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CERTIFIED PUBLIC ACCOUNTANT

ADVANCED LEVEL 1 EXAMINATIONS

A1.3: ADVANCED FINANCIAL REPORTING

DATE: TUESDAY 25, APRIL 2023

MARKING GUIDE AND MODEL ANSWERS

SECTION A

QUESTION ONE: UGE GROUP

Marking guide

Part (a) (i): Treatment of goods purchased by Muzuri-Link from UGE

	Marks
Explanation for the translation of purchase of goods on the transaction date in accordance with IAS 21	1
Reference to the requirement to retranslate the trade payable balance (as a monetary item) at the reporting date using the closing exchange rate (0.5 marks); and reference to the correct accounting treatment for the exchange difference in accordance with IAS 21 or using a double entry approach (0.5 marks) (note: this is regardless of whether the calculated trade payable balance is correct or incorrect)	1
Each correct calculations (either separately in a schedule or within the detailed explanations) done for the translations and for the exchange difference - awarded 0.5 marks for each correct calculation (maximum of 1 mark)	1
A correct explanation for the required adjustment (and/or a double entry) for the treatment of the exchange difference in Muzuri-Link's financial statements (note: this is regardless of whether the calculated exchange difference is correct or incorrect)	1
In the UGE consolidated financial statements:	
A correct explanation for the required adjustment (and/or a double entry) for the treatment of the intra-group receivable and payable balance in UGE consolidated financial statements (note: this is regardless of whether the calculated intra-group loan balance is correct or incorrect)	1
Total marks for part (a) (ii)	**5**

Part (a) (ii): Treatment of Loan to Muzuri-Link from UGE

In the Individual Financial statements of Muzuri-Link	**Marks**
Explanation for the translation of Loan from UGE on the transaction date into GNF in accordance with IAS 21	1
Reference to the requirement to retranslate the loan balance (as a monetary item) at the reporting date using the closing exchange rate (0.5 marks); and reference to the correct accounting treatment for the exchange difference in accordance with IAS 21 or using a double entry approach (0.5 marks) (note: this is regardless of whether the calculated trade payable balance is correct or incorrect)	1
Each correct calculations (either separately in a schedule or within the detailed explanations) done for the translations and for the exchange difference - awarded 0.5 marks for each correct calculation (maximum of 1 mark)	1

A correct explanation for the required adjustment (and/or a double entry) for the treatment of the exchange difference in Muzuri-Link's financial statements (note: this is regardless of whether the calculated exchange difference is correct or incorrect)	1
In the UGE Group consolidated financial statements:	
A correct explanation for the required adjustment (and/or a double entry) for the treatment of the intra-group loan in UGE Group consolidated financial statements (note: this is regardless of whether the calculated intra-group loan balance is correct or incorrect)	1
Total marks for (a)(i)	**5**

Part (b): Explanation for and a presentation for Muzuri-Link's translated statement of financial position ast at 31 December 2021

	Marks
Explanation and application of IAS 21 principles in the translation of Muzuri-Link's statement of financial position for:	
• Assets and liabilities at closing rate	1
• Share capital and reserves at the date of acquisition at the exchange rate on the date of acquisition	1
• Dividends paid at the actual rate and an indication that Muzuri-Link did not have any dividends paid	1
• the balancing figure in the post-acquisition reserves considered as the exchange difference	1
Explanation for the correct treatment of the exchange differences on the re-translation of Goodwill in accordance with IAS 21	1
Explanation for the allocation of the exchange differences on the retranslation of the foreign operation's (Muzuri-Link) financial statements with a share of the exchange differences allocated to the parent (UGE) and to the NCIs	1
Explanation for subsequent application of the translated assets, liabilities and goodwill of Muzuri-Link into their respective line-by-line items in the consolidated financial statements	1
In the translated statement of financial position for Muzuri-Link:	
• Award 0.5 marks for each correct translated line item (maximum 7 marks)	7
• Award 1 mark for the correct exchange difference (either in the statement of financial position or where a separate computation of the exchange difference is compiled award 0.5 marks for a maximum of 1 mark)	1
Total marks for (b)	**15**

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Part (c): Consolidated statement of financial position as at 31 December 2021

	Marks
Award 0.5 marks for correct each figure making up the total of each line item making a maximum of 1 mark for each correct line item and corresponding amount (or 0.5 marks for figures posted in the financial statements as picked from workings whose marking guide is provided below) presented in the consolidated statement of financial position (up to a maximum of 10 marks).	10
For each workings (either presented separately or within the face of the presented consolidated financial statements) award as below:	
• Goodwill calculation (including correct double entries): award 0.5 marks for each correct line totals, sub totals and final totals (each in FRW and not figures in GNF) including the exchange difference on re-translation and/or double entries made	5
• Consolidated retained earnings (including correct double entries): award 0.5 marks for each correct line figure, sub totals and final totals (each in FRW and not figures in GNF) and/or any correct double entries made	5
• NCIs (including correct double entries): award 0.5 marks for each correct line figure, sub totals and final totals (each in FRW and not figures in GNF) and/or any correct double entries made	2
• Translation reserve (including correct double entries): award 0.5 marks for each correct line figure, sub totals and final totals (each in FRW and not figures in GNF) and/or any correct double entries made	1
• Investment in Associate (including correct double entries): award 0.5 marks for each correct line figure, sub totals and final totals and/or any correct double entries made	2
Total marks for (c)	**25**
Total Marks for Question One	**50**

Model answers

Part (a) (i): Accounting treatment of the goods purchased from UGE in Muzuri-Link's separate financial statements and the consolidated financial statements

In Muzuri-Link's separate financial statements

The purchase of goods from UGE and the corresponding trade payable is initially translated in Muzuri-Link's financial statements using the spot rate on the date the loan is received (on 1 November 2021).

