CERTIFIED PUBLIC ACCOUNTANT

ADVANCED LEVEL 1 EXAMINATIONS

A1.3: ADVANCED FINANCIAL REPORTING

DATE: TUESDAY 22, AUGUST 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

a) Mob Ltd is company producing Cement from volcanic ashes over 20 years. Draft consolidated financial statements of Mob Ltd are as follows;

Table 2.1: Consolidated Statement of profit or loss account for the year ended 31 December 2021.

Particulars	**FRW million**
Operating profit	2,000
Other income	
Investment income	850
Share of profit from associate	320
	3,170
Expenses	
Distribution cost	(450)
Administrative cost	(750)
Finance costs	(600)
Profit before tax	**1,370**
Income tax expense	(300)
Profit for the year	**1,070**
Other comprehensive income	
Revaluation surplus	100
Total comprehensive income	**1,170**
Profit Attributable to	
Holding company	900
Non-controlling interest	170
	1,070
Comprehensive income attributable to	
Parent	1,000
Non-controlling interest	170
	1,170

Table 2.2: Consolidated Statement of financial position

Particulars	**31-Dec-21 FRW Million**		**31-Dec-20 FRW Million**	
Assets				
Non-current assets				
Property, plant and equipment		2,800		3,290
Intangible assets		214.5		-
Investment in associates		450		200
Total non-current assets		**3,465**		**3,490**
Current assets				
Inventories	650		850	
Receivables	1,070		820	

Particulars		31-Dec-21		31-Dec-20
		FRW Million		FRW Million
Cash in hand	300		-	
Total current assets		**2,020**		**1,670**
Total assets		**5,485**		**5,160**
Equity and liability				
Ordinary share capital of FRW 20 each		510		500
Revaluation reserve		100		
Retained earnings		2,100		1,400
Total Equity owners' funds		**2,710**		**1,900**
Non-controlling interests		853		840
		3,563		**2,740**
Non-current liability				
Lease obligations	200		400	
Loan stock	-		400	
Deferred tax	250		200	
Total non-current liability		**450**		**1,000**
Current liabilities				
Trade payables	315		240	
Interest payable	60		60	
Current tax payable	195		120	
Lease obligations	850		1,000	
Bank overdraft	52		-	
Total current liability		**1,472**		**1,420**
Total equity and liability		**5,485**		**5,160**

Addition information

1. Plant with carrying amount of FRW 300 million was disposed of at a loss of FRW 20 million. There was no cash paid to acquire property, plant, and equipment during the year.
2. During the year ended 31 December 2021, Mob Ltd leased heavy machines from Sorwafe Ltd for 10 years. The present value of lease rentals at time of lease was FRW 200 million.
3. The board approved expansion program to increase shareholders' return. On 01 January 2021, Mob Ltd acquired 75% share capital of White Stone Ltd at agreed consideration of FRW 22 million. Mob Ltd measures non-controlling interest in White stone using proportion of the net assets acquired.

Table 2.3: Consideration to acquire White Stone Ltd was settled as follows;

Particulars	FRW million
Shares issued (Share exchange)	10
Cash payment	12
Total	**22**

4.The net assets of White stone Ltd at the date of acquisition were as follows;

Table 2.4: White Stone Ltd's net assets at acquisition date.

Particulars	FRW million
Property, plant and equipment	100
Inventory	50
Receivables	20
Cash and bank	(40)
Payables	(75)
Current tax	(45)

Required:

Prepare consolidated statement of cash flow of Mob group Ltd for the year ended 31 December 2021 (using the indirect method under IAS 7 Statement of Cash flows).

(40 Marks)

b) IFRS 10 defines an investment entity as an entity that: (i) obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services; (ii) commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both; and (iii) measures and evaluates the performance of substantially all of its investments on a fair value basis.

Required:

i) Explain the consolidation exception applicable to an investment entity. (5 Marks)

ii) Discuss the disclosure requirements applicable to an entity that becomes, or ceases to be an investment entity. (5 Marks)

(Total: 50 Marks)

SECTION B

QUESTION TWO

(a) Byumba General Enterprises (BGE) is a goods transporting company located in Rwanda with its headquarters found in the Northern province. BGE's business is transport large volume items for a number of customers across in Rwanda that mainly include construction companies. BGE leases all its trucks from PK Trucks Ltd.

