CERTIFIED PUBLIC ACCOUNTANT

INTERMEDIATE LEVEL EXAMINATIONS

I1.2: FINANCIAL REPORTING

DATE: TUESDAY, 24 AUGUST 2021

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.
4. Section **B** has **two** questions, **one** question to be attempted.
5. In summary attempt **four** questions, **three** in section A and **one** in section B.
6. Marks allocated to each question are shown at the end of the question.
7. Show all your workings where applicable

SECTION A

QUESTION ONE

a) Explain the objective of general-purpose financial reporting as per the conceptual framework. (4 Marks)

b) Compare and contrast cash and profit in the analysis of financial statements. (4 Marks)

c) The following information relates to Mugisha Ltd, a private company:

Statement of profit and loss for the year ended 31 December 2020	
	Frw "000"
Revenue	2,553,000
Cost of sales	(1,814,000)
Gross profit	**739,000**
Other Income	
Interest received	25,000
Distribution cost	(125,000)
Administrative expenses	(264,000)
Finance costs	(75,000)
Profit before tax	**300,000**
Income tax expense	(140,000)
Profit for the year	**160,000**

Additional information:

i. Proceeds from disposal of non-current asset investments amounted to Frw 30 million.

ii. Fixtures and Fittings, with an original cost of Frw 85 million and a carrying amount of Frw45 million, were sold for Frw 32 million.

iii. The following information relates to Property, Plant and Equipment

	31.12.2020 Frw"000"	**31.12.2019 Frw"000"**
Cost	720,000	595,000
Accumulated depreciation	340,000	290,000
Carrying amount	**380,000**	**305,000**

iv. Dividends of Frw 80 million were paid during the year

v. The following working capital information also was provided for two financial years:

Assets	2020	2019
Inventories	150,000	102,000
Trade Receivables	390,000	315,000
Non-current assets investment	0	25,000
Liabilities		
Trade and other payables	127,000	119,000
Taxation	120,000	110,000

Required:

Prepare an extract of a cash flow statement for Mugisha Ltd indicating cash flow generated from operating activities as per IAS 7 for the Year ended 31 December 2020. (Use indirect Method) (12 Marks)

(Total: 20 Marks)

QUESTION TWO

On 1 July 2019, Beza Ltd acquired 75% of the equity share capital of Bwiza Ltd. Bwiza Ltd had been experiencing difficult trading conditions and making significant losses. In allowing for Bwiza Ltd 's difficulties, Beza Ltd made an immediate cash payment of only Frw 150 per share. In addition, Beza Ltd will pay a further amount in cash on 31 December 2020 if Bwiza Ltd returns to profitability by that date. The value of this contingent consideration at the date of acquisition was estimated to be Frw 180 million, but at 31 December 2019 in the light of continuing losses, its value was estimated at only Frw 150 million. The contingent consideration has not been recorded by Beza Ltd. Overall, the directors of Beza Ltd expect the acquisition to be a bargain purchase leading to negative goodwill. At the date of acquisition shares in Bwiza Ltd had a listed market price of Frw 120 each.

Below are the summarized draft financial statements of both companies.

Statements of profit or loss for the year ended 31 December 2019

	Beza Ltd Frw"000"	Bwiza Ltd Frw"000"
Revenue	11,000,000	6,600,000
Cost of sales	(8,800,000)	(6,720,000)
Gross profit/(loss)	**2,200,000**	**(120,000)**
Distribution costs	(300,000)	(200,000)
Administrative expenses	(525,000)	(240,000)
Finance costs	(25,000)	-
Profit/(loss) before tax	**1,350,000**	**(560,000)**
Income tax (expense)/ Relief	(350,000)	100,000
Profit/(loss) for the year	**1,000,000**	**(460,000)**

Statements of financial position as at 31 December 2019

Assets	**Beza Ltd**	**Bwiza Ltd**
Non-Current Assets	**Frw"000"**	**Frw"000"**
Property, Plant and equipment	4,100,000	2,100,000
Financial assets: Equity investment (see note (iii))	1,600,000	-
	5,700,000	2,100,000
Current assets	1,650,000	480,000
Total assets	**7,350,000**	**2,580,000**
Equity and liabilities		
Equity		
Equity shares of Frw 50 each	3,000,000	600,000
Retained earnings	2,850,000	1,200,000
	5,850,000	1,800,000
Current liabilities	1,500,000	780,000
Total equity and Liabilities	**7,350,000**	**2,580,000**