The trade payable balance at the reporting date is considered as a foreign currency monetary item in Muzuri-Link's financial statements which means, the trade payable needs to be retranslated at the closing rate of exchange. The exchange differences will be recognized in Muzuri-Link's profit or loss and therefore this affects the retained earnings.

	FRW (million)	Exchange rate	GNF (million)
Payable on purchase of Goods (1 November 2021)	1,400	12.6	17,640
Exchange loss - retranslation of payable balance			980
Payable balance on 31 December 2021	1,400	13.3	18,620

As Muzuri-Link has not retranslated the outstanding trade payable balance at the year-end, an accounting adjustment is needed to increase Muzuri-Link's current liabilities by GNF 980 million and reduce the retained earnings by the same amount.

Debit Profit or loss (retained earnings) GNF 980 million

Credit Long-term Loan (non-current liabilities) GNF 980 million

In the Consolidated financial statements

In addition, after retranslation, FRW 1,400 million will be cancelled from both the trade receivables and the trade payables (current liabilities) to eliminate the intra-group financial balances on consolidation using the actual FRW amount of the trade receivable balance as recognized in UGE's financial statements. The intra-group balance will be eliminated from the consolidated statement of financial position as below:

Debit Consolidated trade payables (current liabilities) FRW 1,400 million

Credit Consolidated trade receivables FRW 1,400 million

Part (a) (ii): Accounting treatment of the Loan from UGE in Muzuri-Link's separate financial statements and the consolidated financial statements

In Mazuri's separate financial statements

The loan from UGE is initially translated in Muzuri-Link's financial statements using the spot rate on the date the loan is received (on 1 February 2021).

The loan is considered as a foreign currency monetary item in Muzuri-Link's financial statements which means, the outstanding loan balance at the year-end needs to be retranslated at the closing rate of exchange. The exchange differences will be recognised in Muzuri-Link's profit or loss and therefore this affects the retained earnings.

	FRW (million)	**Exchange rate**	**GNF (million)**
On receipt of loan (1 February 2021)	1,400	11.8	16,520
Loan part-repayment (1 November 2021)	(840)	12.6	(10,584)
Remaining balance	560		5,936
Exchange rate loss (on re-translation of outstanding loan balance) - balancing figure			1,512
Loan balance on reporting date (31 Dec 2021)	**560**	**13.3**	**7,448**

As Muzuri-Link has not retranslated the outstanding loan balance at the year-end, an accounting adjustment is needed to increase Muzuri-Link's long-term loan balance (in the non-current liabilities) by GNF 1,512 million and reduce the consolidated retained earnings by the same amount.

Debit Profit or loss (retained earnings) GNF 1,512 million

Credit Long-term Loan (non-current liabilities) GNF 1,512 million

In consolidated financial statements

In addition, after the retranslation, FRW 560 million will be cancelled from both the financial assets and the long-term loans to eliminate the intra-group financial balances on consolidation using the actual FRW amount of the loan balance as recognized in UGE's financial statements. The intra-group loan will be eliminated from the consolidated statement of financial position as below:

Debit Consolidated Long-term Loan (non-current liabilities) FRW 560 million

Credit Consolidated Financial assets FRW 560 million

Part (b) Translation of Muzuri-Link's statement of financial position as at 31 December 2021

In order to translate Muzuri-Link's statement of financial position appropriately in preparation for consolidation into UGE Group's financial statements, the assets and liabilities shown in the foreign operation's statement of financial position are translated at the closing rate at the year-end, being 13.3 GNF to FRW 1 as at 31 December 2021, regardless of the date on which those items originated.

For consolidation purposes, a subsidiary's share capital and any reserves balances at acquisition are translated at the historic rate at the date of acquisition which is 11.2 GNF to FRW 1 on 1 January 2021 when UGE acquired its shareholding interest in Muzuri-Link.

The post-acquisition movements in retained earnings are broken down into the profit and dividend for each post-acquisition and in this case, it is just one year that ended 31 December 2021. The profit for each post-acquisition year is translated at actual rate or average rate for that year if it is a close approximation. Dividends are translated at the actual rate on the date dividends are declared. Muzuri-Link did not pay a dividend in the current year.

The balancing figure on translating the statement of financial position represents the exchange difference on translating the foreign subsidiary's net assets.

A further exchange difference arises on goodwill because it is treated as an asset of the subsidiary and is therefore retranslated at the closing rate each year end. The exchange difference for the year is reported in other comprehensive income in the consolidated statement of profit or loss and other comprehensive income.

The group's share of the cumulative exchange differences is recorded as a "translation reserve within the other equity reserves" and the non-controlling interests' (NCI) share is recorded in the NCI balance within the Group equity.

The translated assets and liabilities must then be aggregated with Muzuri-Link's assets and liabilities in the consolidated statement of financial position on a line-by-line basis.

The accounting adjustments for the purchased goods and loan from UGE in (a) must be incorporated into Muzuri-Link's statement of financial position stated in GNF before the translation into FRW of the corrected position is performed.

