CERTIFIED PUBLIC ACCOUNTANT

FOUNDATION LEVEL 1 EXAMINATION

F1.3: FINANCIAL ACCOUNTING

TUESDAY, 30 NOVEMBER 2021

MODEL ANSWERS AND MARKING GUIDE

SECTION A

QUESTION ONE

Marking guide	**Marks**
a) Standard setting process – (1 mark for each correctly identified step, Max. 6 marks)	6
b) Measurement bases (Award 1.5 marks for each correct measurement base well explained, Max. 6 marks, award 1 mark only if a measurement base is given and not explained)	6
C) i) Manufacturing account (Award 0.5 Marks for each correct line item except totals and subtotals, for the factory profit award 1 full mark – Max. 8 Marks)	8
ii) - Statement of comprehensive income (Award 0.5 Marks for each correct line item except totals and subtotals, Max. 7.5 Marks)	7.5
- Workings (Award 0.5 for each correct line of workings as per the model answer except for the totals, Max. 5 Marks)	5
iii) Statement of financial position (Award 0.5 Marks for each correct line item except totals and subtotals, Max. 7.5 Marks)	7.5
Total marks	**40**

Detailed Answer

a) The typical sequence for the development of a new International Financial Reporting Standard is as follows:

1. Setting the agenda: The IASB identifies a topic that should be covered and appoints a committee from its members to work on the subject;
2. Planning the project
3. Developing and discussing the discussion paper, including the public consultation
4. Developing and publishing the exposure draft, including the public consultation
5. Developing and publishing the standards
6. Procedures after the standard is issued: education activities around the standard and dealing with implementation issues including the review of the standard

b) The framework identifies four measurement bases, which are used to a different degree on different items and in varying combinations in financial statements:

1. **Historical cost:**
Historical cost is used where the basis for computing the carrying amount of an asset is the amount of cash paid to acquire it in the first place.
2. **Current cost:**

This measurement base corresponds to the amount of cash that would need to be paid to replace the item today. The idea here is to state financial statements in such a way that current economic conditions are considered, as opposed to just reflecting historical "price tags" from past transactions.

3. **Realizable value:**
   A realizable value is the amount of cash that could be obtained if the asset were sold today in an orderly, non-forced transaction.
4. **Present value:**
   A present value is equal to the discounted value of all future benefits that are expected to be generated by the asset in the normal course of business.

c)

i)Alex

Manufacturing account for the year ended 30 September 2020

	FRW "000"	FRW "000"
Opening Raw materials	5,040	
Add purchases	91,200	
Cost of raw materials available for use		96,240
Less closing raw materials	(6,600)	
Raw materials consumed		89,640
Direct labour (W1)	58,880	
Prime costs		148,520
Factory overheads		
Salary of factory Management staff	11,400	
Repairs- Factory building	480	
Repairs-Machinery and Plant	2,400	
Rent and Rates (W4)	3,341	
Light and Power (W4)	5,472	
Canteen subsidy (W4)	1,152	
Depreciation of machinery (W2)	1,680	
Factory manager commission	3,165	
		29,090
Adjustment for WIP		
Opening WIP	10,200	
Less closing WIP	10,800	(600)
Production cost		177,010
Factory profit (177,010*20%)		35,402
Transfer price		212,412

ii) Alex

Statement of Comprehensive Income for the year ended 30 September 2020

	FRW "000"	FRW "000"
Revenue		234,360
Cost of goods sold		
Opening finished inventory	7,200	
Production cost/Transfer price	212,412	
Less closing finished inventory	(5,520)	
Cost of goods sold		214,092
Gross profit		20,268
Add profit from manufacturing		35,402
Decrease in Unrealized profit		280
Total gross incomes		55,950
Operating expenses		
Salary of clerical staff	17,612	
Rent and Rates (W4)	2,227	
Light and Power (W4)	3,648	
Canteen subsidy (W4)	768	
Motor expenses	4,980	
Postage and telephone	3,816	
Printing and Stationery	1,392	
Carriage and packing	9,792	
Depreciation of Motor van (W2)	1,650	
Audit and Consultancy	1,800	
Allowance for doubtful debts (38,568*1%)	386	
Total operating expenses		48,071
Net profit for the year		7,879