The following information is relevant:

i) At the date of acquisition, the fair values of Bwiza Ltd's assets were equal to their carrying amounts with the exception of a leased property. This had a fair value of Frw 200 million above its carrying amount and a remaining lease term of 10 years at that date. All depreciation is included in cost of sales.

ii) Beza Ltd transferred raw materials at their cost of Frw 400 million to Bwiza Ltd in September 2019. Bwiza Ltd processed all of these materials incurring additional direct costs of Frw 140 million and sold them back to Beza Ltd in November 2019 for Frw 900 million. At 31 December 2019 Beza Ltd had Frw 150 million of these goods still in inventory. There were no other intra-group sales.

iii) Beza Ltd has recorded its investment in Bwiza Ltd at the cost of the immediate cash payment; other equity investments are carried at fair value through profit or loss as at 1 January 2019. The other equity investments have fallen in value by Frw 20 million during the year ended 31 December 2019.

iv) Beza Ltd's policy is to value the non-controlling interest at fair value at the date of acquisition. For this purpose, Bwiza 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.

v) All items in the above statements of profit or loss are deemed to accrue evenly over the year unless otherwise indicated.

Required:

a) In the context of IAS 27 "Separate Financial Statements" and IAS 28 "Investment in Associates and Joint Ventures", explain the difference between significant influence and control. (3 Marks)

Prepare the consolidated statement of profit or loss for Beza Group for the year ended 31 December 2019 and the consolidated statement of financial position for Beza Group as at 31 December 2019. (27 Marks)

(Total: 30 Marks)

QUESTION THREE

a) IFRS 16 "Leases" was issued by the International Accounting Standards Board (IASB) on 13 January 2016 and had a mandatory effective date of 1 January 2019. Early application was permitted for companies that also applied IFRS 15 "Revenue from Contracts with Customers".

Leasing provides an important and flexible source of financing for many businesses. However, the old lease accounting Standard (IAS 17 "Leases") makes it difficult for investors and others to compare and get an accurate picture of a company's leased assets and liabilities. Leases were classified previously under IAS 17 as finance or operating leases at inception, depending on whether substantially all the risks and rewards of ownership transfer to the lessee. Under a finance lease, the lessee has substantially all of the risks and reward of ownership.

IFRS 16 sets out the principles (for the recognition, measurement, presentation and disclosure of leases) that both parties to a contract i.e., the customer ('lessee') and the supplier ('lessor'), apply to provide relevant information about leases in a manner that faithfully represents those transactions. To meet this objective, a lessee is required to recognize assets and liabilities arising from a lease. 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. Lessors continue to classify leases as operating or finance, with IFRS 16's approach to lessor accounting substantially unchanged from its predecessor, IAS 17.

Required:

Explain the accounting treatment of leases under IFRS 16 leases in the financial statements of the lessor. (5 Marks)

b) XYZ Plc, a publicly listed company had two loans in existence in the year it commenced construction of a qualifying asset.

The details of the loans are:

	1st January 2019 Frw "Million"	31st December 2019 Frw "Million"
12% bank loan repayable in 2021	500	500
9% bank loan repayable in 2022	750	750

The two loan notes were originally obtained in a "general loan pool" but partly applied to the construction of a qualifying asset.

Construction works began on 1st April 2019 with expenditure of Frw 180 million and Frw 70 million drawn down for the construction on 1st April 2019 and 1st November

2019 respectively, from existing loans. Construction works were completed on 31st December 2019.

Required:

Explain and quantify how the borrowing costs on the loans and the qualifying asset shall be accounted for by XYZ for the year ended 31st December 2019 in accordance with IAS 23 "Borrowing costs." (15 Marks)

c) Jambo Ltd acquired an item of plant on 1st July 2019 with the following costs:

	Frw "Million"
List price	240
Trade discount (5% of list price)	
Modification cost to enable use of the plant	30
Delivery and installation costs	15
1-year warranty cost	2

Jambo qualified for a government grant of 25% of acquisition cost of the plant qualifying for capitalization before the end of the current accounting period. The grant had not been received by 30th June 2020 though the government had indicated to Jambo Ltd that the grant would be disbursed within two weeks after 30th June 2020.

