CERTIFIED ACCOUNTING TECHNICIAN (CAT)

STAGE 3 EXAMINATION

S3.1 FINANCIAL ACCOUNTING

DATE: MONDAY, 29 NOVEMBER 2021

MODEL ANSWERS AND MARKING GUIDE

SECTION A

Marking guide

Question Number	Answer
1	**D**
2	**C**
3	**D**
4	**B**
5	**B**
6	**D**
7	**D**
8	**A**
9	**A**
10	**D**

		Marks
Question 1 to 10	2 marks for each correct answer	2
Total marks for the section		**20**

Detailed Answer

QUESTION ONE

The correct answer is D

Businesses are required to consider and comply with National Legislation (A), International Financial Reporting Standards (IFRS) (B) and they are supposed to use Judgment in the application of accounting assumptions and conventions (C).

QUESTION TWO

The correct answer is C

The features of Significant Influence include:

i. Representation on the board of directors (or equivalent) of the investee
ii. Participation in the policy making process
iii. Material transaction between investor and investee
iv. Interchange of management personnel

But they do not include holding not less than 10% of the voting power of the entity.

Note: Other options A, B and D are incorrect because options A and B include a wrong feature i.e., “ii) holding not less than 10% of the voting power of the entity” while option D assumes all the features provided are not correct with respect to significant influence.

QUESTION THREE

The correct answer is D

The gross profit margin = Gross profit/sales = 1,508,000/3,458,000 = 43.6%
Option A is incorrect because it uses Cost of sales as a numerator in the formula instead of gross profit.
Option B is incorrect because it uses other income as a numerator in the formula instead of gross profit.
Option C is incorrect because it uses gross income as a numerator in the formula instead of gross profit.

QUESTION FOUR
The correct answer is B
The inventory turnover period in days for a 365 days/year = (Inventory/Cost of goods sold)*365 = (450,000/1950,000)*365 = 84.23 Days
Option A is incorrect because it calculates receivables collection period instead of inventory turnover in days
Option C is incorrect because it uses sales on the denominator in the formula instead of cost of goods sold
Option D is incorrect because it uses 360 days per year

QUESTION FIVE
The correct answer is B
IAS 16 Disclosure requirements include among others:

i. Measurement bases (A)
ii. Depreciation Methods (C)
iii. Reconciliation of the carrying amount at the beginning and of the end of the period (D)

But they do not include asset financing method (B)

QUESTION SIX
The correct answer is D
An entity that reports under IAS 40 is required to disclose:

i. Reconciliation of the carrying amount of the investment property at the beginning and at the end of the period (A)
ii. Significant adjustments to an outside valuation (if any) (B)
iii. Rental income from investment property (C)

But it is not required to disclose the depreciation method used (D) since the asset is not depreciated.

QUESTION SEVEN

The correct answer is D

An accounting function should aim to produce reliable information in a timely manner in the most cost-effective way.

Options **A**, **B** and **C** are not correct because they exclude one or more of the three main aims.

QUESTION EIGHT

The correct answer is A

The analysis of financial statements is carried out so that the significance of the financial statements can be better understood through comparisons with historical performance and with other companies.

Option B, C and D are not correct assertions in relation to the analysis of financial statements.

QUESTION NINE

The correct answer is A

Disclosure notes provide more detail for the users of financial statements about the information in the statement of financial position and statement of profit or loss and other comprehensive incomes.

Option B is not correct since the purpose of notes **is not to** present financial information in a **favorable way** by disclosing **some issues** in the notes and not on the main financial statements.

Option C is not correct because disclosure notes **cannot** give all the details of all the transactions that occurred during the period.

Option D is not correct because disclosure notes are not presented solely to explain the accounting treatment adopted where management have chosen not to apply accounting standards.

QUESTION 10

The correct answer is D

IAS 10 requires disclosing the nature of both material and non-material non-adjusting events.