On 1 January 2022, BGE entered into a 4-year lease contract with PK Trucks Ltd to lease fifty (50) long vehicle trucks having incurred legal costs of FRW 45,000 million paid to a legal firm that set up the lease contract. Though the economic useful life of these trucks is 12 years, BGE intends to use the trucks for four (4) years making 4 annual payments of FRW 500,000 million every 1 January with the first payment made on 1 January 2022. Based on BGE's incremental borrowing rate of 7.5% per annum the following discount rates are applicable to the rental payments under the lease contract:

Date/year	Discount rate
1 January 2022	1.000
1 January 2023	0.930
1 January 2024	0.865
1 January 2025	0.805

Required:

In terms of the lease contract above**, show the calculations for the following as should be recognised by BGE in its financial statements:**

i. **The present value of the lease liability on 1 January 2022** (2 Marks)
ii. **The fair value of the right-of-use asset on 1 January 2022** (2 Marks)
iii. **The balances for the lease liability and right-of-use asset for each of all the four years up to 31 December 2025** (8 Marks)

(b) In addition to the information provided above, the Rwanda Revenue Authority only allows a tax relief for the lease rentals paid by BGE and not any other periodic expenses incurred in the lease.
The tax rate applicable to BGE's deferred tax calculations is 30%

Required:
Using appropriate calculations, explain to BGE the deferred tax implications arising from the lease contract of the trucks and the accounting treatment for the deferred tax on 31 December 2022 (6 Marks)

(c) **Briefly explain to PK Trucks limited how the above lease agreement should be classified and treated in the financial statements of PK Trucks Ltd.** (Hint: ignore any calculations) (2 Marks)

(d) You are the Finance manager of BGE and a Certified Public Accountant (CPA) member with the Institute of Certified Public Accountants of Rwanda (ICPAR). Mr. Deo Kazungu is the Managing Director of BGE and he is also a CPA member of the ICPAR. You are aware that in January 2023, Deo shared with his wife Alice, all the information concerning BGE's lease contract with PK Trucks Ltd disclosing to her details of an additional lease contract which is about to be signed between BGE and PK Trucks Ltd where BGE will lease another 200 trucks on ten-year basis starting in January 2024. The new lease contract is anticipated to result into a significant increase in PK Truck Ltd's share price which is expected to increase by about 5 times (PK Truck Ltd's shares are listed on the Rwanda stock market). Deo has advised Alice to purchase shares in PK Trucks Ltd before the additional contract and for this reason he will ensure the lease contract is signed to benefit Alice with an increase in the value of her investment in PK Truck Ltd. Consequently, Alice acquired 25% shareholding in PK Trucks Ltd in March 2023. Alice plans to dispose of the shares after the new lease contract is signed immediately when the share price goes up as anticipated.

Required:

Identify and discuss the ethical issues arising from the scenario and the actions you should take as a consequence. (5 Marks)

(Total: 25 Marks)

QUESTION THREE

(a) Rwanda Executive Suites (RES) is a public limited company and a local company in Rwanda owning a number of hotels and apartments for rent to the public. RES operates with a year-end of 31 December.

The head office of RES is a large 15-floor building located in Kigali. RES commenced the construction of this head-office building on 1 January 2018 and construction was completed on 30 September 2019 although the building did not operate due to the pending office partitioning and interior access routes in the building which were delayed and completed on 31 December 2019. The total construction costs by the end of the construction excluding the finance costs were FRW 600,000 million (this includes FRW 90,000 million for office partitioning and installation of the access routes).

On 1 January 2018, RES took out a five-year loan of FRW 500,000 million to finance the construction of the head-office building. The interest on the loan is payable at 15% per annum with all the interest payable once at the end of the loan term together with the principal amount.

During the construction period, due to the slump in property values in Rwanda, the market values of buildings similar to RES's head office fell significantly. RES estimated that on 31 December 2019, the net selling price of its head office building was FRW 690,000 million while the value-in-use was FRW 638,000 million.