The plant is to be depreciated on a straight-line basis over three years with a nil estimated residual value. It is Jumbo Ltd's practice to recognize grants as deferred income.

Required

Explain and quantify how the above transaction should be accounted for when finalizing financial statements of Jambo for the year ended 30th June 2020.

(10 Marks)

(Total: 30 Marks)

SECTION B

QUESTION FOUR

EMJ operates groceries business in Kigali. Tto expand its business, the company decided to open a branch in Nairobi. The Nairobi branch is an integral foreign operation of EMJ. At the end of 30 September 2020, the following balances were extracted from Head office and its branch in Nairobi:

	Kigali		**Nairobi**	
	Frw "000"		**Sh."000"**	
	Dr	**Cr**	**Dr**	**Cr**
Share capital	-	2,000	-	-
Reserves & Surplus	-	1,000	-	-
Land	500	-	-	-
Buildings @cost	1,000		-	-
Buildings Accumulated Depreciation	-	200	-	-
Plant and Machinery @ cost	2,500	-	200	-
Plant& Machinery Accumulated Depreciation	-	600		130
Receivables & Payables	280	200	60	30
Inventories @ 1st October 2019	100	-	20	-
Cash and bank balances	10	-	10	-
Purchases &Sales	240	624	25	123
Managing Director's salary	30	-	-	-
Wages & salaries (other personnel)	75	-	45	-
Rent	-	-	12	-
Office expenses	25	-	18	-
Commission receipts	-	256	-	107
Miscellaneous expenses	120	-	-	
Total	**4,880**	**4,880**	**390**	**390**

The following information is also available:

1) Inventories as at 30 September 2020: Kigali Frw 150,000 and Sh. 312.5 for Nairobi branch.
2) Exchange rates:
    - Opening rate 1Ksh@ 8 Frw
    - Closing rate 1Ksh@ 10 Frw
    - Average rate 1Ksh@ 9 Frw

Required:

a) **Translate the balances as exactly reported in the Nairobi branch's trial balance into the Head office's (Kigali) presentation currency.**
(7 Marks)

b) **Prepare in columnar format the:**
    i) **Head office, branch and combined statement of profit or loss for the year ended 30 September 2020.** (7 Marks)

ii) **Head office, branch and combined statement of Financial Position as at 30 September 2020.** (6 Marks)

(Total: 20 Marks)

QUESTION FIVE

a) Since 2016, the Government of Rwanda embarked on a project of shifting from cash basis of accounting to full accrual accounting basis to meet International Public Sector Accounting Standard Board (IPSASB) requirements, but so far, the trend is not yet as good as expected due to prevailing challenges. **Explain the challenges faced by the Government of Rwanda to smoothly transit from the cash-based IPSAS to the accrual-based IPSAS accounting framework** (5 Marks)

b) The following trial balance was extracted from the books of Teganya Pension Fund as at 31 December 2020:

	Frw "Million"	**Frw "Million"**
Accumulated fund as at 1 January 2020		23,078
Administrative expenses	142	
Demand deposits	1,173	
Reduction in market value of an investment	1,132	
Commutation and lump sum retirement benefits	241	
Contribution due within 30 days	247	
Employer Normal contribution		1,504
Individual transfer from other schemes		320
Individual transfer to other schemes		93
Investment income		2,370
Investment property	6,616	
Fixed income investment	13,180	
Members normal contributions		912
Members voluntary contributions		228
Pensions Paid	382	
Equity investments: Quoted	4,392	
Unquoted	1,000	
	28,505	**28,505**

Additional information:

The following expenditure were not paid at the year-end and by mistake, the accountant failed to recognize them in the statement of Net assets

a) Sundry expenses of Frw 12 million
b) Unpaid benefit of Frw 16 million

Prepare a:

i) **Statement of change in net assets for the year ended 31 December 2020** (8 Marks)

ii) **Statement of Net Assets as at 31 December 2020**. (7 Marks)

(Total: 20 Marks)

End of Question Paper