CERTIFIED PUBLIC ACCOUNTANT

ADVANCED LEVEL 1 EXAMINATIONS

A1.3: ADVANCED FINANCIAL REPORTING

DATE: TUESDAY 25, APRIL 2023

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

The following draft financial statements relate to Umuntu General Enterprises (UGE), its subsidiary Muzuri-Link and an associate company Jambo Stores are specialized in the sale of construction materials. UGE and its associate company Jambo Stores are both located in Rwanda and operate a number of hardware stores across the country. UGE holds an investment in Muzuri-Link, a subsidiary based in Guinea (in West Africa) whose financial statements are presented in the Guinean Francs (GNF) currency.

Below are the draft financial statements of UGE, Muzuri-Link and Jambo Stores for the year ended 31 December 2021.

Statement of financial position as at 31 December 2021			
	UGE	**Muzuri-Link**	**Jambo Stores**
	FRW (million)	**GNF (millions)**	**FRW (million)**
Assets			
Non-Current Assets			
Property, plant & equipment	39,200	54,600	14,700
Investment in Muzuri-Link – cost	15,400	-	-
Investment in Jambo Stores – fair value	6,440	-	-
Financial assets	1,680	13,720	1,260
	62,720	**68,320**	**15,960**
Current assets			
Inventories	2,800	2,240	1,680
Trade receivables & other receivables	4,200	5,040	3,500
Cash and Bank	1,960	12,600	1,540
	8,960	**19,880**	**6,720**
Total Assets	**71,680**	**88,200**	**22,680**
Equity			
Ordinary share capital	11,200	29,400	7,000
Retained earnings	32,200	40,880	10,360
Other components of equity	5,600	-	1,680
Total equity	**49,000**	**70,280**	**19,040**
Non-current liabilities			
Long-term loans	9,100	9,800	700
Deferred tax	4,200	5,600	280
	13,300	**15,400**	**980**
Current liabilities	9,380	2,520	2,660
Total Equity & Liabilities	**71,680**	**88,200**	**22,680**

The following information is relevant to the preparation of the consolidated financial statements of the UGE:

(1) UGE owns 60% of the equity shares of Muzuri-Link, a company located in Guinea which uses Guinean Francs (GNF) as its functional currency. UGE acquired the investment in Muzuri-Link on 1 January 2021 at a cost of GNF 51,520 million. On the date of acquisition, Muzuri-Link retained earnings were GNF 36,120 million but there were no other equity reserves. There were no fair value adjustments deemed to be necessary in regard to Muzuri-Link's net assets on the date of acquisition. The fair value of the non-controlling interest was GNF 30,800 million on the acquisition date. Muzuri-Link has not issued any other equity shares after the shares acquired by UGE.

On 31 December 2021, following an impairment review, the goodwill in Muzuri-Link was impaired by 10%.

(2) On 1 February 2021, UGE gave a loan to Muzuri-Link for FRW 1,400 million which was interest-free. Muzuri-Link correctly recorded the loan in its financial statements using the spot exchange rate. Muzuri-Link repaid FRW 840 million on 1 November 2021 and this was recorded correctly using the spot rate of exchange on that date. The outstanding loan balance will be repaid in two years from the reporting date. No exchange differences relating to this loan have been made in Muzuri-Link's financial statements. The outstanding balance remains within the financial assets of UGE and the non-current liabilities of Muzuri-Link.

(3) On 1 November 2021, UGE sold goods to Muzuri for FRW 1,400 million on credit making a profit margin of 20%. On 31 December 2021, all of these goods were sold by Muzuri. However, the full credit amount remained outstanding on 31 December 2021 with the payable balance in the financial statements of Muzuri recognised using the exchange rate on date of their purchase.

(4) On 1 January 2021, UGE acquired 40% of the equity shares in Jambo Stores (a company based in Rwanda) at a cost of FRW 17,240 million and gained significant influence over Jambo Stores from that date. On 1 January 2021, Jambo Stores's retained earnings were FRW 5,460 million, other equity reserves were FRW 1,680 million and the fair value of its net assets were FRW 16,800 million.

Jambo Stores reported a profit of FRW 4,900 million for the year ended 31 December 2021 and out of these profits, Jambo Stores paid a dividend of FRW 1,400 million on the reporting date. Since UGE received its share of the dividend on 15 January 2022, the dividend income was not recognized by UGE in its financial statements on 31 December 2021.

