CERTIFIED PUBLIC ACCOUNTANT

ADVANCED LEVEL 1 EXAMINATIONS

A1.3: ADVANCED FINANCIAL REPORTING

DATE: TUESDAY,29 MARCH 2022

MARKING GUIDE AND MODEL ANSWERS

SECTION A

QUESTION ONE

Marking guide

Ihora Ltd, Consolidated statement of financial Position as at 30 June 2021

	Marks
Property, plant and equipment	**3.5**
Intangible assets	**2.5**
Inventories	**2**
Trade receivables	**2**
Cash and cash equivalents	**1**
Share capital	**1**
Long-term borrowings	**1**
Deferred grant income	**2.5**
Long-term provision	**1.5**
Trade and other payables	**2**
Tax payable	**1**
Total equity and liabilities	

Correct translation ½ mark, then aggregate ½ mark and any adjustment ½ mark except for Long-term provision 1 ½ marks due to the working involved.

Workings

	Marks
1. Structure	
Ihora Ltd Direct investment	**1**
2. Goodwill determination	
Fair value of consideration	**1**
Fair value of NCI	**1**
Fair value of net assets acquired	
Share capital	**1**
Retained earnings at acq	**1**
Other equity acq	**1**
Fair value adjustment	**1**
Goodwill at acquisition	**1**
Goodwill impaired	**1**
Goodwill balance	**1**
Retranslation gain in GW	**1**
3. Retained earnings	
At reporting date	**1.5**
Pre-acquisition	**1**

Goodwill impaired	**1**
Extra depn due to Fair Value adj	**1**
UP on inventory	**1**
Retranslation (gain)/loss on profit	**0.5**
Amortization Intangibles	**1.5**
Amortization grant	**1.5**
4. Other equity (includes retranslation)	
At reporting date	**0.5**
Retranslation gain/(loss) on profit	**0.5**
Total carried forward	
5. Noncontrolling interest	
At acquisition	**1**
At reporting date	**1**
Pre-acquisition	**1**
Goodwill impaired	**1**
Extra depn due to Fair Value adj	**1**
UP on inventory	**1**
Amortization Intangibles	**1**
Amortization grant	**1**
Retranslation gain/(loss) on profit	**1**

Mark as indicated (each entry in the working where marks are allocated is 0.5 marks

Marks on the face of Statement of financial position = 20 marks

Marks from the workings = 30 marks

Total marks = 50 marks

Model answers

Ihora Ltd, Consolidated statement of financial Position as at 30 June 2021

	Ihora Ltd	Imiza Ltd	Zambe Ltd	Zambe Ltd	Adjustments	Consolidated
	FRW million	FRW million	ZMW million	FRW million	FRW million	FRW million
Assets:						
Non-current assets						
Property, plant and equipment	4,150.0	1,150.0	322.0	16,100.0	568.0 W2, W3, Note 4	21,968.0
Investment - Imiza Ltd	1,500.0	-	-			
Investment - Zambe Ltd	9,000.0	-	-			
Intangible assets	710.0	30.0	10.0	500.0	-238.0 W3	1,002.0
Goodwill						260.0
Total non-current assets	15,360.0	1,180.0	332.0	16,600.0		23,230.0
Current assets:						
Inventories	1,350.0	275.0	146.0	7,300.0	-12.0 W3	8,913.0
Trade receivables	910.0	225.0	64.0	3,200.0	-60.0 NOTE3	4,275.0
Cash and cash equivalents	1,020.0	500.0	16.0	800.0		2,320.0
Total current assets	3,280.0	1,000.0	226.0	11,300.0		15,508.0
Total assets	**18,640.0**	**2,180.0**	**558.0**	**27,900.0**		**38,738.0**
Equity and liabilities:						
Share capital	12,000.0	1,200.0	200.0	8,000.0		12,000.0
Retained earnings	3,200.0	650.0	160.0	4,400.0		6,286.4