SECTION B

QUESTION 11

Marking Guide

	Marks
Explaining operating activities	2
Giving examples of operating activities (1 mark each – Max. 2 marks)	2
Explaining Investment activities	1
Giving examples of investing activities (1 mark each – Max. 2 marks)	2
Explaining financing activities	1
Giving examples of financing activities (1 mark each – Max. 2 marks)	2
Total marks	**10**

Detailed Answer

The cash flow statement is made of three activities namely operating activities, investment activities and financing activities.

Operating activities

This is perhaps the key part of the statement of cash flows because it shows whether, and to what extent, companies can generate cash from their operations. It is these operating cash flows which must, in the end, pay for all cash outflows relating to other activities, i.e., paying loan interest, dividends and so on. Most of the components of cash flows from operating activities will be those items which determine the net profit or loss of the enterprise, i.e., they relate to the main revenue-producing activities of the enterprise.

The standard gives the following as examples of cash flows from operating activities. (a) Cash receipts from the sale of goods and the rendering of services (b) Cash receipts from royalties, fees, commissions, and other revenue (c) Cash payments to suppliers for goods and services (d) Cash payments to and on behalf of employees. Certain items may be included in the net profit or loss for the period which do not relate to operational cash flows; for example, the profit or loss on the sale of a piece of plant will be included in net profit or loss, but the cash flows will be classed as investing.

Investing activities

The cash flows classified under this heading show the extent of new investment in assets which will generate future profit and cash flows.

The standard gives the following examples of cash flows arising from investing activities. (a) Cash payments to acquire property, plant and equipment, intangibles and other non-current assets, including those relating to capitalized development costs and self-constructed property, plant and equipment (b) Cash receipts from sales of property, plant and equipment, intangibles and other non-current assets (c) Cash payments to acquire shares or loan notes of other entities (d) Cash receipts from sales of shares or loan notes of other entities (e) Cash advances and loans made to other parties (f) Cash receipts from the repayment of advances and loans made to other parties.

Financing activities

This section of the statement of cash flows shows the share of cash which the entity's capital providers have claimed during the period. This is an indicator of likely future interest and dividend payments.

The standard gives the following examples of cash flows which might arise under these headings. (a) Cash proceeds from issuing shares (b) Cash payments to owners to acquire or redeem the entity's shares (c) Cash proceeds from issuing loans, bonds, mortgages and other short- or long-term borrowings (d) Cash repayments of amounts borrowed (e) Cash payments by a lessee for the reduction of the outstanding liability relating to a lease.

QUESTION 12

Marking Guide	**Marks**
a) Determining net Realizable value (NRV)	1
Identifying the lower of the cost and net realizable value	1
Determining the correct profit (1 mark for each correct line – No marks allocated on the profit before correction line – Max. 3 marks)	3
b) Calculation of the capitalization rate (1 mark for each bank weighted interest, Max. 2marks)	2
Calculation of interest to expense to be capitalized – Bank A Plc	1
Calculation of interest income on invested amount	1
Calculation of interest to expense to be capitalized – Bank B Plc	1
Total marks	**10**

Detailed answer

	Item	**Calculations**
a)	**Determining Net Realizable Value**	
	Expected selling price	14,758,350
	Less costs to sale	(1,856,400)
	NRV	**12,901,950**
	Original cost before damage	22,586,450
	Cost of the inventory (Lower of NRV and original cost)	12,901,950
	Determining the correct profit for the year	