Following an impairment loss review conducted on 31 December 2021, the investment in Jambo Stores was assessed to be impaired by 20% (based on historical cost on 1 January 2021)

In addition, Jambo Stores made sales to UGE during the year amounting to FRW 2,100 million making a profit margin of 25% and half of these goods remained unsold by UGE by 31 December 2021.

(5) The following exchange rates are relevant to the preparation of the group financial statements:

	GNF to 1 FRW
1 January 2021	11.2
1 February 2021	11.8
1 November 2021	12.6
31 December 2021	13.3
Average for year to 31 Dec 2021	11.9

Required:

a) **Explain, with supporting calculations, the entries Muzuri-Link needs to make in its individual financial statements (using its presentation currency) and in the consolidated financial statements of UGE Group as at 31 December 2021 to account for:**

i. The goods purchased from UGE; and

ii. The loan received by Muzuri-Link from UGE. (10 Marks)

b) **Translate Muzuri-Link's statement of financial position as at 31 December 2021 into Rwandan Francs (FRW) for inclusion in the consolidated statement of financial position and explain your calculations to the directors, including how to incorporate the translated figures into UGE Group's consolidated financial statements.** (15 Marks)

c) **Prepare the consolidated statement of financial position for the UGE Group as at 31 December 2021.** (25 Marks)

(Total: 50 Marks)

Note: It is the group's policy to present the translation reserve as part of the "other equity reserves" in the Group equity

SECTION B

QUESTION TWO

Butera Engineering plc is a local company listed on the stock market and specializes in the manufacturing of large construction equipment and machinery. The company has four main factories in Rwanda with over 100,000 employees working in these factories. Butera Engineering plc has a financial year ending 31 October. Below are some of the transactions for Butera Engineering plc for the year ended 31 October 2021.

(a) Pension scheme

The company operates a defined benefit pension scheme for its factory employees with the pension assets held separately in funds under the control of trustees. The company is seeking for your advice regarding the computation and accounting treatment of the pension plan. Below is the information relating to the pension plan in the year to 31 October 2021.

	FRW (million)
Present value of obligation on 1 November 2020	28,000
Present value of obligation on 31 October 2021	33,600
Fair value of Plan assets on 1 November 2020	26,600
Fair value of Plan assets on 31 October 2021	31,500
Current service cost	2,800
Pension benefits paid	2,660
Total contributions paid to the scheme for year to 31 October 2021	2,380

The interest rate on high corporate bonds for the pension plan is:

- 1 November 2020 7%
- 31 October 2021 8%

Re-measurement differences are recognized in line with IAS 19 "Employee benefits". The contributions were paid and benefits were withdrawn from the pension plan on 31 October 2021.

Required:

Show the accounting treatment for the above pension scheme in the financial statements of Butera Engineering plc for the year ended 31 October 2021 specifically:

i. **The movement comprising the changes in the values over the year for the pension obligations**. (2.5 Marks)
ii. **The movement comprising the changes in the values over the year for the pension assets.** (2.5 Marks)
iii. **An extract of a summary transaction figures as they will appear in the statement of profit or loss and other comprehensive income.** (2 Marks)

iv. An extract of the summary account balances as they will appear in the statement of financial position as at 31 October 2021 and the prior year ended 31 October 2020.

(1 Mark)

(b) Construction contract with a customer

On 1 November 2020, Butera Engineering plc entered into a contract to construct a crane machine on a customer's premises for a promised transaction price (consideration) of FRW 210 million with a bonus of FRW 14 million if the machine is completed within 24 months. At the inception of the contract, Butera Engineering plc correctly accounts for the promised bundle of goods and services as a single performance obligation in accordance with IFRS 15 "Revenue from a contract with customers".

At the inception of the contract, Butera Engineering plc expects the costs to be FRW 112 million and concludes that it is highly probable that a significant reversal in the amount of cumulative revenue recognized will occur. Completion of the crane machine is highly susceptible to factors outside Butera Engineering plc's influence as this is due to mainly with the supply of components used in the construction of the machine.

During the year, Butera Engineering plc incurred costs on the contract amounting to FRW 65 million and this includes components that will be used to continue with the machine construction in the following year. The total invoices issued to the customer amounted to FRW 140 million and by 31 October 2021, the customer had settled FRW 120 million of the invoiced amount. On 31 October 2021, Butera Engineering plc has satisfied 45% of its performance obligation on the basis of costs incurred to-date and concludes that the variable consideration is still constrained in accordance with IFRS 15.