Post-acquisition reserves				5,740.0		
Other equity	240.0	20.0	14.0	560.0		390.0
Non-controlling interest						7,510.6
Total equity	15,440.0	1,870.0	374.0	18,700.0	-	26,187.0
Non-current liabilities:						
Long-term borrowings	1,200.0	95.0	10.0	500.0		1,795.0
Deferred grant income	250.0	25.0	6.0	300.0	-109.0 Note 5	466.0
Long-term provision					10.0 Note 4	10.0
Total non-current liabilities	1,450.0	120.0	16.0	800.0		2,271.0
Current liabilities						
Trade and other payables	1,150.0	150.0	120.0	6,000.0	-60.0 Note 3	7,240.0
Tax payable	600.0	40.0	48.0	2,400.0		3,040.0
Total current liabilities	1,750.0	190.0	168.0	8,400.0		10,280.0
Total liabilities	3,200.0	310.0	184.0	9,200.0		12,551.0
Total equity and liabilities	**18,640.0**	**2,180.0**	**558.0**	**27,900.0**		**38,738.0**

Workings

1. Structure		Imiza Ltd	Zambe Ltd	Zambe Ltd
Ihora Ltd Direct investment		80%	60%	
2. Goodwill determination	FRW million	FRW million	FRW million	ZMW million
Fair value of consideration		1,500.0	9,000.0	
Fair value of NCI		300.0	5,000.0	
Fair value of net assets acquired				
Share capital		1,200.0	8,000.0	
Retained earnings at acquisition		200.0	4,400.0	
Other equity acquisition		20.0	560.0	
Fair value adjustment		220.0	400.0	
		(1,640.0)	(13,360.0)	
Goodwill at acquisition		160.0	640.0	16
Goodwill impaired	(640.0)	(100.0)	(540.0)	(12)
Goodwill balance	260.0	60.0	200.0	4
Retranslation gain in GW			100.0	-
3. Retained earnings				
At reporting date	3,200.0	650.0	10,140.0	
Pre-acquisition		(200.0)	(4,400.0)	
Goodwill impaired		(100.0)	(540.0)	
Extra depreciation due to Fair Value adjustment		(22.0)	(40.0)	
UP on inventory		(2.0)	(10.0)	
Retranslation (gain)/loss on profit			(250.0)	
Amortization Intangibles	(142.0)	(6.0)	(90.0)	
Amortization grant	50.0	5.0	54.0	
Parents share	3,178.4	260.0	2,918.4	
Total carried forward	6,286.4			
4. Other equity (includes retranslation)				
At reporting date	240.0			
Retranslation on GW				
Retranslation gain/(loss) on profit			250.0	
Parents share	150.0		150.0	
Total carried forward	390.0			
5. non-controlling interest				
At acquisition		300.0	5,000.0	

At reporting date		650.0	10,140.0	
Pre-acquisition		(200.0)	(4,400.0)	
Goodwill impaired		(100.0)	(540.0)	
Extra depreciation due to Fair Value adjustment		(22.0)	(40.0)	
UP on inventory		(2.0)	(10.0)	
Amortization Intangibles		(6.0)	(90.0)	
Amortization grant		5.0	54.0	
Retranslation on GW				
Retranslation gain/(loss) on profit			250.0	
Total carried forward	7,510.6	365.0	7,145.6	

QUESTION TWO

Marking guide

Part (a)

Revenue is recognized according to the five-step model presented.

(0.5 mark for stating each step = 2.5 marks, 0.5 mark Well brief explanation of each step = 2.5 mark to make total 5 marks)

Part (b)

For construction contracts, the performance obligations are satisfied over a period of time.
1mark performance obligations are satisfied over a period of time; 1 mark for reference to CEL transactions on construction contract

1mark for Use of the stage of completion to calculate how much revenue should be recognized to date for contracts flowing over a period of time: **referring to CEL situation 1 mark**

1mark Reference to onerous contract and IAS 37 used

1mark for method to use - the input method (cost to cost) or the output method (survey of Construction) to measure the progress towards completion.

1mark for recognition in profit/loss for costs incurred to fulfil a contract with a customer

Calculating the contract asset or contract liability under IFRS 15

	FRW	
Revenue recognized to date	X	**0.5 mark**
Less: Amounts invoiced to date	(X)	**0.5mark**
Contract asset/(liability)	X/(X)	**1 mark**

correct definition of Contract asset and treatment – 3 marks

correct definition of contract liability and treatment – 3 marks

Part (c)

IAS 23 Borrowing Costs treatment by CEL

(**Any relevant/correct point on borrowing costs treatment by CEL 1 mark up to maximum of 5 marks) Definition of Borrowing cost is not awarded marks**

Model answers

Part (a)

The core principle of IFRS 15 is that an entity shall recognize revenue from the transfer of promised goods or services to customers at an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and services. The core principle of the converged standard is that revenue should be recognized to “depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in an exchange for those goods or services. The five-step model applies to revenue earned from a contract with a customer with limited exceptions, regardless of the type of revenue transaction or the industry.