iii) Alex

Statement of Financial position as at 30 September 2020

Assets	**FRW "000"**	**FRW "000"**
Freehold property		10,800
Machinery and plant (8,400 -1,680)		6,720
Motor van (6,600 - 1,650)		4,950
Total NCA		22,470
Current Assets		
Inventory (W3)	22,000	
Prepaid Rent and Rates	432	
Trade debtors (38,568-386)	38,182	
Total current Assets		60,614
Total Assets		**83,084**
Equity and Liabilities		
Capital (43,200-19,200)	24,000	
Retained Earnings	7,879	
Total Equity		31,879
Current liabilities		
Trade Creditors	38,400	
Bank overdraft	4,904	
wages in arrears	1,280	
Outstanding Audit and consultancy	1,800	
Factory Manager's commission	3,165	
Outstanding Power and Light	1,440	
Outstanding Telephone and postage	216	
Total Current liabilities		51,205
Total Equity and Liabilities		**83,084**

Workings	**FRW 000**
W1) Wages -Trial Balance	57,600
Wage arrears	1,280
Wage expenses	58,880

W2) Depreciation	FRW 000
Machinery and Plant (8,400*20%)	1,680
Motor Van (6,600*25%)	1,650

	FRW 000
W3) Inventory	
Raw material	6,600
Work in progress	10,800
Finished goods (5,520*100/120)	4,600
	22,000

W4) Allocation of overheads	**Manufacturing (60%)**	**Profit/loss (40%)**
	FRW "000"	**FRW "000"**
Rent and Rates (6,000-432)	3,341	2,227
Light and Power (7,680 + 1,440)	5,472	3,648
Canteen subsidy	1,152	768

SECTION B

QUESTION TWO

Marking guide	**Marks**
a) Categories of ratios – (1 mark for each correctly explained type of ratio, Max. 4 marks)	4
b) Computation of ratios (Award 1.5 marks for each correctly computed ratios i.e., 0.5 marks Only for a correct formula, Max. 12 marks for all ratios)	12
c) Commenting on ratios (Award 1 mark for a relevant interpretation of each of the ratios Max. 4 marks for comments on all of the 4 ratios computed)	4
Total marks	**20**

Detailed answer

a) Categories of ratios are:

1. Profitability/ Performance Ratios; these ratios help to assess how profitable the company is. E.g.: Gross Profit Margin (GPM), Return on capital Employed (ROCE) etc.

2. Liquidity Ratios: The ratios in this category assess the ability to pay current liabilities, implying a short-term perspective. E.g.: Current ratio, Acid test ratio, etc.…

3. Long-term stability ratios: The main points to consider when assessing the longer-term financial position are: The level of debts does a company have and the level of overtrading.

   - Gearing: There are two methods commonly used to express gearing as follows. Debt/equity ratio: Loans + Preference share capital Ordinary share capital + Reserves + Non-controlling interest Percentage of capital employed represented by borrowings: Loans + Preference share capital Ordinary share capital + Reserves + Non-controlling interest + Loans + Preference share capital
   - Overtrading.

4. Investor ratios: These are ratios relevant to investors and show mainly the return to investors as compared to the capital invested. Examples include:

   Earnings per share, dividend per share,

   Price / Earnings (P/E) ratios: Measures the relationship between the current price of a company’s common stock and the level of earnings per share, or EPS generated by the business.