	Profit before correction	229,199,494
	Less original cost of inventory (It had underestimated cost of goods sold thus overestimating the gross profit and consequently the profit)	(22,586,450)
	Add Inventory as per IAS 2	12,901,950
	Profit after adjustment	219,514,994
b)	**Calculation of capitalization Rate**	
	Bank A plc Loan	4,500,000,000
	Bank B plc Loan	3,850,000,000
	Total Loan	8,350,000,000
	Bank A plc Interest rate	15.0%
	Bank B plc interest rate	16.5%
	Bank A plc Interest Rate Weighted	4.5B/8.35B*15%=8.1%
	Bank B interest Rate Weighted	3.85B/8.35B*16.5%=7.6%
	Weighted average rate	**8.1+7.6=15.7%**
	Calculation of borrowing costs to be capitalized	
	Borrowing costs for Bank A Plc	
	Loan	4,500,000,000
	Interest to be capitalized for the year	4.5B*15.7%=706,500,000
	Less interest income received	2.865B*6.5%*3/12= (46,556,250)
	Bank A plc Interest to be capitalized	655,943,750
	Borrowing costs for Bank B plc	
	Loan	3,850,000,000.00
	Interest to be capitalized for the year	3.85B*15.7%= 604,450,000
	Total Borrowing cost to be capitalized	**1,260,393,750**

SECTION C

QUESTION 13

Marking Guide

	Marks
a) Explaining the term inherent limitations	2
Giving examples/reasons of why inherent limitations occur (2 marks relevant example/reason – Max. 8 marks)	8
i)Differentiating fraud and error (1 mark each – Max. 2 marks)	2
ii) Types of Fraud (Award 0.5 marks for each type and 0.5 marks each example – Max.2 marks)	2
iii) Impacts of fraud (Award 2 mark for each well explained impact – Max. 6 marks)	6
Total marks	**20**

Deatailed answer

a) Any internal control system can only provide the directors with reasonable assurance that their objectives are reached, because of inherent limitations. These are limitations which are unlikely or difficult to avoid, including the following:

- ✓ The potential for human error : These include the fact that human judgement in decision-making can be faulty or produce simple errors and mistakes. This is particularly important where any element of judgement or estimate is required. On the other hand, there may be controls in place, but the personnel do not fully understand their implications, and fail to review any system highlighted problems or investigate unusual items sufficiently.
- ✓ The possibility of controls being by-passed or over-ridden : Controls can be circumvented by the collusion of two or more people or management may inappropriately override controls. For example, management could enter into a side agreement with customers that alters the terms and conditions of sales contracts, which could result in improper revenue recognition.
- ✓ The costs of controls outweighing their benefits This is a particular problem faced by smaller entities. For example, smaller entities often have fewer employees which may limit the extent to which segregation of duties is practicable. It would not make commercial sense to employ additional staff purely for the purposes of achieving greater segregation of duties. However, this lack of formal control might be compensated for by a responsible and ethical owner-manager, who closely monitors his company's business and accounting processes.
- ✓ Controls tending to be designed to cope with routine and not non-routine transactions Non-routine transactions are by their very nature unusual. As a result it will be difficult to predict what these might be and therefore is less likely that a system will have been devised to deal with these effectively. For example, a sales system may be used to pricing items by kilogram weight, but a sales order has asked for a specific quantity, errors may occur in the calculation.

It is the responsibility of those charged with governance and management to implement an appropriate system of financial and non-financial controls. Any risk inherent in the general controls can be overcome by strong managerial or supervisory controls. Therefore, it is important that the management team review the controls on a regular basis.

b) (i) Fraud is where the person intentionally seeks to make a gain or cause a loss to another person or organisation by depriving them of assets. An error is an unintentional action which causes a loss to a person or organisation.

(ii) Common types of fraud iclude:

Misappropriation of assets, which includes: theft, teeming and lading and the payment of false employees or suppliers.

Misstatement of the financial statements, which includes: the overstatement of assets or profit, and the understatement of profit, losses or liabilities.