Revenue is recognized according to the five-step model presented.

1. Identify contract with the customer;
2. Identify the performance obligations in the contract;
3. Determine the transaction price;
4. Allocate the transaction price to the performance obligations in the contract;
5. Recognize revenue when (or as) an entity satisfies a performance obligation.

Here below steps are defined and explained in details.

Step one in the five-step model requires the identification of the contract with the customer. According to the standard, a contract is an agreement and commitment, with commercial substance, between the contacting parties. It establishes each party’s obligations and rights, including payment terms. In addition, a contract exists only if collectability is probable. The model applies once the payment terms for the goods or services are identified, and it is probable that the entity will collect the consideration.

Step two requires the identification of the separate performance obligations in the contract. The key factor in identifying a separate performance obligation is the distinctiveness of the good or service, or a bundle of goods or services.

The performance obligations within a contract represent promises to transfer distinct good(s) or service(s). A good or service is distinct if the customer can benefit from it on its own or in combination with readily available resources and if the promise to transfer it can be separated from other promises in the contract. Each identified performance obligation is accounted for separately.

Step three requires the entity to determine the transaction price, which is the amount of the consideration that an entity expects to be entitled to in exchange for the promised goods or services.

The transaction price is what the seller estimates will be received in exchange for transferring the good(s) or service(s) identified in the contract. The transaction price is then allocated to each identified performance obligation. Revenue is recognized when a performance obligation is fulfilled.

An entity must determine the amount of consideration to which it expects to be entitled in order to recognize revenue.

Step four requires the allocation of the transaction price to the separate performance obligations. The allocation is based on the relative standalone selling prices of the goods or services promised and is made at the inception of the contract.

Step five requires revenue to be recognized as each performance obligation is satisfied. An entity satisfies a performance obligation by transferring control of a promised good or service to the customer, which could occur over time or at a point in time.

Part (b)

For construction contracts, the performance obligations are satisfied over a period of time.

For contracts where performance obligations are satisfied over a period of time, the stage of completion is required to calculate how much revenue should be recognized to date.

However, there is no requirement to calculate the estimated profit/loss on the contract (except to the extent of determining whether the contract is onerous where IAS 37 will be used)

You can use either the input method (cost to cost) or the output method (survey of Construction) to measure the progress towards completion.

Any costs incurred to fulfil a contract with a customer should be expensed to the statement of profit or loss as they are incurred.

Calculating the contract asset or contract liability under IFRS 15

	FRW
Revenue recognized to date	X
Less: Amounts invoiced to date/Received	(X)
Contract asset/(liability)	X/(X)

Contract asset: An entity's right to consideration in exchange for goods or services that the entity has transferred to a customer when that right is conditioned on something other than the passage of time (for example, the entity's future performance). This means that a contract asset arises when an entity has done work for a customer that has been recognized as revenue to date but has not yet issued an invoice or received payment for that work. Contract liability: An entity's obligation to transfer goods or services to a customer for which the entity has received consideration (or the amount is due) from the customer. contract liability arises when an entity has invoiced the customer or received payment from them but has not yet done the work and the invoices and/or payments exceed the revenue recognized to date.

Part (c)

IAS 23 Borrowing Costs requires that borrowing costs directly attributable to the acquisition, construction or production of a 'qualifying asset' are included in the cost of the asset. Other borrowing costs are recognized as an expense.

A qualifying asset is one that necessarily takes a substantial period of time to get ready for its intended use or sale)

In the context of CEL, any borrowing going towards a given construction contract (taking a period of more than one year), interest cost will then be part of the initial cost of the contract. Where funds are part of a general pool, the eligible amount is determined by applying a capitalization rate to the expenditure on that asset. The capitalization rate will be the weighted average of the borrowing costs applicable to the general pool.

