CERTIFIED PUBLIC ACCOUNTANT

INTERMEDIATE LEVEL EXAMINATIONS

I1.2: FINANCIAL REPORTING

DATE: TUESDAY 27, AUGUST 2024

MARKING GUIDE & MODEL ANSWERS

QUESTION ONE

MARKING GUIDE FOR QUESTION ONE

	Marks
Part (a): Rwanda Agriculture Research Agency (RARA)	
Public Sector Entity - Statement of financial position	
Award 0.5 marks for each correct figure used in the presentation of RARA statement of financial position including any relevant workings used (excluding the totals and/or sub totals). Maximum of 6 marks	**6**
Part (b): Burera Mixed Farm (BFM)	
(i) Research and development projects	
The Cabbage project	
Award as below:	
1 mark for a correct / reasoned explanation referring to the grant relating to a research-phase project	
1 mark for explaining the treatment of research expenses (expensed to the P&L) for the related research expenses for this project	
1 mark for a reference that the grant received should be deferred on receipt (alternatively this may be illustrated by use of an accounting journal entry) on the date of receiving the grant	
1 mark for a correct reference to the matching concept i.e., a periodic release of the grant income to P&L in the future period relating to the incurred research expenses	
Maximum marks - Cabbage project	**4**
The Fruits project	
Award as below:	
1 mark for a correct / reasoned explanation referring to the grant relating to a capitalized development-phase project	
1 mark for explaining the treatment of development expenses (capitalized as an intangible asset) for the related development costs for this project	
1 mark for a reference that the grant received should be deferred on receipt (alternatively this may be illustrated by use of an accounting journal entry) on the date of receiving the grant	
1 mark for a correct reference to the matching concept i.e., a periodic release of the grant income to P&L in the future period relating to the commercial production of the fruits	
Maximum marks - Fruits project	**4**
(ii) Grant for Vocational experience tours	
Award as below:	

1 mark for a reference that the grant received should be deferred on receipt (alternatively this may be illustrated by use of an accounting journal entry) on the date of receiving the grant	
1 mark for a reference of the realisation of grant income related to the amortization rate based on the total grant period of 5 years (or in total 60 months).	
1 mark for a reference to the presentation of government grant deferred income balance (split presentation in the "current liabilities" and "non-current liabilities")	
1 mark for an application to BMF's unfulfilled student tours in the year ended 30 June 2024 and the expected unfulfilled student tours in the remaining 4 years	
0.5 marks for each correct /relevant calculations used in the answer (the calculations may include the following: the monthly amount to be released as recognised grant income per month; total grant income to be recognised in the P&L in the year to 30 June 2024; the total balance of the government grant in the deferred income on 30 June 2024; the deferred income grant balance in the current liabilities on 30 June 2024; non-current liabilities deferred income grant balance on 30 June 2024, the repayment provision total amount etc.) (maximum of 2 marks for calculations)	
Maximum marks - Vocational experience tours	**6**
Maximum marks for Question One	**20**

MODEL ANSWER

Part (a): Published financial statements for a public sector entity using IPSAS – Rwanda Agriculture Research Agency (RARA)

RARA's statement of financial position as at 30 June 2024

	FRW millions
ASSETS	
Current assets	
Cash and cash equivalents	3,543
Short-term receivables	746
Inventories	8,104
Other current assets	750
	13,143
Non-current assets	
Receivables	
Investments in associates	
Other financial assets	
Infrastructure, property and equipment (NBV = 47,925 less 5,620)	42,305

Intangible assets	480
	42,785
Total assets	**55,928**
LIABILITIES	
Current liabilities	
Short-term payables	2,397
Short-term borrowings	6,588
Short-term provisions	455
	9,440
Non-current liabilities	
Long-term payables	5,765
Long-term borrowings	12,000
Long-term provisions	893
	18,658
Total liabilities	**28,098**
Net assets	**27,830**
NET ASSETS/EQUITY	
Capital contributed by Central Government (through MINAGRI)	15,000
Accumulated surpluses (11,927 + 903)	12,830
Total net assets/equity	**27,830**

Part (b): Grants made to BMF

(i) Research and development projects:

The general principle of IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* is that grants should be matched in the statement of profit or loss with the expenditure to which they are intended to contribute. In terms of BMF, this implies that the amount received from the government grant will not be credited directly to profit or loss as income on receipt of the funds but will be recognized in the profit or loss systematically over the period to which the related funded costs are recognized as expenses in the profit or loss.

Cabbage project

On the basis that there is no constructive conclusion on this research in the cabbage project by the reporting date (30 June 2024), this is evidence that this grant relates to a research phase project.

As the expenditure on the Cabbage project is research, the research expense is charged / recognized directly to the profit or loss as BMF incurs the research costs (IAS 38 *Intangible Assets*).

On receipt of the government grant for the cabbage project, the received amount of FRW 1,000 million should be recognized as deferred income within the liabilities of the entity.

DR Bank or Cash	FRW 1,000m	
CR Deferred income (Government Grant)		FRW 1,000m

The grant of FRW 1,000 million from RAB will therefore be credited (released) to profit or loss in the years in which the expenditure to which it relates is incurred. This implies that for every research expense (qualifying under the grant received) incurred by BMF, an equivalent amount of the government grant shall be transferred from the deferred income (liabilities) account and credited to the profit or loss.