Muzuri-Link's translated statement of financial position as at 31 December 2021

	GNF (millions)	Adjustments in GNF (millions)	Exchange Rate	FRW millions
Assets				
Non-Current Assets				
Property, plant & equipment	54,600		13.3	4,105
Financial assets	13,720		13.3	1,032
	68,320			**5,137**
Current assets				
Inventories	2,240		13.3	168
Trade receivables & other receivables	5,040		13.3	379
Cash and Bank	12,600		13.3	947
	19,880			**1,495**
Total Assets	**88,200**			**6,632**
Equity				
Ordinary share capital	29,400		11.2	2,625
Retained earnings:				
Pre-acquisition on 1 Jan 2021	36,120		11.2	3,225
Post- acquisition:				
Profit: year to 31 Dec 2021 (40,880 – 36,120)	4,760	(2,492)	11.9	191
Exchange difference (balancing figure)				(944)
Other equity reserves	-		11.2	
Total equity	**70,280**			**5,097**
Non-current liabilities				
Long-term loans	9,800	1,512	13.3	851
Deferred tax	5,600		13.3	421
	15,400			**1,272**
Current liabilities	2,520	980	13.3	263
Total Equity & Liabilities	**88,200**	**-**		**6,632**

Note: Alternative working (for Exchange difference - translation of Muzuri-Link's financial statements)

	GNF	Rate	FRW
	Million		**Million**
Net assets on 1 January 2021			
Share capital	29,400	11.2	2,625
Retained earnings	36,120	11.2	3,225
	65,520		**5,850**
Net assets on 31 Dec 2021	67,788	13.3	5,097
Change in net assets	2,268		(753)
Retained earnings for the year at Average rate	2,268	11.9	191
Exchange loss - translation of Muzuri-Link's financial statements			**(944)**

Part (c): Consolidated statement of financial position for the UGE Group as at 31 December 2021

Assets	**FRW (millions)**
Non-Current Assets	
Property, plant & equipment (39,200 + 4,105)	43,305
Goodwill (W1)	1,137
Investment in Jambo Stores (W5)	15,192
Financial assets ((1,680 + 1,032 -560 (part a(i))	2,152
	61,786
Current assets	
Inventories (2,800 + 168 - 105 (un-realised profits))	2,863
Trade receivables & other receivables ((4,200 + 379 – 1,400 (a)(ii) + 560 (W5)	3,739
Cash and Bank (1,960 + 947)	2,907
	9,510
Total Assets	**71,295**
Equity	
Ordinary share capital (only Parent's share capital)	11,200
Retained earnings (W2)	30,637
Other equity reserves ((5,600 - 699 (W4 translation reserve))	4,901
Non-controlling interests (W3)	2,303
Total equity	**49,041**

Assets	FRW (millions)
Non-current liabilities	
Long-term loans ((9,100 + 851 - 560 (part a(i))	9,391
Deferred tax (4,200 + 421)	4,621
	14,012
Current liabilities ((9,380 + 263 - 1400 (part a (ii))	8,243
Total Equity & Liabilities	**71,295**

Workings

W1: Consolidated Goodwill (held in the subsidiary Muzuri-Link)

	GNF (million)	Rate	FRW (million)
Purchase consideration on acquisition (1 Jan 2021)	51,520	11.2	4,600
Plus: Fair value of non-controlling interests	30,800	11.2	2,750
Less: Fair value of net assets (29,400 + 36,120)	(65,520)	11.2	(5,850)
Goodwill on acquisition - 1 Jan 2021	**16,800**		**1,500**
Less: Impairment loss (10% x 16,800)	(1,680)	11.9	(141)
Exchange loss (balancing figure)	-		(222)
Goodwill balance on 31 December 2021	**15,120**	**13.3**	**1,137**

Accounting treatment for impairment loss on Goodwill:

	FRW (millions)	FRW (millions)
Debit: Consolidated Retained earnings (60% x 141)	85	
Debit: Non-controlling interests (40% x 141)	56	
Credit: Goodwill		141

Accounting treatment for exchange loss on retranslation of Goodwill:

	FRW (millions)	FRW (millions)
Debit: Consolidated Translation Reserve (60% x 222)	133	
Debit: Non-controlling interests (40% x 222)	89	
Credit: Goodwill		222

W2: Consolidated Retained earnings

	UGE	Muzuri-Link	Jambo Stores
	FRW (millions)	FRW (millions)	FRW (millions)
Retained profits in UGE (Parent) - at 31 Dec 2021	32,200		
Post-acquisition profits in Muzuri-Link and Jambo Stores		191	4,900
Less: Impairment loss on Goodwill (W1)		(141)	
Less: Provision of un-realized profits (sales by Jambo Stores to UGE) (25%* 2,100 */2)			(263)
Less: Impairment loss on investment in Jambo Stores (20% x 17,240) (W5)	(3,448)		
	28,752	**49**	**4,638**
UGE Group's share of post-acquisition retained earnings in:			
Muzuri-Link - 60%	30		
Jambo Stores - 40%	1,855		
Total	**30,637**		

The provision for un-realized profit (arising from the unsold goods from Jambo Stores to UGE) is computed to include the profit element (25%) X unsold goods (1/2 x FRW 2,100) X UGE's share in associate (40%) giving FRW 105 million

	FRW (millions)	FRW (millions)
Debit: Profit share from associate (Jambo Stores's Retained earnings) (40% share x 263)	105	
Credit: Consolidated Inventory (40% share x 263)		105

W3: Non-controlling interests in Muzuri-Link (Group Equity)

	FRW (millions)
Fair Value on acquisition (1 Jan 2021) (W1)	2,750
Plus: Share of post-acquisition profit/(loss) in Muzuri-Link (W2) (40%*49)	20
Less Exchange loss - retranslation of Goodwill (W1)	(89)
Less: NCI's share of exchange loss on translation of Muzuri-Link's financial statements (part b) (40%*944)	(377)
	2,303