   Apart from the above 4 categories, a student can also explain turnover/operating ratios.

b) Computation of ratios

Acid test ratio	Current assets less inventory/Current liabilities	
Acid test ratio	Kisimenti Shop	Down Town Shop
Current assets minus inventory	42,000	35,700
Current liabilities	37,500	48,750
i)Acid test ratio	**1.12:1**	**0.73:1**
Gearing ratio	Long term debts/total equity+ Long term debt	
Long term debts	45,460	130,382
Total equity	321,840	305,748
ii)Gearing ratio	**12%**	**30%**
ROCE	PBIT/Equity	
PBIT	26,320	19,740
Total equity	321,840	305,748
iii) ROCE	**8%**	**6%**
Receivable collection period	(Receivable/credit sales)*365	
Receivable	36,000	30,600
credit Sales (60% of total sales)	120,960	90,720
iv)Receivable collection period	**109**	**123**

C) Interpretation of ratios

1. Liquidity position: both Kisimenti and Down town shops have good liquidity position of 1.12:1 and 0.73:1 respectively. Kisimenti is higher than sector average liquidity level whereas Down town is near but below the sector average. Generally, we can see that liquidity position is good even though Kisimenti branch may be said to hold a lot of liquid assets and the management should be cautious not to hold idle assets.
2. Gearing ratio: both branches have less debt than the average as they have 12% and 30% respectively compared to the average of the sector. However, Down town is having more debts than Kisimenti and thus should pay more attention as it is increasing its risks.
3. ROCE: ROCE for both shops are 8% and 6% for Kisimenti and Down town respectively. They are all below the sector average of 9.3% which indicates poor financial performance in terms of profitability and thus both branches should improve on their efficiency and revenue generation to increase their profitability to the level of the sector.
4. Receivable collection periods for Kisimenti is 109 days whereas for Down town are 123 days. They are far above the sector average which indicates inefficiency in the recovery of these two shops. This is another area where both branches need to improve.

QUESTION THREE

Marking guide	**Marks**
a) Explaining the treatment of development expenditure with example – (Award 1 mark)	1
Explaining the treatment of research expenditure with an example (Award 1 mark)	1
b) i) Reconciling opening balances (Award 1mark for each correct figure except the last total, Max. 6 marks)	6
ii) Adjusted Cash book (Award 1 mark for a correctly posted figure – Mo marks allocated for totals, Max. 7 marks)	7
iii) Bank Reconciliation (Award 1 mark for each correct reconciliation item including the balances, Max. 5 marks)	5
Total marks	**20**

Detailed answer

a)

1. Research expenditure: this is a write off as incurred to the statement of profit or loss. The examples include the research costs incurred during the research phase of developing a product prototype.

2. Development expenditure: This is recognized as an intangible asset if, and only if, an entity can demonstrate all the following:

   • Probable flow of economic benefit from the asset, whether through sale or internal cost savings.
   • Intention to complete the intangible asset and use or sell it
   • Reliable measure of development cost
   • Adequate resources to complete the project
   • Technical feasibility of completing the intangible asset so that it will be available for use or sale
   • Expected to be profitable, i.e., the costs of the project will be exceeded by the benefits generated.
   Example include any costs incurred during the development phase provided the above conditions are met.

b)

i) Reconciliation of Opening Balances

	FRW '000"
Balance as per Bank Statement	87,390
Balance as per Cash Book	82,455
Difference	**4,935**
Cheques issued in previous period	
Cheque 836780	2,130
Cheque 836782	3,685
Lodgment	(880)
Total	**4,935**

ii) Adjusted Cashbook

Dr	Update Cashbook		Cr
	FRW '000"		**FRW '000"**
Bal. b/d as per cashbook	99,865	Bank Charges	235
Cheque overstated	45	Standing Order	685
		Payment no in cash book (923)	1,485
		Error in lodgment	5
		Bal. c/d	**97,500**
	99,910		99,910

iii) Bank Reconciliation

	FRW
Balance as per Bank Statement	98,690
Less payment not presented	(485)
Payment not on Bank statement	(1300)
Add lodgment not on Bank statement	595
Balance as per cash book	**97,500**