Fruits project

The Fruits project appears to satisfy the criteria of IAS 38 *Intangible assets* to capitalize development costs on that basis that the project is expected to be extremely popular and commercial production of the new fruits will commence in one year from the current reporting date (i.e., on 1 July 2025) with large profits expected.

Therefore, under IAS 38, BMF will capitalize the development expenditure (as an intangible asset) as and when incurred on the fruits project for the remaining one year until commercial production commences (1 July 2025). Subsequently from 1 July 2025, BMF will systematically amortize the capitalized development expenditure to the profit or loss over the period of successful production.

The government grant received from RAB of FRW 1,000 million relating to the fruits project will also be carried forward as deferred income (in the liabilities) on the date of receipt.

DR Bank or Cash	FRW 1,000m	
CR Deferred income (Government Grant)		FRW 1,000m

Subsequently from 1 July 2025, the government grant will be released to profit or loss in line with the amortisation rate of the capitalized development expenditure.

Therefore, at the current reporting date (30 June 2024), the received grant of FRW 1,000 million will fully be recognized as deferred income (liabilities) of BMF's statement of financial position under current and non-current liabilities as appropriate.

(ii) Grant for vocational experience student tours

General accounting

The grant does not relate to any specific expenditure but to a non-financial objective which in this case BMF must conduct monthly tours to a specified number of students for their practical study training over a specified period of time.

On the receipt of the government grant (1 July 2023), BMF should make a deferral of this grant by recognizing the received grant of FRW 6,000 million in the deferred income (under liabilities).

DR Bank or Cash	FRW 6,000m	
CR Deferred income (Government Grant)		FRW 6,000m

The terms of the grant suggest that it is effectively earned at a rate of FRW 100 million per visit (FRW 6,000m / 60 months making the 5 years) and therefore a credit (representing a release from the deferred income) shall always be credited to the profit or loss as income at that rate. In the year to 30 June 2024, the amount of the grant released /credited to the profit or loss as income will be computed as below:

FRW 100m (per month) x (12 months less 5 months when BMF did not conduct the monthly student tours) i.e., FRW 100m x 7 months = FRW 700m

DR Deferred income (a release from the Liabilities) FRW 700m

CR P&L (for example "Other incomes") FRW 700m

The remaining amount of the deferred income (government grant in the liabilities) in BMF's financial statements at the end of the reporting period (i.e., on 30 June 2024) shall be FRW 5,300 million (i.e., 6,000m – 700m). This balance shall be reduced by the total period in months for the amount relating the expected unfulfilled student tours (details below) and the net balance of the grant amount recognised in future periods over the remaining period of four years related to the grant.

Specifically, the amount of the grant balance expected to be transferred to the profit or loss in the next 12 months from the reporting date (30 June 2024) shall be presented in the current liabilities (calculations below).

The balance of the grant relating to period after the next 12 months shall be presented in the non-current liabilities.

The grant is not spread over the life of the bus as it does not specifically contribute to its cost of the purchase of the bus.

Repayments
A repayment of FRW 500 million (i.e., FRW 100m x 5 months) is due relating to unfulfilled student tours in the current year and should be provided for in the year ended 30 June 2024. However, as this is expected to recur in each of the remaining four years of the grant, a provision also needs to be made in total for repayments relating to 20 months (i.e., 5 months' x 4 years) of the forecasted student tours expected to be unfulfilled.

Dr: Grant 500 million

Cr: Payable 500 million

A contingent liability should be disclosed relating to the potential repayment of the grant relevant to the visits in future periods which are expected to take place.

Summarised amounts for the financial statements

Profit or loss	FRW million
Grant income realised (7 months × FRW 100m per month)	700
Statement of financial position	FRW million
Current liabilities:	700

Government Grant (1 year × 7 months next year after providing for the expected 5 months for the forecast unfulfilled student tours × FRW 100m per month)	
Grant repayable	500
Non-current liabilities:	
Government Grant for the last 3 years 6,000 i.e full amount of grant received less 700 i.e amount realized in year and taken to other income less 700 i.e grant classified under current liability less 500i.e grant payable in the current year less 2,000 i.e provision for repayable grant	2,100
Provision for grant repayment (6,000/5 years × 5 months/12*4years)	2,000

QUESTION TWO

MARKING GUIDE

	Marks
Preparation of RTB's financial statements for the year ended 30 June 2024	
Award 0.5 marks for each correct figure used in the preparation of RTB's financial statements (excluding totals and sub-totals) - this figure may be posted directly on the financial statements or may applied in workings used to support the figures in the financial statements (award only once) The workings that attract marks are working on loan asset, computation of Depreciation, lease and intangible (Licenses)	
RTB's financial statements include:	
Statement of profit or loss and other comprehensive income for the year ended 30 June 2024; and	
Statement of financial position as at 30 June 2024	
Do Not Award for explanations of accounting principles or accounting treatment (though the correct figures if used in the explanations or journals entries will be awarded 0.5 marks each)	
Maximum marks for Question Two (cumulatively for both part(a) and (b))	**30**

MODEL ANSWER

RTB's statement of profit or loss and other comprehensive income for the year ended 30 June 2024