(iii) 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 14

Marking Guide

	Marks
Group statement of financial position (Award 1 mark for each correct line item except totals and subtotals - Max. 10 marks)	10
Workings (1 mark for each correct line item for each working except for totals and subtotals – Max. 10marks – No marks allocated for the group structure determination)	10
Total marks	**20**

Detailed Answer

Kamonyi Group	
Statement of Financial Position as at 31 December 2021	**FRW 000**
Non-Current Assets	
Property, Plant and Equipment (1,050,000+825,000+20,000)	1,895,000
Goodwill (W2)	155,000
	2,050,000
Current Assets	
Inventory (375,000+200,000-32,000)	543,000
Receivables (450,000+187,500 - 50,000)	587,500
Bank (150,000+87,500)	237,500
	1,368,000
Total Assets	**3,418,000**
Equity and liabilities	
Equity and reserves	
FRW 1,000 ordinary shares	2,250,000
Retained earnings (W4)	123,750
Non-Controlling Interest (W3)	364,250
	2,738,000
Current Liabilities	
Payables (305,000+50,000)	355,000
Tax Payables (175,000+200,000-50,000)	325,000
	680,000
Total Equity and liabilities	**3,418,000**

Workings

W1

Group Structure

Parent -700,000shares/1,000,000 shares*100	70%	
Non-Controlling Interest (100%-70%)	30%	

W2

Goodwill

Cost of Investment	836,250	
Fair Value (FV) of Non-Controlling Interest (NCI)	353,750	
Total Consideration		1,190,000
Fair Value of Net Assets		
Share Capital	1,000,000	
Retained earnings	15,000	
FV adjustments	20,000	
Total FV of net assets		1,035,000
Goodwill at acquisition		**155,000**

W3

Non-Controlling Interest

FV of NCI at Acquisition	353,750	
Post-Acquisition Share (30%*35,000)	10,500	
NCI at the reporting date		**364,250**

W4

Consolidated Retained earnings

Kamonyi ltd	131,250	
Gakenke ltd (70%*35,000)	24,500	
Unrealized Profit on Inventory (240,000*25/125*2/3)	(32,000)	
Consolidated Retained earnings at the reporting date		**123,750**

QUESTION 15

Marking Guide

	Marks
Statement of profit or loss and other comprehensive income (Award 1 mark for each correct line item except total comprehensive income)	10
Workings (There are 10 lines/figures in the model answer – Award 0.5 marks for each correct line/figure – Max. 5marks)	5
Statement of changes in Equity (award 1 mark per each correct figure except the totals)	5
Total marks	**20**

(a)	**ATRIKA LTD**	FRW
	Statement of profit or loss and other comprehensive income	
	for the year ended 31 December 2020	
	Revenue	2,784,000
	Cost of sales*	(973,000)
	Gross Profit	1,811,000
	Other income	45,000
	Operating expenses	(395,000)
	Finance costs**	(45,000)
	Profit before tax	1,416,000
	Taxation	(283,000)
	Profit for the year	1,133,000
	Other comprehensive income Gains on property revaluation***	450,000
	Total comprehensive income for the year	1,583,000

Workings

- Purchases = FRW782,000
- Opening inventory = FRW378,000
- Depreciation of Buildings = FRW1,750,000/35 years = FRW50,000

- Depreciation of Plants and machinery = (FRW1,560,000 – FRW260,000) □ 15% =FRW195,000
- Closing inventory = FRW432,000

* Cost of Sales = 782,000 + 378,000 + 195,000 + 50,000 – 432,000

** Finance costs = FRW500,000 * 9% = FRW45,000

*** Gains on property revaluation = Gains on Land revaluation + Gains on Buildings revaluation

- Gains on Land revaluation = FRW800,000 – FRW700,000 = FRW100,000
- Gains on Buildings revaluation = FRW1,750,000 – (FRW2,000,000 – FRW600,000) =FRW350,000
- Gains on property revaluation = FRW100,000 + FRW350,000 = FRW450,000

(b) ATRIKA LTD
Statement of changes in equity for the year ended 31 December 2020

	Share capital	Revaluation surplus	Retained earnings	Total
	FRW	FRW	FRW	FRW
At 1 January 2018	1,500,000	—	1,195,000	2,695,000
Profit for the year	—	—	1,133,000	1,133,000
Revaluation of property	—	450,000	—	450,000
Dividends	—	—	(150,000)	(150,000)
At 31 December 2018	**1,500,000**	**450,000**	**2,178,000**	**4,128,000**

End of model answers and marking guide.