Required:

Prepare extracts of Butera Engineering plc's financial statements reflecting the financial performance and position for the construction contract with the customer for the year ended 31 October 2021 with a brief explanation of the impact of the bonus on the accounting for the contract in Butera Engineering plc's financial statements. (7 Marks)

(c) Convertible loan notes and Shares options issued by Butera Engineering Plc

On 1 November 2020, Butera Engineering plc had ordinary share capital in issue amounting to FRW 3.5 billion with each share having a par value of FRW 500. There were no new ordinary shares issued during the year to 31 October 2021.

On 1 November 2020 in order to raise additional finance, Butera Engineering plc issued a FRW 2.8 billion of a 6% convertible loan stock with each FRW 5 million of the loan stock convertible into 4,000 ordinary shares on 1 November 2024 at the option of the loan note holder.

In addition, Butera Engineering plc had in issue outstanding share options that were previously issued to its directors with a dilutive effect equivalent to issuing 1,680 billion shares for no consideration.

Butera Engineering has reported a profit for the year ended 31 October 2021 of FRW 2.7 billion (ignore any adjustments needed in parts (a) and (b) (above). Butera Engineering plc pays tax at a rate of 30%

Required:

In accordance with IAS 33 Earnings per share, **what is Butera Engineering plc's fully diluted earnings per share for the year ended 31 October 2021 taking into account the issued convertible loan notes and share options** (7 Marks)

Note: Your answer should take into account calculation for:

i. The basic earnings per share for the year-ended 31 October 2021;
ii. The diluted earnings per share arising from only the impact of the convertible loan notes; and
iii. The fully diluted earnings per share arising from both the impact of the convertible loan notes and the share options

(d) Legal Claim against Butera Engineering plc

On 31 October 2021, Butera Engineering plc was being sued by a customer for a breach of a warrant relating to equipment sold with a major default. The customer is suing for damages of FRW 750 million. Butera Engineering plc's legal expert has advised that a fair value of any contingent liability of FRW 300 million can be estimated and that it is more likely not to result into outflow of funds in regard to this legal claim.

Required:

Advise Butera Engineering plc how to account for this potential liability in Butera Engineering plc's financial statements in accordance with IAS 37 "Provisions, contingent liabilities and contingent assets" (3 Marks)

(Total: 25 Marks)

QUESTION THREE

Muhanga Limited

Muhanga Ltd is a large company based in Rwanda and operates in the sale of agricultural products on a retail basis. The company has grown significantly over the last few years and it is currently preparing its financial statements for the year ended 31 December 2021. The following transactions that have occurred during the year need to be recognized in the company's financial statements.

(a) Share-based payments

(i) Share options to senior management

The company granted share options to its senior management on 1 January 2021 when the fair value of the options at that date was FRW 420 million. The employees under this scheme have to remained in employment with Muhanga Ltd at the end of the three (3) year period for the options to vest on 31 December 2023. The company estimate that 10% of the employees will leave during the year ended 31 December 2021.

Required:

Explain the accounting principles and treatment for the share options granted to the senior management of Muhanga Ltd at grant date and as at 31 December 2021.

(5 Marks)

(ii) Share Appreciation Rights to Branch managers

In addition, on 1 January 2019, Muhanga Ltd granted 500 Share Appreciation Rights (SARs) to each of its twenty (20) Branch managers. All the SARs vest after two years' service and they can be exercised during the following two years up to 31 December 2022. The fair value of the right at the grant date was FRW 20,000. It was estimated that three (3) managers would leave over the initial two-year period and they did so. The fair value of each right was as follows:

Year	**Fair value at the year end**
31 December 2019	FRW 24,000
31 December 2020	FRW 19,000
31 December 2021	FRW 27,000

On 31 December 2021, seven (7) managers exercised their SARs when the intrinsic value of the SARs was FRW 21,000.

Required:

Using calculations where appropriate, explain the amount of the liability and expense that will be recognized in the financial statements of Muhanga Ltd at 31 December 2021.

(7 Marks)

(b) Financial guarantee

On 1 January 2020, Muhanga Ltd gave a financial guarantee contract on behalf of an affiliate local charity organization called "Freedom Tots Charity" (FTC), where Muhanga Ltd has committed to repay the principal amount of FRW 840 million if FTC defaults on any payments due under a bank loan. FTC obtained the 3-year loan in order to fund the construction of its new head office premises and it is being repaid by equal annual installments of the principal loan with the first annual payment having been made on its scheduled repayment date in the year ending 31 December 2020.