QUESTION FOUR

Marking guide	**Marks**
a) Differentiating preference from ordinary shares – (Award 1 mark for each correctly identified difference, Max. 2 Marks)	2
b)	
i)Double entries on application (Award 1mark for each correct debit or credit, Max. 3 Marks)	3
Double entry on allotment of shares (Award 1.5 markS for each correct debit or credit, Max. 6 Marks)	6
Double entry on share re-issue (Award 1mark for each correct debit or credit, Max. 3Marks)	3
ii) Extract of the statement of financial position (Award 2 marks per each correct line, Max. 6Marks)	6
Total marks	**20**

Detailed answer

a) There are several differences between ordinary shares and preference shares and this model answer include some of these:
The primary difference between ordinary shares and preference shares is that the latter have more priority in terms of payment of dividends and in the case of liquidation of a bankrupt company. Another difference is that the preference shares are normally issued to investors while ordinary shares are issued to founders of the business.
A student would also use some other criteria to differentiate the two as per the example below:

Ordinary shares	**Preference shares**
Have voting rights	Have no voting rights
Dividends are paid last	Have a priority in dividend distribution
Paid last in the event of company liquidation	Have priority in the event of company liquidation
Dividends vary depending on the performance	Dividends are fixed irrespective of performance
Issued to founders	Issued to investors

b) Issue of Shares
i)Double entries

Entries upon Application

Bank		1,150,000	
	Preference share application a/c		500,000
	Equity share application a/c		650,000

(Being preference and Equity shares application money received on 20,000 preference and 26,000 ordinary shares @ FRw25 per share)

Upon allotment of shares 1.5 Mark per entry / 6 Marks in total

Preference Share application a/c	500,000	
Equity Share application a/c	650,000	
Preference Share capital a/c		500,000
Equity Shares capital a/c		650,000

(Being the application money on preference and ordinary shares transferred to the respective share capital accounts.)

Re-issued forfeited Ordinary shares

Bank (4000* 25 * 90%)	90,000	
Discount on issue of shares	10,000	
Equity share		100,000

ii) Statement of Financial Position as at 31 December 2020 (Extract)

Current Assets	
Bank	1,150,000
Equity	
Ord shares	650,000
Preference shares	500,000

QUESTION FIVE

Marking guide	**Marks**
a) Advantages of using IPSAS – (Award 1 mark for each correct advantage, Max. 5Marks)	5
b) Role of a control account (Award 1mark for each correct role, Max. 3 Marks)	3
c) i) Receivables control account (Award 0.5 marks for each correct figure including totals Max. 6 Marks)	6
ii) Payables control account (Award 0.5 marks for each correct figure including totals Max. 6 Marks)	6
Total marks	**20**

Detailed answer

a) Advantages of adopting IPSAS to Rwanda include the following:

1. Greater Accountability and transparency
2. Improved efficiency
3. High quality of government financial reporting
4. Assisting in financial planning
5. Reliable base for audit

There might be other relevant advantages not listed in the above model answer

b) The roles of a control account include the following:

1. It helps in confirming the arithmetic correctness of transactions posted in the individual ledger accounts.
2. It acts as a summary of the total account balances to be posted in the trial balance at the end of the financial period.
3. It is a tool for detecting and preventing errors and frauds in the respective accounts
4. It facilitates delegation of duties to clerks responsible of maintaining debtor and creditor accounts.
5. It quickens the process of preparing the final accounts of the business. The control accounts provide the balances to be used in the preparation of statement of financial position for it avails only a single figure which is an aggregate of derived from the subsidiary ledgers.

c)

i) Receivable control A/c		
	Dr	Cr
	FRW	FRW
Bal b/f	45,360	192
Credit sales	312,780	
Discount allowed		10,950
Return inwards		4,350
Irrecoverable debts written off		1,320
contra entry for Kalisa		6,000
contra entry	150	
Payment received		289,620
Bal c/d		45,858
	358,290	**358,290**

ii) Payables control A/c		
	Dr	Cr
	FRW	FRW
Bal b/f	354	25,500
Purchases		253,038
Discount received	9,144	
Return outwards	3,120	
contra entry for Kalisa	6,000	
contra entry		150
Payments made to suppliers	258,402	
Bal c/d	1,872	204
	278,892	**278,892**

End of Model answers and Marking Guide