	FRW millions
Interest income (11,656 + 4,844 W1)	16,500
Bank fees income	3,863
Interest expense (110 + 58 Note 2)	(168)
Bank fees expenses (1,182 - 258 Note 1)	(924)
Impairment loss on Loan assets (W1) (Note 2)	(910)
Foreign exchange income (1,887 - 52 prior year income + 25 additional current year income) (Note 2))	1,860
Other incomes	64
Total operating income	**20,285**
Less Expenses including:	
Personnel costs	(5,970)
Depreciation and amortisation charge (4,500 PPE (W2) + 676 Leased asset (W3) + 75 license (W4)	(5,251)
Other operating expenses (3,271 - 1,000 Advance lease rental paid W3 (Note 5))	(2,271)
Other finance charges (on lease liability) (W3)	(576)
Profit before income taxes	**6,217**
Income tax expense (300 paid + 425 current taxes payable (W5) + 265 Deferred tax (W5))	(990)
Profit for the year	**5,227**
Other comprehensive income items:	
Fair value gain - investment in equity instruments (Note 3)	109
Total comprehensive income	**5,336**

RTB's statement of financial position as at 30 June 2024

	FRW millions	FRW millions
Assets		
Non-current assets		
Property, plant and equipment (34,000 - 9,000 -4,500 W2)	20,500	
Right of use asset (W3)	6,083	
Intangible assets (W4)	375	
Loan assets (82,500 + 4,844 (W1) - 910 (W1)	86,434	
Other investments (36,216 + 109) Note 3	36,325	
Sub-total: Non-current assets		**149,717**
Current assets		
Prepaid Statutory fee charges to National Bank of Rwanda (Note 1)	258	
Foreign exchange income receivable (Note 2)	25	
Cash and balances held with National Bank of Rwanda	38,089	
Cash balances held in other banks	19,212	
Sub-total: current assets		**57,584**
Total assets		**207,301**
Equity and Liabilities		
Equity:		
Ordinary share capital	13,743	
Share premium	36,947	
Other equity reserves (W6)	764	
Retained earnings (W5)	18,274	
Total equity		69,728
Non-current liabilities		
Long-term borrowings (1,138 + 58 (Note 2))	1,196	
Deferred taxes (855 + 265 additional deferred tax (W5))	1,120	
Lease liability (W3)	5,335	
Sub-total: non-current liabilities		7,651
Current liabilities		
Customer deposits liability	128,317	
Current income taxes payable (W5)	425	
Provision for refund of overcharged bank fees income charged (Note 1)	180	
Lease liability (W3)	1,000	
Sub-total: current liabilities		**129,922**
Total Equity and liabilities		**207,301**

Workings

Note: The workings below support the figures used in both parts (a) and (b) of the question requirement. All relevant figures are rounded to the nearest full FRW millions (no decimal places)

W1: Loan assets (financial assets carried at amortised cost)

Opening balance (1 July 2023) - in the trial balance	82,500
Plus: Interest income (based on effective interest rate: 20% x 82,500)	16,500
Less: Cash interest income received (based on fixed interest rate: 18% x 82,500)	(11,656)
Closing balance / amortised value of loan asset on 30 June 2024 (before the credit loss)	**87,344**

Required adjustment: Increase the loan asset by FRW 4,844 million (87,344 - 82,500)

DR Loan Asset (Non-current assets)	4,844	
CR P&L (Interest income)		4,844

Adjustment for the expected credit loss (impairment loss) on the loan assets – Note 2

DR P&L (Impairment loss on loan assets)	910	
CR Loan Asset (Non-current assets)		910

W2: Depreciation for PPE

Buildings:	
Cost for building (18,000 - 8,000 for land)	10,000
Annual depreciation charge for buildings (10,000 / 20 years)	**500**
Other depreciable PPE items:	
Cost for other depreciable PPE items (34,000 - 18,000 for L&B)	16,000
Annual depreciation charge for other PPE items (16,000 x 25%)	**4,000**
Total annual depreciable charge for PPE (500 + 4,000)	**4,500**

W3: Leased asset

Right-of-use asset:	
Initial measure on 1 July 2023:	
Present value of future lease payments	5,759
Plus: Advance lease rental (paid on 1 July 2023)	1,000
Initial measure on 1 July 2023 - Right of use asset (5,759 + 1,000)	6,759
Less: Annual depreciation (6,759 / 10 years)	(676)
Closing balance (30 June 2024): Right-of-use asset (6,759 - 676)	**6,083**

Adjustment: Advance lease rental paid on 1 July 2023

DR Right-of-use asset	1,000	
CR Other operating expenses (correction of an error)		1,000

Treatment: Annual depreciation for Right-of-use asset

DR P&L (Depreciation charge for Right-of-use asset)	676	
CR Right-of-use asset		676

Lease liability:	
Initial measure (1 July 2023): Present value of future lease payments	5,759
Plus: Finance charge for year ended 30 June 2024 (10% x 5,759m)	576
Closing balance (30 June 2024): Lease liability (5,759 + 576)	**6,335**

Treatment for finance cost on lease obligation

DR P&L (Finance costs - separately from "interest expenses" on RTB's loan from other banks	576	
CR Lease liability		576

Presentation of lease liability balance (on 30 June 2024):	
Current Liability: Amount of advance lease rental payment	1,000
Non-Current Liability: Balance of lease liability balance (6,335 - 1,000)	5,335
Total lease liability balance (30 June 2024)	**6,335**

W4: Ten-year License (an intangible asset)

Cost (in trial balance)	750
Less: Accumulated amortisation on 1 July 2023 (in trial balance)	(300)
Less: Annual amortisation charge - this year (750 / 10 years)	(75)
Closing balance (30 June 2024) Ten-year license	**375**

W5: Income taxes

Additional current income taxes (725 - 300 advance payment) (Note 7)