Muhanga Ltd has not secured any compensation in return for giving the financial guarantee, but has assessed that any compensation loss has a fair value of FRW 16.8 million (based on valuation from an insurance company). The guarantee is measured at fair value through profit or loss. The guarantee was given on the basis that FTC will make the annual loan repayments on time and therefore it was assessed that it is probable that the guarantee would not be called upon.

After preparation of financial statements for the year ended 31 December 2021, Muhanga Ltd became aware of the fact that FTC was having financial difficulties with the result that it has not paid the second annual installment of the loan payment. Consequently, it is assessed that it is probable that the guarantee will now be called. However, just before the signing of the financial statements for the year ended 31 December 2021, FTC secured a significant donation which enabled FTC to make the second annual repayment before the guarantee was called upon. It is now anticipated that FTC will be able to meet the final (third) annual loan payment.

Assume that discounting is immaterial and the fair value of the guarantee is higher than the amount of the loss allowance determined in accordance with the IFRS 9 rules on expected credit losses.

Required:

Muhanga Ltd wishes for your advice regarding the principles behind the accounting treatment for the above financial guarantee under IFRS and how the transaction would be accounted for in the financial records. (10 Marks)

(c) Determination of cash generating units

Muhanga Ltd operates with a significant network of retail branches. In the financial statements for the future years, Muhanga Ltd proposes to change the determination of a cash generating unit (CGU) for impairment testing purposes at the level of each product line, rather than at each individual branch. In the proposal, the determination of the CGUs will now be based on the fact that each of the individual branches of Muhanga Ltd does not operate on a standalone basis as some income, such as volume rebates and costs are dependent on the nature of the product line rather than on individual branches. Muhanga Ltd considers that cash inflows and outflows for individual branches do not provide an accurate assessment of the actual cash generated by those branches.

However, Muhanga Ltd has daily sales information and monthly statements of profit or loss produced for each individual branch and this information is used to make decisions about continuing to operate individual branches

Required:

With justification, **advice Muhanga Ltd whether the proposed change to the accounting practice relating to the treatment of CGUs is acceptable under International Financial Reporting Standards. (IFRS)** (3 Marks)

(Total: 25 Marks)

QUESTION FOUR

(a) Rubavu Mint Industries (RMI) is based in Rwanda and it is partly a Government Business Entity where the Government of Rwanda holds 51% ownership with the remaining shareholding held by the public through ordinary shares issued on the Rwanda Stock Exchange. RMI manufactures raw materials that are used and sold within Rwanda and other countries in East Africa. In the last ten years, the Board of RMI has emphasized the need to act responsibly as a key focus of the company. Given the nature of its operations, RMI has recently set up an innovation initiative in order to find new ways to solve environmental challenges. The Finance Director of RMI takes the view that by investing in innovative technology, the company will be able to find solutions to environment issues, thereby enhancing the environment for future generations. They believe that all expenditure on this newly created initiative can be immediately classified as a non-current asset.

Required:

In reference to RMI, **discuss what is meant by corporate responsibility and in particular the factors which should encourage companies to disclose social and environmental information** (15 Marks)

(b) The Government of Rwanda has currently adopted a modified cash accounting approach to its public sector financial reporting. This is legally implemented in respect of country accounting policy which states that the modified cash basis should be used "using appropriate accounting policies supported by reasonable and prudent judgements and estimates".

Taking into account that on 31 December 2021, Rwanda Cement Manufacturing (RCM) (a public sector entity) enters into a transaction to sale bulk quantities of cement to a major customer for FRW 1.2 billion. The sale is on a credit basis with a special arrangement to receive all the cash in one installment in three (3) years after the satisfaction of the performance obligations which are completed on the reporting date of 31 December 2021.

Required:

Using the example of RCM above, **briefly describe the nature and principles behind the cash basis, accrual basis of accounting and modified cash basis of accounting for the public sector entities** (10 Marks)

Note: Your answer should highlight in brief:

✓ Cash basis of accounting – its meaning and application of RCM example.

✓ Accrual basis of accounting - its meaning and application of RCM example.

✓ Modified cash basis – its meaning, comparison with cash-basis and accrual basis; and the application of the RCM example.

(Total: 25 Marks)

End of the question paper

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