Capitalization should commence when expenditures are being incurred, borrowing costs are being incurred and activities that are necessary to prepare the asset for its intended use or sale are in progress (may include some activities prior to commencement of physical production). Capitalization should cease when substantially all of the activities necessary to prepare the asset for its intended use or sale are complete.

Where construction is completed in stages, which can be used while construction of the other parts continues, capitalization of attributable borrowing costs should cease when substantially all of the activities necessary to prepare that part for its intended use or sale are complete.

QUESTION THREE

Marking guide

Report

Format (correct - opening title, from: to date: RE: - 1 mark + intro, body and concluding remark – 1 mark)

In the body of the report

Part a)

1 mark on describing revenue trend, cost of sales trend, Gross profit trend then 1 mark on Profit trend and lastly 1 mark on comment on the profit on disposal in 2021 = 3 marks

1 mark on describing Gross profit margin movement, 1 mark on operating Profit margin movement, 1 mark on efficiency ratios movement = 3 marks

1 mark for describing the change in cash flows, 1 mark on the liquidity ratios movement = 4 marks

1 mark each relevant point discussed relating to each of finance costs are increasing, stable dividend payout, non-current assets are increasing, and Current liabilities are also increasing. = 5 marks

Part b)

Any relevant point on Employees reporting 1 mark up to maximum of 4 marks

Any relevant point on Effects of Covid 19 reporting 1 mark up to maximum of 4 marks

Model answers

Report

From: Financial analyst and reporting head

To. Board members

Date: 20/08/2021

<u>Re: Analysis of financial performance and position together with two narrative information</u>

From your request, we provide analysis of financial performance and position using financial ratios and past data trend. The calculated ratios are provided in the appendix for reference. We also provide two narrative information notes relating to employees and effects of Covid 19 in the company's cost of sales.

a)

Financial performance

From the revenue figures, there is an increasing trend though the costs are increasing more than the revenue increase especially in the year 2021. The profit is reduced significantly moving from 2019 to 2020 then increased in 2021. Though the increase in 2021 is mainly due to the significant profit on disposal of production plant of FRW 11,620 million which if it was not there then there is significant loss of FRW 12,670 million**.** Looking at revenue of 54,700 which includes profit on disposal of assets of FRW 11,620 i.e means revenue from trading activities is 43,080 which means decrease of 12% in revenue in absence of gain from disposal of assets.

Looking at cost of sales which is supposed to go in line with sales, there have been increase in cost of sales and significantly increased in 2021(increase of 36% from 2020) despite the decrease in sales of 12% noticed means cost of sales increased by 48% above sales by excluding gain on disposal of production plant from revenue and assuming that there was no disposal of long-term assets in 2020 and 2019. This implies need of review to highlight and cut unnecessary cost or review of selling prices if the increase in Cost of sales is associated mainly with the increase in material cost evidenced by transport limitation due to covid 19 effects.

In terms of ratios the profitably has reduced as shown by the Gross profit margin especially in 2021 moving from over 20% in previous two years to 4%. The operating profit margin has reduced slightly from 8% in 2019 to 6% in 2020 and then nearly doubled in 2021, Though as indicated, the main cause of the increase was the profit on disposal of the production plant which if it was not for the asset disposal, there could have been an operating loss margin. Earnings per share reduced significantly from 208 FRW in 2019 to 50 FRW in 2020 then increased slightly to 88 FRW in 2021. Looking from the efficiency ratios, the receivables and payable payment periods together with the inventory holding period are increasing significantly over the three years. If there was no change of policy, looks like the company is taking long to collect cash from receivables (moving from 9 days in 2019 to 45 days in 2020 and then 67 days in 2021. Thus, also taking time to pay suppliers, receivable period being increasing above increase in payable days, this implies that company will need to borrow to finance the payable thus increase the cost to the company. Asset's turnover is also reducing from 9 times to 4 times as this is mainly due to the significant acquisitions in 2021. Thus means the company is not able to turn its investment in new asset into the revenue. i.e assets are idle while are new and expected to be more productive. New strategies are need to increase productivity of machines.