DR P&L (Income tax expense)	425	
CR Current taxes payable (current liabilities)		425

Additional deferred tax liability in the year (1,120 - 855 balance in trial balance) (Note 7)

DR P&L (Income tax expense)	265	
CR Deferred tax liability (non-current liabilities)		265

W6: Retained earnings

Brought forward - 1 July 2023 (in the trial balance)	12,995
Plus: Prior year adjustment (accrued foreign exchange income for prior year) (Note 2)	52
Plus: Profit for the year (from P&L in part a)	2,033
Closing balance - 30 June 2024	**15,080**

W7: Other equity reserves

Brought forward - 1 July 2023 (in the trial balance)	655
Plus: Fair value gain on equity investments held at FVTOCI (Note 3)	109
Closing balance - 30 June 2024	**764**

QUESTION THREE

MARKING GUIDE

Part (a) - meaning of some key terms in accordance with IAS 7 Statement of cash flows.	**Marks**
(i) Cash equivalents - award as below:	
Award 1 mark for a reasonable definition / meaning of the term "cash equivalent" (or a maximum of 0.5 marks where the student only uses a correct example to illustrate a case for a cash equivalent). Max. of 1 mark	1
(ii) Activity categories - award as below:	
Operating activities: Award 1 mark for a reasonable definition / meaning of the term "operating activities" and 1 mark for any correct example used for a cash flow related to an operating activity (Max. of 2 marks for the examples used). In total a max. of 3 marks	3
Investing activities: Award 1 mark for a reasonable definition / meaning of the term "investing activities" and 1 mark for any correct example used for a cash flow related to an investing activity (Max. of 2 marks for the examples used). In total a max. of 3 marks	3
Financing activities: Award 1 mark for a reasonable definition / meaning of the term "financing activities" and 1 mark for any correct example used for a cash flow related to a financing activity (Max. of 2 marks for the examples used). In total a max. of 3 marks	3
Maximum marks for Q3(a)	**10**
Part (b): RTG's consolidated statement of cash flows	
Award 0.5 marks for each correct figure used to present the consolidated statement of cash flows (excluding the totals and/or sub totals)-Maximum 13 Allocate marks on workings as below Goodwill 1.5 Impairment loss on goodwill 1.5 Amortization charge for intangible 1 Income tax 1.5 Finance costs 1.5	
Note: The figures may either be presented on the face of the consolidated statement of cash flows or in a separate working(s) - this includes the separate correct presentation of the cash and cash equivalents at the start and end of the reporting period	
Maximum marks for Q3(b)	**20**
Total marks for Question three	**30**

MODEL ANSWER

(a) Meaning of the following terms in accordance with IAS 7 *Statement of cash flows*:

(i) Cash equivalents

Cash equivalents are short-term highly liquid investments that can easily be converted in known amounts of cash. Examples of cash equivalents include short-term treasury bills/bonds, bank overdrafts etc.

(ii) Activity categories

Operating activities

Operating activities represent the principal-revenue producing activities of the entity or any other activity that is not an investing and financing activity.

Examples of cash flows related to operating activities of an entity include:

- cash received from the sale of goods / services;
- cash paid for materials;
- cash paid for labour costs;
- cash paid for operational overheads etc

Investing activities

Investing activities represent the acquisition and/or disposal of non-current assets by the entity.

Examples of cash flows relating to investing activities include:

- Cash paid to purchase (and/or cash receipts from the disposal of) property, plant and equipment;
- Cash paid to purchase (and/or cash receipts from the disposal of) intangible assets;
- Cash paid to purchase (and/or cash receipts from the disposal of) investments like equity and/or debt instruments issued by other entities
- Cash receipts in form of interest income arising from (say) debt instruments held in other entities
- Cash receipts in form of dividend income arising from (say) equity instruments held in other entities; etc.

Financing activities

Financing activities are those activities that directly impact on the composition of the entity's capital structure.

Examples of cash flows generated from financing activities include:

- Cash receipts from the issue of (and/or cash payments for redemption of) equity instruments
- Cash receipts from the issue of (and/or cash payments for redemption of) debt instruments
- Cash paid as dividends to equity holders; etc.

Part (b): RTG's Consolidated Statement of Cash Flows for the year ended 30 June 2024 (in FRW millions)

Cash flows generated from operating activities	
Profit before tax	5,380
Adjustments for:	
Finance cost (in the P&L)	650
Gain on disposal of PPE (non-operating activity - Note 2)	(120)
Depreciation charge for PPE - non cash item (non-cash item in Note 2)	6,275
Impairment loss of Goodwill (non-cash item) (W2)	470
Amortisation charge for intangible assets - non cash item (19,500 c/f *less* 18,000 b/f - Note 4) or W3	1,500
Operating cash flows before changes in working capital	**14,155**
Decrease / (increase) in inventories (1,600 c/f *less* 900 b/f)	(700)
Decrease / (increase) in trade receivables (3,220 c/f *less* 2,540 b/f)	(680)
Increase / (decrease) in trade payables (12,000 c/f *less* 11,810 b/f)	190
Cash generated from operations	**12,965**
Interest paid (650 P&L *plus* 1,500 b/f *less* 980 c/f) or W5	(1,170)
Income taxes paid (1,376 P&L *plus* 10,140 b/f *less* 5,881 c/f) or W4	(10,635)
Net cash from operating activities	**1,160**
Cash flows generated from investing activities	
Cash proceeds - disposal of property (Note 2)	8,120
Cash paid - purchase of other PPE (Note 2)	(12,500)
Purchase consideration - acquisition of new subsidiary (KTC) (Note 1)	(25,000)
Net cash from investing activities	**(29,380)**
Cash flows generated from financing activities	
New issued ordinary shares for cash (55,000 c/f *less* 40,000 b/f) (Note 1)	15,000
Ordinary share dividends paid (Note 5)	(400)
Issued loan notes for cash (15,000 c/f *less* 10,000 b/f) (Note 1)	10,000
Net cash from financing activities	**24,600**
Net change in cash and cash equivalents in the period	**(3,620)**
Plus: Cash and cash equivalents brought forward	4,230
Cash and cash equivalents at the reporting date (30 June 2024)	**610**