W4: Translation Reserves (To Group other equity reserves)

	FRW (millions)
Exchange loss - translation of Muzuri-Link's financial statements (part b) (60%*944)	(566)
Less Exchange loss - retranslation of Goodwill (W1)	(133)
	(699)

W5: Investment in Associate (Jambo Stores)

	FRW (million)
Initial cost of investment (1 January 2021)	17,240
Plus: Share (40%) of profit in associate in the year (40%*4,900)	1,960
Less: Dividends income (40% of the declared dividend) (40%*1,400)	(560)
Less: Impairment loss on investment in Jambo Stores (20%*17,240)	(3,448)
Closing balance - 31 December 2021	**15,192**

SECTION B

QUESTION TWO: BUTERA PLC

Marking guide

Part (a): Accounting treatment for Butera's defined benefit plan

	Marks
Award 0.5 marks for each correct line computed and/or presented regarding the defined benefit scheme amounts presented as below:	
• Line amounts making up the changes in the values over the year for the defined benefit pension obligations	2.5
• Line amounts making up the changes in the values over the year for the defined benefit plan assets	2.5
• Amounts to be included in the extract statement of profit or loss and other comprehensive income	2
• Amounts to be included in the extract statement of financial position	1
Total marks for (a)	**8**

Part (b): Construction contract with a customer

	Marks
Computing/determining the total expected financial performance (total profit expected) on the contract (0.5 mark for each correct line figure)	1
Explanation for the accounting treating of the "bonus" (variable consideration) as below:	
• At the inception of the contract (1 November 2020)	1
• At the reporting date (31 October 2021)	1
Explanation for the financial performance of the contract (linked to the percentage completion rate based only on the "fixed consideration") at the reporting date (31 October 2021)	1
Computation of the financial status of the contract on 31 October 2021 as an extract in:	
• Profit or loss (award 0.5 mark for each correct line item including totals leading to the "gross profit for the year"	1
• statement of financial position (award 0.5 mark for each correct line item including totals leading to the "contract liability" and the "receivable balance")	2
Total marks for (b)	**7**

Part (c): Fully Diluted Earnings Per Share

	Marks
Award for the computation of:	
• Number of ordinary shares in existence at the reporting date (31 October 2021)	1
• Basic earnings per share (award 0.5 marks for each correct figure making up the final answer)	1
• The dilutive effect of the convertible loan note resulting into the diluted earnings per share due to ONLY the convertible loan notes (award 1 mark for correct figures computed for the "after-tax savings on loan interest"; 1 mark for "number of converted ordinary shares"; and 0.5 mark for final answer of diluted earnings per share)	2.5
• The fully diluted earnings per share due to BOTH the convertible loan notes and share options (award 0.5 marks for every correct figure used in the calculation add 0.5 marks for the correct final answer of the fully diluted earnings per share)	2.5
Total marks for (c)	**7**

Part (d) Legal claim

	Marks
Award 1 mark for identifying that the legal claim does not result into a provision for a liability and linking this to the IAS 37's requirement for a liability to qualify as a provision	1
Award 1 mark for identifying that the legal claim qualifies as a "contingent liability" and linking this to the IAS 37's definition for a contingent liability	1
Award 0.5 marks for each correct "information that needs to be disclosed" for the contingent liability in accordance with IAS 37 (to a maximum of 1 mark)	1
Total marks for (d)	**3**
Total Marks for Question Two	**25**

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Model answers

Part (a): Accounting treatment for Butera Engineering's defined benefit plan

(i) Movement in the present value of the defined benefit obligation

	FRW (millions)
Present value of obligation on 1 November 2020	28,000
Plus: Interest on obligation (7%*28,000)	1,960
Plus: Current service cost	2,800
Less: Benefits paid	(2,660)
	30,100
Re-measurement loss through to OCI (balancing figure)	3,500
Present value of obligation on 31 October 2021	**33,600**

(ii) Movement in the fair value of plan assets

	FRW (millions)
Fair value of plan assets on 1 November 2020	26,600
Plus: Interest on plan assets (7% x 26,600)	1,862
Plus: Contributions paid into the pension plan	2,380
Less: Benefits paid	(2,660)
	28,182
Re-measurement gain through to OCI (balancing figure)	3,318
Fair value of plan assets on 31 October 2021	**31,500**

(iii) In the statement of profit or loss and other comprehensive income (year ended 31 October 2021)

Profit or loss	**FRW (millions)**
Current service cost	2,800
Net interest on the net defined liability at 7% (28,000 - 26,600)	98
Net expense	**2,898**
Other comprehensive income: re-measurement of the defined benefit plan	
Re-measurement loss on pension obligations	(3,500)
Re-measurement gain on pension assets (excluding amounts in net interest)	3,318
Net re-measurement loss	**(182)**

(iv) In the statement of financial position (at 31 October 2021)

	31 October 2021	1 November 2020
	FRW (millions)	**FRW (millions)**
Present value of defined benefit obligation	33,600	28,000
Less: Fair value of plan assets	(31,500)	(26,600)
Net Pension Liability	**2,100**	**1,400**

Part (b): Construction of a crane machine for a customer

Butera Engineering plc accounts for the construction of the crane machine for the customer as a single performance obligation in accordance with IFRS 15 "Revenue from contracts with customers". At the inception of this contract, Butera Engineering plc expects the following financial performance on the completion of the construction:

	FRW (millions)
Transaction price	210
Less: Total estimated contract costs	(112)
Total expected contract profit	98

The bonus of FRW 14 million constitutes a variable consideration under IFRS 15. At the inception of the contract, Butera Engineering plc should exclude the bonus of FRW 14 million from the transaction price because it cannot conclude that it is highly probable that a significant reversal in the amount of cumulative revenue recognized will not occur. This is the case as the completion of the construction of the crane machine is highly susceptible to factors outside Butera Engineering plc's influence.