The cash flow performance indicates slight reduction of cash flows from operating activities moving from 2019 to 2021 and significant decrease in 2021 to a net cash outflow. This implies that there the company is struggling with cash flow difficulties and this is also seen through an increase in short-term borrowing and struggles to collect cash from customers. On the liquidity ratios, the current and quick ratios are reducing through the years halving in 2020 and reducing slightly in 2021. This may show problems of liquidity (as short-term borrowings are increasing). This also is associated by financing long term assets by the short-term borrowing. Of which there is no evidenced increase in operations associated with the addition of assets highly in 2021 where huge investment in long term assets were made.

The finance costs are increasing too mainly due to the increased borrowings.

Despite the reduction in profitability, the company continued with its stable dividend payout. This was even possible in the year 2021 mainly because there was profit earned from disposal of production plant.

On financial position, the non-current assets are increasing from 2019 to 2021 nearly doubling each year showing possible acquisitions. The replacement of the production plant in 2021 may indicate possible future benefits as the replacement asset is new. However, this increase in net asset does not reflect the increase in operations, unless additions are still work in progress.

The current asset items are all increasing with significant increase in inventories nearly doubling each year and the receivables increasing significantly from 2019 to 2020 and a further increase in 2021. For these, it may show problems of liquidity given that there are more inventories and more receivable (not changing into cash).

Current liabilities are also increasing significantly as the Trade and other payables more than double each year and significant increases in the short-term borrowings. It looks like the short-term borrowings are being used to finance all the operations that include the financing of long-term assets. This shows a poor management of cash as the company needs to secure long-term funds to finance the long-term assets.

b)

On narrative information, possible information is the disclosure about employees in terms of a short report

The company highly depends on employees who are a major factor in the production process which also includes use of machines in the production plant. There company endeavors to make sure the safety and health of employees is taken care by implementing the Safety and Health policies in place that includes provision of safety equipment for staff, providing fire safety measures and education together with mental health clinic for staff. With the effects of Covid 19, no employee was laid off, the company continued to pay staff full salary even during the times when lock downs were implemented. This was making sure that the staff are well maintained and motivated so as to always choose the company as best employer. The company is expected to have long term benefits for the loyalty of staff. Despite to this, the company evidenced increase in production staff however, this is not evidenced by increase in operations as revenue in 2021 decreased by 12% compared to 2020. Thus, management needs to review strategies to make staff productive, so that increase in staff reflect increase in operations/revenue earnings.

On the other disclosure especially with the effects of Covid on production

The production costs have increased significantly especially in 2021. This has indicated was due to the effects of Covid 19 Epidemic that caused the supply chain of its major component of production. The costs became significant higher. The company is still trying to monitor the situation and will try as much as possible to reduce the impact in subsequent periods. The company inventories mainly increased due the higher cost of the major component of production.

Analysis has been made on the trend of the figures on performance and financial position showing a deteriorating situation. The company is expected to take care of the situation by securing long term finance and reduce reliance on short term borrowing. Other narrative information regarding employees and effects for Covid 19 have been presented and how the company expects to reduce the bad effects.

QUESTION FOUR

Marking guide

Report

Format (correct - opening title, from to date RE: - 1 mark + intro, body and concluding remark – 1 mark)

Part a)

Where control exists

IPSAS 28, 29 and 30: **Showing in separate financial – 1 mark + correct name or number of standard - 3 marks + Relevant reference to the assets of GoR– 1 mark**

IPSAS 35 and IPSAS 38: **Showing in consolidated financial 1 mark + correct name or number of standard - 2 marks + Relevant reference to the assets of GoR– 1 mark**

Where GoR is non-controlling interest

IPSAS 28, 29 and 30: **Showing in separate financial – 1 mark + correct name or number of standard - 3 marks + Relevant reference to the assets – 1 mark**

IPSAS 36 and IPSAS 38: **Showing in consolidated financial 1 mark + correct name or number of standard - 2 marks + Relevant reference to the assets of GoR– 1 mark**

IPSAS 16: **Correct name or number of standard - 1 mark**

Part b)

- 1 mark each for correct description of the following
- What IPSAS 17 governs and does not govern
- Cost model
- Revalued model
- Depreciation
- Impairment in accordance with IPSAS 2
- Derecognition
- Disclosure

Note:

The question requires candidates to have knowledge of relevant public sector pronouncements (IPSAS) relating to government investments in the three different investments and specifically in detail about Property, plant and equipment. In the three different investments, two will be disclosed differently in separate financials and consolidated financials.