Workings

W1: Goodwill - on acquisition of new subsidiary (KTC)

	FRW million
Purchase consideration (all in cash)	25,000
Plus: Fair value of non-controlling interests	5,600
Less: Fair value of net assets (all relates to PPE)	(25,380)
Goodwill on acquisition of KTC (on 1 July 2023)	**5,220**

W2: Impairment loss of Goodwill (on 30 June 2024)

	FRW million
Opening balance (1 July 2023)	3,800
Plus: Goodwill on acquisition of new subsidiary (Kigali Tiles Center)	5,220
Less: Closing balance (30 June 2024)	(8,550)
Impairment loss on Goodwill (balancing figure) - included in administration costs	**470**

W3: Amortisation charge for other intangible assets

	FRW million
Opening balance (1 July 2023)	19,500
Less: Closing balance (30 June 2024)	(18,000)
Amortisation charge (balancing figure) - included in costs of sales	**1,500**

W4: Income taxes paid

	FRW million
Opening balance (1 July 2023) - Current tax payable	10,140
Plus: Income taxes for the year (in the P&L)	1,376
Less: Closing balance (30 June 2024) - Current tax payable	(881)
Income taxes paid (in cash) - balancing figure	**10,635**

W5: Finance costs paid

	FRW million
Opening balance (1 July 2023) - Interest payable	1,500
Plus: Interest cost for the year (in the P&L)	650
Less: Closing balance (30 June 2024) - Interest payable	(980)
Interest paid (in cash) - balancing figure	**1,170**

QUESTION FOUR

MARKING GUIDE

	Marks
Part (a): Computation of ratios for MTA for the year ended 30 June 2024	
Award 0.5 marks for each correctly ratio related to the industrial averages (the 0.5 mark is awarded to only the final answer for each relevant ratio). A maximum of 6 marks	6
Do Not Award the workings and/or formulae	
Part ((b): A report on the analysis of MTA's financial performance	
Award as below:	
A reasonable introduction (maximum of 1 mark) Award 1 mark for each well explained point made in the analysis (refer to the model answer for guidance or any other valid point raised in the student's answer). The analysis must be linked to a relevant calculated ratio and/or information given in the scenario under the following categories: - Operational performance; - Liquidity - Gearing - Investor's ratio analysis - A maximum of 1 mark for a reasoned conclusion - A maximum of 12 marks (including the introduction and conclusion but excluding the professional marks) for the analysis	12
Professional marks: Award 1 mark for a good report format (using the model answer as a reference) and 1 mark for overall quality of discussion on part (b) - maximum of 2 professional marks	2
Do Not Award: Generic points made without reference to specific information provided in the scenario	
Total marks for Question three	**20**

MODEL ANSWER

Part (a): Calculation of MTA's specified ratios (where applicable figures are rounded to FRW millions)

	Formula	Working	MTA	Industrial Average
Return on capital employed	$\frac{Operating\ profit}{capital\ employed}$	{(248 + 45 loan interest) / (447 + 400)} x 100%	34.6%	22.1%
Net assets turnover (times)	$\frac{Sales}{Capital\ employed}$	3,233 / (447 + 400)	3.8	1.8
Gross profit margin	$\frac{Gross\ profit}{Sales}$	740 / 3,233 x 100%	22.9%	30%
Operating profit	$\frac{PBIT}{Sales}$	(453) / 3,233 x 100%	14%	12.5%
Current ratio	$\frac{Current\ assets}{Current\ liabilities}$	794 / 667	1.19	1.6

Quick ratio	$\frac{Current\ assets - Inventory}{Current\ liabilities}$	(794 - 367) / 667	0.64	0.9
Inventory holding period (days)	$\frac{Inventory}{Cost\ of\ sales} * 365$	367 / 2,493 x 365	54	46
Accounts receivable collection period (days)	$\frac{Receivables}{Revenue} * 365$	427 / 3,233 x 365	48	45
Creditor payment period (days)	$\frac{payables}{Cost\ of\ sales} * 365$	467 / 2,493 x 365 (based on cost of sales)	68	55
Debt to equity	$\frac{Long\ term\ debt}{Total\ equity}$	400 / 447 x 100%	89%	40%
Dividend yield - as calculated from a dividend per share figure of 15c {(FRW 120m / (200m/2.5)} divided by a share price of FRW 6	$\frac{Dividend\ paid}{Share\ price * no\ shares}$	{(FRW 12m / (200m*6/2.5)}	2.5%	6%
Dividend cover (times)	$\frac{Net\ profit}{Dividend\ paid}$	38 / 12	3.2	5

Part (b): Analysis of MTA's financial performance compared to industrial average for the year to 30 June 2024:

To: Board of Directors, Muganza Tech Agencies (MTA).
From: Financial Analyst
Date: XXX

Introduction
The analysis below relates to an assessment of MTA's financial performance compared to the industrial averages for the year ended 30 June 2024. The analysis has been made on the request of MTA's board and this includes an assessment of the operating performance, liquidity, gearing and the investors' ratio

Operating performance

The return on capital employed of MTA at 34.6% is impressive as compared to the industrial average of 22.1% which is more than 50% higher than the industrial average. The components of the return on capital employed are the asset turnover and profit margins. In these areas MTA's asset turnover of 3.8 times is much higher (nearly double) than the average of 1.8 times, and also the operating profit of 14% is better than that one for industry of 12.5%.