On 31 October 2021, Butera Engineering plc re-assesses the variable consideration (bonus of FRW 14 million) and still concludes that the amount is still constrained implying the bonus will still not be recognized within the contract revenue at 31 October 2021. Therefore, at 31 October 2021, Butera Engineering plc will only recognize the portion of the fixed consideration of FRW 210 million related to the progress to-date (45%) as revenue in the profit or loss.

On 31 October 2021, the following extracts of the financial statements for Butera Engineering plc will be presented in regard to the construction contract for the crane machine:

Extract: In the Profit or Loss (year ended 31 October 2021)

	FRW (millions)
Contract revenue (45%*210)	94.5
Less: Contract costs 112*45%	(50.4)
Gross profit - attributed to contract	**44.1**

Extract: In the Statement of financial position (at 31 October 2021)

Computation of the Contract Liability:	**FRW (millions)**
Cumulative costs incurred to-date	65
Plus: Contract profits (from P&L)	44.1
	109.1
Less: Amount invoiced by 31 October 2021	(140)
Contract Liability	**(30.9)**
Receivable balance	
Total invoiced amount	140
Less: Cash receipts from customer	(120)
Receivable balance	**20**

Part (c): Calculation of the Butera Engineering plc's Fully Diluted earnings per share for the year ended 31 October 2021

Initially the Basic earnings per share for Butera Engineering plc for the year ended 31 October2021 will be calculated as below:

Basic EPS = Profits / No. of ordinary shares

W1: No or ordinary shares in issue on 31 October 2021	7,000,000	ordinary shares
Basic EPS (2,700,000,000 / 7,000,000)	**385.7**	**per share**

Thereafter a diluted earnings per share for Butera Engineering plc due to the impact of ONLY the convertible loan stock in issue by the reporting date will be as calculated below:

W2: After-tax savings on loan interest (70% x 6% x 2,800 million)	117,600,000	FRW
W3: Increase in ordinary shares if loan notes are converted into ordinary shares	2,240,000	ordinary shares
Diluted EPS (due to impact of convertible loan stock) (2,700 m + 117.6 m) / (7m + 2.24m)	**304.94**	**per share**

Lastly the fully diluted earnings per share for Butera Engineering plc due to the impact of both the convertible loan stock and the share options in issue by the reporting date will be as calculated below:

Total profits (2,700 m + 117.6 m)	2,817,600,000	FRW
Total No. of ordinary shares (7m + 2.24m + 1.68billion)	1,689,240,000	ordinary shares
Fully Diluted EPS (2,817,600,000 / 1,689,240,000)	**1.668**	**per share**

Part (d): Treatment of the legal claim against Butera Engineering plc

The legal claim against Butera Engineering plc does not meet the definition of a provision under IAS 37 "Provisions, contingent liabilities and contingent assets". One of IAS 37's requirements for a provision is that an outflow of resources embodying economic benefits should be highly probable, and based on the legal expert, it is more likely than not that such an outflow of funds will not occur.

However, the possible payment will fall within the IAS 37's definition of a contingent liability, which is:

- A possible obligation depending on whether some uncertain future event occurs; or
- A present obligation but a payment is not probable or the amount cannot be measured reliably

Therefore, as a contingent liability, the details of the claim should be disclosed in the notes to the financial statements of Butera Engineering plc including:

- The nature and type of transaction (i.e. a legal claim)
- The possible amount of the obligation (i.e. the estimated fair value of FRW 300 million of the contingent liability)
- Reasons supporting why the obligation is only possible and not probable

QUESTION THREE: MUHANGA LTD

Marking guide

Part (a) Share-based arrangement

Part (a)(i) Share options granted to senior management

	Marks
Award 1 mark for identifying (with a justification or linking to the scenario) Muhanga's granted share options as an "equity-settled share-based arrangement" or 0.5 marks if the answer only identifies as equity-settled transaction without a justification or linking to the case in the scenario	1
Award 1 mark for each point made relating to the accounting treatment for an equity-settled share-based arrangement directly linked Muhanga's share options for the period starting on 1 January 2021 (grant date) and the year to the reporting date (31 December 2021) in accordance with IFRS 2	3
Award 1 mark for the calculation of the share-based expense in the year to 31 December 2021	1
Total marks for (a) (i)	**5**

Part (a) (ii) Share Appreciation Rights to Branch managers

	Marks
• Measuring to fair value the SARs at each reporting date OF 2019 and 2020	2
• Recognition for the fair value changes at each reporting date and showing double entries	2
• Fair value of the liability at the reporting date (31 December 2021)	1
• Value of rights exercised in 2021	1
• Expense (as a balancing figure) for the year to 31 December 2021	1
Total marks for (a) (ii)	**7**