On completion of the construction, it was estimated that the economic useful life of the head office building was twenty-five (25) years while the roof had an estimated useful life of twenty (20) years before it would be replaced and this estimate has remained valid. It was validated in the engineer's report on 1 January 2020 that the head office roof represents 30% of the entire building cost.

RES has adopted a policy of annual revaluations of the head office building due to the unstable market values of similar buildings. The following values for the head office building were established:

Particulars	31 December 2020	31 December 2021
Net selling price	560,000	530,000
Value in use	580,000	540,000

Revaluation surpluses or deficits are apportioned appropriately between the head office building and the roof.

Required:

Using suitable calculations, **explain the accounting treatment of the head office building in the financial statements of RES for the financial years ended:**

(i) 31 December 2019 (7 Marks)

(ii) 31 December 2020 (5 Marks)

(iii) 31 December 2022 (5 Marks)

Note: All figures should be rounded to FRW' million without any decimals.

(b) In early 2022, on confirmation that there was an increased need for rent of office buildings by foreign investors in Rwanda, the Board approved the plan to change the use of the head office building into a commercial building available for rent to the public. On 1 February 2022, a 10 years tenancy agreement with Kwik Insurance Co (the "tenant") was signed and RES vacated the entire building relocating to another of RES's own smaller building in Remera.

Immediately prior to the new tenant occupying the building, an expert revaluation report indicated that following a sudden significant increase in property values within Kigali, RES's head office building had a market value of FRW 610,000 million on 1 February 2022 and FRW 650,000 million on 31 December 2022. The economic useful life did not change. The depreciation charge for the period to 31 January 2022 can be assumed to be negligible.

Required:

Using suitable calculations, explain the implication to RES's financial statements for the year ended 31 December 2022 the change in the use of the head office building. (8 Marks)

(Total: 25 Marks)

QUESTION FOUR

Rwanda Action on Child Abuse Trust (RACAT) is a public sector entity which is managed by the Government of Rwanda as a not-for-profit organization whose aim is to mobilize the national efforts against child abuse in Rwanda. RACAT operates with its head-office in Kigali and branches in each province of Rwanda. The main sources of funding for RACAT are donations in cash and in kind which are received from both local and international funders.

RACAT applies the "modified cash accounting" under the IPSAS framework in the preparation of its financial statements. Under this accounting system, RACAT prepares its financial statements taking into consideration:

- Cash accounting for short-term incomes, operational expenses and expenditure on short-term assets (where short-term is a period not exceeding 12 months); and
- Accrual accounting for long-term incomes and capital expenditures (for assets with an economic useful life of more than one-year on acquisition)

Below is a set of account balances for RACAT for the year ended 31 December 2022:

Particulars	FRW'million	FRW'million
Cash grants (Note 1)		825,000
Suspense account (Note 1)		100,000
Personnel costs	195,675	
Administrative expenses	158,419	
Operational expenses	88,230	
Communication and publicity expenses	67,215	
Other expenses	7,120	
Motor vehicles (Note 1)	100,000	
Land (FRW 250,000 million) and buildings - cost (Note 2)	750,000	

Particulars	FRW'million	FRW'million
Furniture and fixtures (Note 2)	250,000	
Office equipment (Note 2)	315,600	
Cash and cash equivalents	231,500	
Depreciation 1 January 2022 - buildings		150,000
Depreciation 1 January 2022 - Furniture and fixtures		100,000
Depreciation 1 January 2022 - Equipment and other fixed assets		126,240
10% Bank loan (Property mortgage) (Note 2)		100,000
Fixed deposit investments - On 1 January 2022 (Note 3)	80,000	
Extra-ordinary item (Note 4)	27,500	
Prepayments & Receivables	68,000	
Payables to suppliers		90,000
Capital contribution - By Government of Rwanda		800,000
Accumulated reserves - 1 January 2022		48,019
	2,339,259	**2,339,259**

The following additional notes are relevant to the preparation of RACAT's financial statements for the year ended 31 December 2022:

(1) Three new grants were signed between RACAT and its funders in the year and these included:

- Within the cash grants is a new annual grant of FRW 200,000 million which was received in advance in one lumpsum on 31 December 2022. The grant agreement requires RACAT to only utilize these funds to fund the administrative expenses for the office in Gisenyi for 9-months in the year 2023 starting from April 2023.