This short analysis seems to imply that MTA's superior return on capital employed is due entirely to an efficient asset turnover i.e. MTA is making its assets work twice as efficiently as its competitors.

A closer inspection of the underlying figures may explain why its asset turnover is so high. It can be seen from the note on property, plant and equipment that MTA's PPE items appear to be quite old. Their net carrying value for the PPE is only 15% (720m / 4,800m) of the PPE original cost. This has at least two implications that include:

- the PPE will need replacing in the near future and yet MTA is already struggling for funding with a current bank overdraft;
- and the low net carrying value of the PPE gives a high figure for asset turnover.

Unless MTA has underestimated the life of its PPE in its depreciation calculations, its PPE will need replacing in the near future. When this occurs its asset turnover and return on capital employed figures will be much lower perhaps less than (or equal to) those of the industrial averages. This aspect of ratio analysis often causes problems and to counter this anomaly some companies calculate the asset turnover using the cost of non-current assets rather than their net book value as this gives a more reliable trend. It is also possible that MTA is using assets that are not on its balance sheet. For example, MTA may be utilizing leased assets of a short-lease period that are not recognized as assets and thus the assets and corresponding obligations are not recognised in the statement of financial position.

A further issue is which of the two calculated margins should be compared to the industrial average (i.e. including or excluding the effects of the non-routine loss). The gross profit margin of MTA of 22.9% is much lower than the 30% as the industrial average. If the non-routine loss is recognised in the cost of sales (since this relates to MTA trading activity as these was due to a disposal of obsolete inventory), MTA's gross margin would be even worse. As MTA's net margin of 14% is better to the industrial average of 12.5%, it would appear that MTA has better control over its operating costs.
In addition, considering that MTA has a higher gearing at 89% which is more than twice of the industry at 40%, the company still is able to retain a profit after paying off high finance costs from which it is able to pay dividend.

Liquidity
Here MTA shows real cause for concern. Its current and quick ratios are much worse than the industrial average, and indeed far below the acceptable rates. Current liquidity problems appear due to high levels of trade payable and a high bank overdraft.

The high levels of inventory contribute to the poor quick ratio and may be indicative of further obsolete inventory. MTA may be holding high volumes of outdated computers which will be the reason for the high closing inventory balance indicating customers will have switched to the competitor.

The trade receivable period figure is reasonable as MTA's 48 days is close to the 45 days the other companies in the industry take to collect the trade receivables. However, MTA takes longer to settle its trade payables taking 68 days which is almost two (2) weeks longer than its competitors in the industry taking an average of 55 days. Whilst this is a source of 'free' finance, it can damage MTA's relations with suppliers and may lead to suppliers withdrawing or reducing the credit facilities offered to MTA which will adversely impact on MTA operations considering that with a bank overdraft it may not have available cash to pay suppliers before goods are received.

Gearing
As referred to above, gearing (as measured by debt/equity) of MTA at 89% is more than twice the level of the industrial average at 40%. Though this may be an uncomfortable level, it is currently beneficial for shareholders. The company is making an overall return of 34·6%, but only paying 10% interest on its loan notes. However, the gearing level may become a serious issue if MTA becomes unable to maintain the finance costs which is highly probable considering that MTA is currently with an overdrawn bank account indicating the doubt to settle the interest payments in future.

Investor ratios
Despite reasonable profitability figures, MTA's dividend yield is poor compared to the industrial average. From the analysis of the retained earnings, MTA paid ordinary share dividends of FRW 12 million out of available profit for the year of only FRW 38m. This explains MTA's low dividend cover of 3 times.
It is important to note that MTA paid an interim dividend of FRW 9 million which is three (3) times higher than the final dividends paid of FRW 3 million. This may indicate a worsening performance during the year, as normally final dividends are higher than interim dividends.

However, with all the above worrying factors regarding the investors' ratios, MTA's share price has consistently been maintained on the stock market at FRW 6 per share (above the nominal par value of FRW 2.5 per share) which is evidence that the shareholders and the public still have confidence in the company's financial performance.

Conclusion
MTA compares favorably with the industrial average figures for profitability. However, the company's liquidity and gearing position is quite poor and gives cause for concern. If it is to replace its old assets in the near future, it will need to raise further finance. With already high levels of borrowing and poor dividend yields, this may be a serious problem for MTA.