Part (b) The accounting treatment for the above financial guarantee

	Marks
Award 1 mark for:	
• Each of the financial liabilities indicated as not carried or measured based on amortized cost (up to a maximum of 2 marks)	2
• Indicating that the financial guarantee (linking it to Muhanga's financial guarantee) is subsequently measured at fair value with changes recognized in the P&L	1
Award 0.5 marks for the correct calculation of the increased liability on 31 December 2021 due to calling of the financial guarantee following FTC's default on the second annual repayment of the loan and 0.5 marks for the accounting entry (with through a double-entry or an explanation)	4
Award 1 mark (to a maximum of 4 marks) for the explanation of the impact of the financial guarantee (provided on behalf the loan received by FTC) in the financial statements of Muhanga Ltd including: • on 1 January 2020 (initial recognition of the financial guarantee) • on 31 December 2020 (when FTC repays the loan on time) • on 31 December 2021 (when FTC defaults on the repayment of the loan) • on 31 December 2021 (when FTC regains the health liquidity and repays the second annual loan repayment)	
Award 1 mark (to a maximum of 3 marks) for the calculation and/or a double entry (can be allowed where the student gives an explanation for the double-entry) for: • amortization (reduction) of the financial guarantee on 31 December 2020 (where FTC makes the first annual loan repayment on time) • 1 mark for the measurement of the liability due to FTC defaulting on the second annual loan repayment (in the year ending 31 December 2021) and 1 mark for the double entry if provided	3

- 1 mark for the measurement of the liability due to FTC regaining the liquidity health on 31 December 2021 (where this confirmed before Muhanga's financial statements are signed off) and 1 mark for the double entry if provided

Total marks for (b)	**10**

Part (c): Cash-Generating Units

	Marks
Award 1 mark for a correct definition of the CGUs in accordance with IAS 36	1
Award 1 mark for each correct explanation in line IAS 36 for the identification of a CGU and whether the proposed change of the identification for CGUs by Muhanga is acceptable under IAS 36 (this should be linked to the information in the scenario regarding Muhanga's proposed change for the CGU identification) up to a maximum of 2 marks	2
Total marks for (c)	**3**
Total Marks for Question Three	**25**

Model answers

Part (a) Share-based payments

(i) Share options granted to senior management

In accordance with IFRS 2 "Share-based Payments", the share options granted on 1 January 2021 to the senior management qualify to be classified as "equity-settled transactions". Under IFRS 2, Muhanga Ltd is required to recognize the cost of the share-based payment to the employees over the period in which the services are rendered. The share options are charged to the profit or loss on the basis of their fair value at the grant date.

On the basis that the only condition attached to the share options is that the employees should remain in employment with the company in the three-year vesting period, then the accounting treatment needed is that Muhanga Ltd should:

- Determine the fair value of the options at the grant date
- Charge this fair value to the profit or loss equally over the three-year vesting period, making adjustments at each accounting date to reflect the best estimate of the number of share options that will eventually vest. This will depend on the estimated percentage of employees leaving during the vesting period.

In the year ended 31 December 2021, the share-based expense is computed as FRW 420 million*90%*1/3 = FRW 126 million and this should be charged to the profit or loss and consequently the shareholders' equity shall be increased by the same amount.

(ii) Share Appreciation Rights to Branch managers

In accordance with IFRS 2 "Share-based Payments", the share appreciation rights granted to the Branch managers are cash-settled share-based payments. IFRS 2 requires that the entity should measure the goods or services acquired and the liability incurred at the fair value of the liability with the fair value of the liability measured at each reporting date until the liability is settled and at the date of settlement. Any changes in the fair value are recognized in the profit or loss for the period.

		FRW	Entries
31 Dec-19	500*(20-3) *24,000*1/2	102,000,000	Dr: Expense 102 million Cr: Liability 102million
31-Dec-20	500*(20-3) *19,000*2/2	161,500,000	161.5-102 = 59.5 Dr: Expense 59.5 million Cr: Liability 59.5 million

After 2020, right can be exercised within the following two years

Right exercised in 2021	**FRW**
Opening balance of liability	161,500,000
Value of right exercised 7*500*21,000	(73,500,000)
	88,000,000
Expense recognized in P/L (balancing figure)	47,000,000
Remeasured liability 500*(20-3-7) *27,000	135,000,000

The expense for the year to 31 December 2021 will be accounted for as follows:

	FRW	**FRW**
Debit: Expense (to the profit or loss)	47,000,000	
Debit: Liability (fair value change in the year) (161.5m – 135m)	26,500,000	
Credit: Cash (for SARs exercised)		73,500,000

Part (b): Financial Guarantee

IFRS 9 "Financial Instruments" requires an entity to classify all financial liabilities as subsequently measured at amortized cost using the effective interest method, with the following exceptions:

- Financial liabilities carried at fair value through profit or loss which must subsequently be measured at fair value; or
- Financial liabilities that arise when a transfer of a financial asset does not qualify for de-recognition; or
- Financial guarantee contracts where the issuer of such a contract after initial recognition must measure the guarantee at the higher of:

- The amount of the loss allowance determined in accordance with the IFRS 9 rules on expected credit losses; and
- The amount initially recognized less the cumulative amount of income recognized in accordance with the principles of IFRS 15 "Revenue from Contracts with Customers"

If an entity chooses to measure a financial guarantee contract (or a loan commitment) at fair value through profit or loss, as in this case, all the fair value movements will be taken to the profit or loss with no transfer to other comprehensive income. Under IFRS 9, the changes in the credit risk of liabilities relating to financial guarantee contracts are not required to be presented in other comprehensive income.

Where the discounting is immaterial, the accounting entries in the financial statements of Muhanga Ltd shall be as follows:

1. On 1 January 2020 when Muhanga Ltd initially provides the financial guarantee without securing a compensation for the guarantee, there will be need to record the loss incurred in giving the guarantee in the financial statements of Muhanga Ltd.