Model answers

Report

From: Consulting advisor

To. Accountant General

Date: 20/08/2021

Re: Explanation on Government Investments and specifically on Property, Plant and Equipment

We are aware that the Government of Rwanda (GoR) is in the process of changing into full International Public Sector Accounting Standards (IPSAS) from the previous modified cash basis of accounting. This report is to provide explanations on relevant IPSAS government investments and specifically in detail on accounting for Property, Plant and equipment according to IPSAS 17 with the same name. These explanations are according to the following paragraphs.

Government investment as described show three categories. Relevant applicable standards will be shown below for each of those categories.

For the case of the companies that the GoR is the sole shareholder, it means that the separate financial statements of the government, the investment will be accounted for as per IPSAS 28, 29 and 30 which are on financial instruments: Presentation, Recognition and measurement and Disclosures respectively.

In presenting the consolidated government financials then the relevant IPSAS that shall apply are IPSAS 35 Consolidated Financial statements and IPSAS 38 Disclosure of Interests in other entities.

On companies that the GoR is the non-controlling shareholder together with other shareholders, then it means that in the separate financial statements of the government, the investment will be accounted for as per IPSAS 28, 29 ad 30 which are on financial instruments: Presentation, Recognition and measurement and Disclosures respectively.

In presenting the consolidated government financials then the relevant IPSAS are IPSAS 36 Investment in associates and joint ventures and IPSAS 38 Disclosure of Interests in other entities.

On other assets of property (land and buildings) that are held for possible investment by investors who will buy them at a time that to build according to various master plans of the cities the relevant IPSAS will be IPSAS 17 Investment properties.

There is further detailed guidance provided in handbooks as promulgated by IPSAB one of the bodies if IFAC.

IPSAS 17 Property, Plant and Equipment (PP&E), governs accounting treatment of assets that also include heritage assets recognized. The IPSAS 17 excludes Agricultural assets, Investment property, leases, mineral assets and reserves.

The IPSAS provides guidance on when PP&E should (meets definition and its probable for future inflows or that ensures the future flows) be recognized and for what amount (Initial cost that includes the purchase cost, cost to bring asset to working condition and estimate of dismantling or future environmental restoration costs). The initial cost can be the fair value at date of recognition if it's acquired in a non-exchange transaction.

IPSAS 17 requires the public sector entity to apply either the "cost model" or the "revaluation model" in the subsequent measurement for the property, plant and equipment as further explained below:

Cost model: Subsequent measurement is the initial cost+ subsequent cost that increases future cash in-flows less accumulated depreciation and impairment loss**.**

Revaluation Model: The subsequent measurement can also be at revalued amounts less accumulated depreciation and impairment loss. In case of revaluation, there should be revaluation of the whole/entire class of assets.

Depreciation is on each part of item of PP&E that has significant cost in relation to total cost. It is a way to spread the depreciable amount over the useful life depending on how economic benefits flow to the government. The depreciation is charged in the surplus or deficit as an expense.

Impairment is governed by IPSAS 21 "Impairment of non-cash generating assets or 26 Impairment of Cash generating assets. Any compensation of impairment is recognized in surplus or deficit as income and also as receivable.

Derecognition of PP&E occurs when disposed or where no future economic benefits are flowing to the entity. The gain or loss is recognized in surplus or deficit being difference between carrying amount and amount received as proceeds (recognized in accordance with IPSAS 9 Revenue from Exchange transactions.

There are disclosure requirements that includes a movement schedule that shows the summary of transactions in the period for the different classes of assets.

Conclusion

As seen above, the first part gave the relevant IPSAS for the three types of investment by the GoR of which showed relevant IPSAS in separate financials and consolidated financials. The last part showed the summary of the detailed guidance of IPSAS Property Plant and Equipment.

Note:

The question requires candidates to have knowledge of relevant public sector pronouncements (IPSAS) relating to government investments in the three different investments and specifically in detail about Property, plant and equipment. In the three different investments, two will be disclosed differently in separate financials and consolidated financials.

END OF MARKING GUIDE AND MODEL ANSWERS