Yours faithfully
Financial analyst

QUESTION FIVE

MARKING GUIDE TO QUESTION FIVE

Part (a)(i): Qualitative characteristics in the conceptual framework and the importance of "faithful representation"	**Marks**
Award 1 mark for each correct reference to a principle from the Conceptual Framework including:	**5**
- a definition of the general term "Qualitative characteristics"	
- A reference to the fact that there are two categories of qualitative characteristics in the conceptual framework (and must mention the categories specifically)	
- The general difference(s) between the "fundamental qualitative characteristics" and the "enhancing qualitative characteristics" - 1 mark for each correct difference up to a maximum of 2 marks	
- A description of what "faithful representation" implies / means (1 mark)	
- An illustration of how "faithful representation" is implemented in the financial statements e.g., completeness, neutrality, free from bias, substance over form etc. This illustration may be supported by any example (e.g., sale & repurchase transactions, sale & leaseback arrangements, factoring of debts etc.) (1 mark each to a maximum of 2 marks)	
Maximum marks for Part (a)(i)	
Do Not Award: Separate definitions of each qualitative characteristics (other than "faithful representation" which is emphasised by the question)	
Part (a)(ii): NFC's sale and repurchase of inventory (timber)	
Award 1 mark for each of the following:	5
- A reasoned assessment that the substance of the transaction is significantly different from the legal form	
- a conclusion that AFC's sale and repurchase transaction is not a sale of inventory but an acquired short-term loan (secured against inventory)	
- a reference to how/where to "present" the timber (as inventory) and the amount received from Capital Bank (as a short-term loan in current liabilities) in NFC's financial statements at the reporting date	
- the accounting treatment (can in form of accounting journals) for the initial recognition of the transaction (on 15 June 2024) and the subsequent re-measurement of the short-term loan (with an interest cost) on 30 June 2024.	
- the **calculation** of the interest cost (must be time-apportioned to 15/30 days) by 30 June 2024	
- the summary presentation of the sale and repurchase arrangement (as extracts) in NFC's financial statements on the reporting date (30 June 2024)	
Maximum marks for Part (a)(ii)	

Part (b): Climate-related risks in financial reporting	
Part (b)(i): Stakeholders and their interests in a company reporting climate-related risks in their financial reports	
Award 1 mark for each stakeholder group (this includes 0.5 marks for stating a correct stakeholder group and 0.5 marks for giving a valid reason / need for this information by the stakeholder group). A maximum of 3 marks Award marks for any valid users other than those stated in the model answer with a justified reasons for an need of climate related risks diclosure	3
Award 1 mark for each valid challenge "explained" faced by a company in disclosing climate-related risk in their financial reports. A maximum of 3 marks	3
Maximum marks for Part (b)	**6**
Part (c): IFRS 1 principles for a FTA entity (Bizimana Appliances Ltd) in preparing an IFRS opening statement of financial position	
Award 1 mark for each relevant principle applied to prepare an IFRS opening statement of financial position as below:	
- A brief reasonable explanation of a "First-Time Adopter" (FTA) in accordance with IFRS 1	
- The requirement for a FTA to make an explicit or unreserved statement that its first set of IFRS financial statements	
- The IFRS 1 requirement (and objective / rationale) for the opening statement of financial position	
- An illustration of the date for the opening statement of financial position (can use the dates applied for Bizimana Appliances Ltd as an example)	
- The specific guiding principles (from IFRS 1) that the FTA must consider when preparing the opening statement of financial position - a maximum of 4 marks for these specific considerations	
- The fact (or reason why) that a FTA is NOT required to publish the opening statement of financial position	
- The requirement for a FTA to apply consistent accounting policies / principles used in the opening statement of financial position in all the presented IFRS financial statements	
Maximum marks for Part (c)	4
Total marks for Question three	**20**

MODEL ANSWER

Part (a)(i): Qualitative characteristics in the conceptual framework and the importance of "faithful representation"

In reference to the Conceptual Framework for Financial Reporting, qualitative characteristics are the attributes that an entity's financial statements must bear to ensure that the financial information contained in the financial statements is useful to the needs and decision making process of the users of the financial statements.

There are two categories of qualitative characteristics that include:

- Two fundamental qualitative characteristics (relevance and faithful representations); and
- Four enhancing qualitative characteristics (comparability, verifiability, timeliness and understandability)

The two fundamental qualitative characteristics are vital attributes to the financial information in the entity's financial statements and without them, the financial statements would not be useful as they may be misleading.

The four enhancing qualitative characteristics improve the usefulness of the financial information. Financial information which is not relevant or does not give a faithful representation is therefore not useful (and worse, it may possibly be misleading). However, financial information which does not possess the enhancing characteristics can still be useful, but not as useful as if it did possess them.

In order for financial statements to be useful to users (such as investors or loan providers), they must present financial information faithfully. That is, financial information must faithfully represent the economic phenomena which it purports to represent (e.g. in some cases it may be necessary to treat a sale and repurchase agreement as an in-substance (secured) loan rather than as a sale and subsequent repurchase). Faithfully represented information should be complete, neutral and free from error. Substance is not identified as a separate characteristic because the IASB says it is implied in faithful representation such that faithful representation is only possible if transactions and economic phenomena are accounted for according to their substance and economic reality.

Part (a)(ii) Ngoma Furniture Company (NCF): Sale and repurchase of Inventory

It is highly likely that any of the two options will be exercised in regard to the sale and repurchase agreement involving the sale of the un-processed timber by NFC to Capital Bank. This transaction should be assessed in its substance form rather than the legal form. Taking the transactions as a whole, the commercial substance is that of a short-term loan obtained by NFC from Capital Bank where this loan is secured on the NFC's inventory.