Debit: Profit or loss FRW 16.8 million

Credit: Financial Liabilities FRW 16.8 million

2. At the end of the first year of the 3-year loan period i.e. on 31 December 2020, Muhanga Ltd will have to account for the reduction in exposure arising from the fact that FTC has made the first loan installment, by amortizing the initial fair value over the life of the guarantee resulting into a reduction in the compensation loss of (FRW 16.8 / 3 payment installments) FRW 5.6m leaving a balance of the compensation loss of (16.8m – 5.6m) FRW 11.2 million.
Debit: Financial Liabilities FRW 5.6 million
Credit: Profit or Loss FRW 5.6 million

3. On 31 December 2021, due to the fact that FTC had defaulted on the second annual loan repayment and consequently implying that the guarantee from Muhanga Ltd will be called up by the loan provider, Muhanga Ltd needs to provide for the probable calling of the financial guarantee by recognizing a liability for the probable loan repayable to the loan provider in its financial statements

Debit: Profit or Loss (840m – 11.2m) FRW 828.8 million
Credit: Financial Liabilities FRW 828.8 million

Lastly in light of FTC's receipt of a significant donation and a return to a liquid financial status supporting FTC making a second annual loan repayment and also considering that it is now highly probable that FTC will settle the final (third) annual loan repayment on time, this means a change in the probability that guarantee will be called. This change takes place before the Muhanga Ltd's

financial statements are signed off and hence it's an event after the reporting date which provides further evidence of conditions existing at the end of the reporting period and therefore considered an adjusting event. This will require an adjustment of Muhanga Ltd's financial statements at 31 December 2021 to record the movement from the expected loss allowance to the measurement at amortised initial value as below:

Debit: Financial Liabilities (840m – 5.6m) FRW 834.4 million

Credit: Profit or loss FRW 834.4 million

Part (c) Cash generating units

In accordance with IAS 36 "Impairment of Assets" a cash generating unit (CGU) is defined as the smallest identifiable group of assets generating cash inflows which are largely independent of the cash inflows from other assets or groups of assets.

According to IAS 36, one factor to consider in determining a CGU is the monitoring of the entity's operations. Muhanga Ltd uses the daily sales information and monthly statements of profit or loss of each individual branch to monitor its operations and to make decisions about continuing or disposing of its assets and operations. Also, in the case of Muhanga Ltd, each individual branch generates cash inflows which are largely independent of those generates by other individual branches. Therefore, each branch should be identified as a separate CGU because Muhanga Ltd monitors and makes decisions about its assets and operations at the individual branch level.

QUESTION FOUR: RWANDA MINT INDUSTRIES (RMI)

Marking guide

Part (a): Corporate Social Responsibility (Social and environmental reporting)

	Marks
Award 1 mark for a correct (and reasonable) explanation for what is meant by a corporate social responsibility (CSR)- either using a reasonable definition or using any illustration to explain the meaning of CSR	1
Award up to 2 marks (up to a maximum of 14 marks) for point that is explained specific to RMI including:	14
• elements that make up the CSR reporting framework relevant for RMI (such as stakeholders, wider effects of strategic decisions, information to disclose in the CSR report, etc)	
• factors that will encourage RMI to disclose social and environmental information	
Total marks for (a)	**15**

Part (b) Cash basis accounting, modified cash basis accounting and accrual basis accounting

	Marks
Award up to 1 mark (up to a maximum of 10 marks) for each valid point well developed/explained in line with accounting for public sector entities including:	10
• Cash-based accounting: meaning, nature of accounting, using the provided example for RMI sales transaction and its comparison with the accrual basis accounting	
• Accrual-based accounting: meaning, nature of accounting, using the provided example for RMI sales transaction and its comparison with the cash basis accounting	
• Modified cash-based accounting: meaning, nature of accounting, using the provided example for RMI sales transaction and its comparison of the modified cash-based accounting with the cash basis accounting and accrual accounting	
Total marks for (b)	**10**
Total Marks for Question Four	**25**

Model answers

Part (a): Corporate Social Responsibility

Corporate social responsibility (CSR) is a business model in which companies make a concerted effort to operate in ways that enhance rather than degrade society and the environment. By practicing corporate social responsibility, also called corporate citizenship, companies can be conscious of the kind of impact they are having on all aspects of society, including economic, social and environmental.

In adopting CSR framework and reporting, RMI should focus on the following factors:

To stakeholders and society

To a large extent, in addition to being profitable, RMI will increasingly be expected to have a responsibility to those groups and individuals that the company's operations affect i.e. its stakeholders and to the society at large. Stakeholders to RMI will largely include customers, suppliers, employees, communities, shareholders and/or other financiers.

Wider consequences of strategic decisions

Since RMI is involved in business activities beyond the borders of Rwanda, its strategic decisions will nearly always have wider social and environmental consequences impacting on all countries its operations extend to. It could be argued that RMI is producing two outputs, the goods that it provides and the social and environmental consequences of its activities in all countries it sells its goods which is a corporate responsibility requiring social reporting and environmental reporting.

Disclosure

Currently there are no standards that apply when making social or environmental disclosures although there are a variety of published guidelines that entities may voluntarily follow. Social and environmental disclosures are therefore voluntary implying that RMI is free to disclose information that it determines to be relevant. This is often a disadvantage associated with the social and environmental disclosures as there is a risk that RMI will only report information that is favorable to its image.

Disclosures in the CSR reports will often include areas that can be monitored such as the level of any of RMI's carbon emissions, the level of community support and the use of sustainable inputs (e.g. buying paper from suppliers that plant new trees) etc.