- A small grants project of FRW 180,000 million funded under the "World bank small grants scheme" to fund the media adverts on "child-abuse alerts" is another cash grant which was signed on 1 October 2022. The expenses under this grant have been fully incurred and are correctly included within the "operational expenses" in the account balances. According to the grant agreement, the funder for this project (The World Bank) will be transferring the funds to RACAT's bank account in January 2023 and this has not been recognised in the financial statements.

- A capital grant of FRW 100,000 million from the Government of Japan which was received in form of a fleet of motor vehicles for use by RACAT presented in the "suspense account". The new vehicles with a useful economic life of 5 years were received by RACAT on 31 December 2022. Prior to this grant, RACAT was leasing all its motor vehicles from Gato motors. The new grant of motor vehicles led to the cancellation of the current lease contract for motor vehicles with Gato Motors Ltd on 31 December 2022. RACAT agreed to pay Gato Motors a lease cancellation penalty of FRW 2,000 million which will be payable in June 2023 (as an operational expense). RACAT has not yet accounted for the lease cancellation penalty.

(2) Non-current assets:

RACAT had the following financial implications for its non-current assets:

- Land and Buildings: RACAT conducted a revaluation for the first time for all land and buildings on 1 January 2022 with the revalued amount for land remaining unchanged but the buildings were revalued to FRW 300,000 million. The remaining useful life of the buildings was assessed to be ten (10) years on 1 January 2022. The revaluation adjustment and the annual depreciation charge for the current year have not been incorporated in the financial statements.

- Included in "land and buildings" is a property located in Rwamagana (RACAT's branch office in the Eastern province) which was acquired by RACAT in January 2018 using a bank mortgage (loan) of FRW100,000 million. The mortgage which has a duration of ten (10) years carries an interest rate of 10% per annum payable to the bank on a 6-monthly basis and presented within the "administrative expenses". The mortgage interest for the last 6-months to 31 December 2022 will be paid in the first week of January 2023 and has not been accounted for in the financial statements.

- RACAT depreciates at a rate of 20% per annum (straight-line method) for both its "furniture and fixtures" and "office equipment". The annual depreciation charge for the year ended 31 December 2022 has not yet been recognised.

- Software: RACAT signed a contract for a "Management Information System" (MIS) software which was supplied to RACAT by the software provider on 1 January 2022. The software which had a purchase price of FRW 40,000 million has a useful life of four (4) years and RACAT agreed to pay the full amount of FRW 40,000 million in January 2023 which is outstanding. RACAT has not accounted for the software in its financial statements

Depreciation and amortization charges should be presented within the "administrative expenses"

(3) As part of the strategy to increase its unrestricted income, on 1 January 2022, RACAT fixed its surplus reserves of FRW 80,000 million in a fixed deposit investment earning a fixed interest rate of 15% and this was correctly recorded in January 2022. The fixed deposit investment matured on 31 December 2022 though both the principal and interest were received on RACAT's bank account on 2 January 2023. RACAT's accountant had not yet updated the final accounts at the reporting date.

(4) The extra-ordinary item is a financial loss suffered by RACAT relating to theft of a "cash grant" of FRW 27,500 million by three (3) senior staff in the "Grants management department"

who fraudulently advised the donor to transfer these funds to a personal account. The fraud was discovered by the accountant in January 2022 after all the three employees had resigned and left the country in December 2021. It is unlikely that any of the funds will be recovered by RACAT.

(5) As a government entity, RACAT is formally exempted from all tax liabilities

Required:

In accordance with the applicable International Public Sector Accounting Standards as far as the information permits**, prepare for RACAT;**

(a) A Statement of financial performance for the year ended 31 December 2022. (10 Marks)

(b) A Statement of financial position as at 31 December 2022. (15 Marks)

(Total: 25 Marks)

End of question paper

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