in the subsequent three months to March 2023. It is on this date that it became clear that the project was technically feasible and commercially viable. Additional costs of FRW 3 million were incurred in the six months from April to September 2023. This new process began operating on 1st October 2023 and was expected to create cost saving over a period of ten years starting from 1st October 2023.

5) On 1st July 2023, Kicukiro limited decided to diversify its activities and acquired a motor vehicle rental business for FRW 223 million. The carrying amount of the assets of the business was estimated based on fair value less disposal costs as follows:

	FRW, "Million"
Motor vehicles	120
Intangible asset (Licence)	35
Trade receivables	25
Cash	15
Trade payables	(12)
	183

On 1st August 2023, three vehicles in the car rental business were reported stolen. These had a fair value less cost of disposal of FRW 30 million. The business had failed to make full disclosure of all risks relating to these vehicles to the insurance company and as a result, these vehicles were uninsured. Kicukiro wishes to recognise an impairment loss of FRW 45 million which includes the stolen vehicles as a result of the decline in the value in use of this business.

On 1st September 2023, another competitor commenced operations in Kigali and it is therefore expected that the revenues of Kicukiro will decline by approximately 20% and as a consequence the present value in use of the business will reduce, which is currently estimated at FRW 125 million. The fair value less cost of disposal of the licence has also declined to

FRW 15 million. The fair value less cost of disposal for the other assets has remained the same throughout the period.

Required:

a) With the use of relevant calculations, **explain how the government grant will be accounted for if Kicukiro decides to adopt the deferred income method to account for the government grant as per IAS 20 *Accounting for government grants and disclosure of government assistance*.** (6 Marks)

b) In accordance with IAS 38 *Intangible assets*, **explain, with the use of relevant calculations, how Kicukiro Ltd will account for the research and development activities undertaken during the financial year ended 31st December 2023.** (8 Marks)

c) **Explain the circumstances that indicate impairment of an asset, and show, with the use of calculations, how the cash generating unit will be accounted for in accordance with IAS 36 *Impairment of assets*.** (5 Marks)

d) With the use of practical examples, **Explain the requirements of IAS 20 *Accounting for government grants and disclosure of government assistance*.** (6 Marks)

Total Marks: (25 Marks)

QUESTION FOUR

a) To have the full regulation of both the preparation and publication of financial statements, legal and market regulations are required in addition to international financial reporting standards. Your director approached you and told you that there will be a presentation on regulatory framework for financial reporting to senior management. **The director requested you to send them an email explaining any four reasons of having a regulatory framework for financial reporting.** (5 Marks)

b) IFRS 16 specifies how an IFRS reporter will recognize, measure, present and disclose leases. The standard provides a single lessee accounting model, requiring lessees to recognize assets and liabilities for all leases unless the lease term is 12 months or less or the underlying asset has a low value.

Required:

i) Explain how the lease classification under IFRS 16 is different from the previous classification under IAS 17 (2 Marks)

ii) Explain how variable lease payment not included in the measurement of lease liability are treated as per IFRS 16. (2 Marks)

c) ANCHOR Ltd prepares financial statements on 31 June each year. On 1 July 2021, ANCHOR Ltd leased a property on a 10-year lease agreement with BORA Properties Ltd. The economic useful life of the leased property is 20 years. The annual lease payment is FRW 5,000,000 payable in advance, the first payment being made on 1 July 2021. ANCHOR Ltd paid initial direct cost of FRW 1,000,000 in arranging this lease and received incentives of FRW 500,000. The annual rate of interest implicit in the lease is 10%.

Required:

Explain how this lease will be accounted for in the financial statements of ANCHOR Ltd for the year ended 30 June 2022 and 30 June 2023 in accordance with IFRS 16 –Leases.

(16 Marks)

Note: *Clearly show the workings for the right-of-use asset and the lease liability to be used for initial recognition and subsequent measurement before presenting extracts of financial statement.*

Total (25 Marks)

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