Factors encouraging RMI to make CSR disclosures

There are many factors which should encourage RMI to disclose information on its level of corporate responsibility in terms of social and environmental reporting in their financial statements. An example, there may be large-sized customers that will have a policy to only conduct business with suppliers that consider CSR in the operations which will be vital for RMI to incorporate CSR activities within its operations.

Public interest

Public interest is one of the most important factors in CSR which is increasing rapidly. It is now widely recognised that although financial statements are primarily produced for investors there are also many other stakeholders in a company. The stakeholders of RMI will potentially be interested in the way in which the company's business affects the community and the environment. Increasingly the end user customer is concerned about how the product is made and concerned about the use of cheap labour and the poor working conditions that are often associated with it. Equally the customer will be concerned about packaging and waste and the effects of this on the environment. If RMI has a good reputation for care of its employees and care for the environment this will be an important marketing tool for RMI's products to the public.

Shareholder value

As the existing and potential investors of RMI become more aware of social and environmental issues affecting society, RMI will need to consider that its approach to corporate responsibility has a direct effect on shareholder value through the share price on the stock market. Therefore, its social and environmental policies are an important part of the overall performance and responsible practices in these areas and the provision of information in the RMI's annual report on these areas will have a positive effect on shareholder value if the company is to be perceived a good investment on the Rwanda Stock Exchange.

Government and professional bodies

A further factor is the increasing influence of governments and professional bodies in their encouragement of disclosure and sustainable practices. In some countries where RMI may be operating, there will be awards for environmental and social reporting and the disclosures provided in the financial statements. Voluntary disclosures often encourage good practice which can help to keep RMI ahead of the curve when new regulations are introduced by governments in the countries in which the company operates.

Published guidelines

There are also a variety of published guidelines and codes of practice designed to encourage the practices of social and environmental reporting, such as the International Integrated Reporting <IR> Framework and Global Reporting Initiative which is crucial to RMI corporate reporting.

However, what is missing is any substantial amount of legislation or accounting requirements in this area. The disclosures to be made by RMI will largely be driven by the factors considered above, but the level and type of disclosure is then at the discretion of the RMI at the time of reporting.

Part (b): Meaning and a comparison of cash basis accounting, modified cash basis accounting and accrual basis accounting

Cash basis accounting

Cash accounting is the accounting method that public sector entities apply majorly for convenience as it is easy to apply. By following this method, entities record entries in their books of accounts only when cash actually changes hands, but not when the transactions occur. It may look like that "cash changing hands" and "transactions occurring" are the same, however, on closer inspection, you'll notice a thin line differentiating the two terms. Transactions conclude as soon as the contract's performance is completed, irrespective of whether payments are made.

In the example of RMI, the actual cash will be received from the customer after three years of the completion of the sale (i.e., by 31 December 2024). Consequently, the profits of that sale are recorded after three years of the actual transaction.

RMI will not report the sales revenue in the financial statements for the year ended 31 December 2021 as the revenue will be reported in the year ended 31 December 2024 even when the sale took place in the year to 31 December 2021.

Accrual accounting

Accrual accounting, contrary to the cash accounting system, recognizes and records transactions as and when they occur, instead of waiting for the cash to change hands.

Accrual accounting involves additional concepts, like accounts receivables and payables, and keeps better track of inventory than the cash system of accounting.

In the case of the sale transaction by RMI, the accounting records of RMI will have two transactions recorded, instead of just the one. The first transaction will be recorded in the year ended 31 December 2021 when the sale transaction occurs, where the corresponding debit will go the accounts receivable account.

Thus, in the year ended 31 December 2021, RMI will recognize the following accounting entry:

Debit: Accounts Receivable	FRW 1,200 million	
Credit: Income		FRW 1,200 million

The second transaction will take place in the year ended 31 December 2024, when the cash changes hands and this shall be recorded as below:

Debit: Cash account	FRW 1,200 million	
Credit: Accounts Receivable		FRW 1,200 million

In comparison between cash accounting and accrual accounting, once the cash is received, the net effect will be the same for both accounting methods - i.e., a debit to cash and a corresponding credit to sales. However, the critical difference between the cash accounting and accrual accounting is that the accrual system recognizes the profits earlier, as soon as the transaction takes place.

Modified cash accounting

The modified cash accounting system attempts to incorporate both the cash and accrual system of accounting by keeping the cash accounting system's convenience while incorporating the many sophistications of maintaining accounts under the accrual system. It achieves this by categorizing the different transactions into long-term or short-term transactions.

Long-term deals will happen over multiple accounting periods, while short-term transactions occur within a single accounting period. Under the modified accrual accounting system, the short-term transactions are recorded as if the accounts are maintained under the cash accounting system.

On the other hand, the long-term transactions are recorded under the accrual method. It's a recognized method for governments to record their accounts, but not for commercial institutions. In the example of RMI industries, the accounting for the sale transaction will be similar to the accrual accounting.

Comparison between modified cash accounting and the other accounting methods:

- Modified cash-basis is a little more time-consuming than cash-basis accounting. Because there are more accounts, you may spend more time recording transactions.
- Rather than only handling cash accounts, modified cash-basis includes both cash and accrual accounts.
- As mentioned, modified cash-basis allows the entity to include short-term items like cash-basis accounting. But an entity can also include long-term items like you can with the accrual method. Therefore, unlike with cash-basis, an entity can record accounts receivable, current and fixed assets and accounts payable with modified cash accounting.

END OF MARKING GUIDE AND MODEL ANSWERS