The inventory should remain in NFC's financial statements as part of the "inventory" at FRW 300m at year end (30 June 2024). The amount received from Capital Bank amounting to FRW 360m should be presented in current liabilities. Therefore, on the receipt of the FRW 360m from Capital Bank, the following accounting entry should be made:

DR Bank or Cash	FRW 360m	
CR Short-term loan (current liabilities)		FRW 360m

The interest payable to 30 June 2024 of FRW 9m (FRW 18m × 15/30 days) should be charged to profit or loss and added to the liability in the statement of financial position. The accounting journal for the interest cost is:

DR Interest cost (in P&L)	FRW 9m	
CR Short-term loan (current liabilities)		FRW 9m

In summary, the following transactions shall be presented in NFC's financial statements as extracts:

Profit or loss

Interest cost	FRW 9m

Statement of financial position
Current assets

Inventory (at carrying value)	FRW 300m

Current Liabilities

Short-term loan from Capital Bank (360m + 9m)	FRW 369m

Part (b): Climate-related risks in financial reporting

Part (b) (i) Stakeholder groups and their interests for a company to include climate-related risks in the financial reports

Investors (shareholders of a company) – demand the company to disclose the impact of climate change on the resilience of the company's business strategies in order to sustain the continued survival of the company. An example is the disclosure of the company's strategies to comply to government regulations on environmental damage arising from the company's activities that could lead to cancellation of the company's license to operate

Loan providers (like banks) – need to understand the impact of climate-related risks on the financial performance of the companies they provide loans to as this enables the loan providers to assess the level of credit risk for the loans provided and incorporate this risk in the cost of borrowing (interest rates) to the company

Credit rating agencies (e.g., the Credit reference bureaus supervised by the National bank of Rwanda) – need information about the climate-related risks in each industrial sector to assess the impact on the credit ratings for companies in each industrial sector

Regulatory bodies (e.g. Rwanda Environment Management Authority) – need information regarding climate-related risks disclosed in the companies' financial reports to evaluate the level of compliance by companies to the national regulations on climate and environmental protection. The government regulators will further use this information to determine the controls needed to address non-compliance including the disciplinary actions needed on non-compliant companies.

Customers (e.g. corporate customers) – need information regarding a company's climate-related risks reported in the financial reports to assess the level of sustainability of their own

business operations linked to the compliance to environmental regulations by their key suppliers of goods and services.
Note: Credit shall be granted to other valid stakeholder groups that are provided by the student responses

Part (b)(ii): Challenges faced by companies in reporting climate-related risks in their financial reports

The following challenges are faced by companies in providing / disclosing information regarding the climate-related risks in their financial reports:

- Companies disclose climate-related risks in their financial reports using a variety of different reporting frameworks and therefore there is a lack of uniform guidelines in form of accounting standards on the format and content to disclose regarding the climate-related risks information by companies. This impacts negatively on the provision of consistent and comparable information reported by companies in their financial reports.

- There are a large number of performance measurement indicators or key performance indicators (KPIs) that are available for companies to apply in reporting performance on climate-related risk where the large number of KPIs creates confusion on choice of the most appropriate KPIs to apply in reporting the climate-related risks in their financial reports.

- The costs of assembling all important information regarding the company's performance on climate-related risks may outweigh the benefits associated with a company reporting this information in their financial reports which hinders the amount and quality of information reported by companies in their financial reports.

- The disclosure of climate-related risks may have a negative impact on the company's financial performance for example a case where the competitors take advantage of the detailed disclosed information which impacts on the company's competitive advantage

Note: Credit will be granted to other valid points regarding challenges that are well explained in the student's response

Part (c): Bizimana Appliances Ltd – First Time Adoption of IFRS standards

IFRS 1 principles for a FTA entity in preparing an IFRS opening statement of financial position

Under IFRS 1 *First-Time Adoption of IFRSs*, an entity that presents its financial statements applying the International Financial Reporting Standards (IFRSs) for the first time is referred to as a First-Time Adopter (FTA). The FTA entity like Bizimana Appliances Ltd must make an explicit or unreserved statement that its first set of IFRS financial statements (including the opening IFRS statement of financial position) have complied to all the relevant IFRS standards.

In the case of Bizimana Appliances Ltd preparing its first IFRS financial statements for the year ended 31 December 2024 (i.e., 1 January 2024 to 31 December 2024), IFRS 1 requires Bizimana Appliances Ltd to prepare an "opening statement of financial position" as at the opening date of the earliest presented financial year for comparative purposes. The minimum is at least one financial year prior to the year in which the company adopts IFRS GAAPs for the first time which in this case will be the prior year ended 31 December 2023.

Therefore, IFRS 1 requires Bizimana Appliances Ltd to prepare an IFRS opening statement of financial position as at 1 January 2023 which will have to comply to each relevant IFRS that applied on 1 January 2023.

Specifically, Bizimana Appliances Ltd.'s while preparing the opening statement of financial position on 1 January 2023 will have to take the following into consideration:

- Recognize all related assets and liabilities that qualify for recognition on that date under the relevant IFRS requirements;
- De-recognize (and/or ignore the recognition) of assets and liabilities which on that date do not qualify for such recognition under the relevant IFRS requirements;
- Reclassify items that the entity recognized in the previously applied GAAPs as one type/class of asset, liability, or component of equity but these qualify as a different type/class of asset, liability or component of equity in the IFRS classification requirements.
- Apply IFRS's requirements in measuring all the recognized assets and liabilities on that date.

IFRS 1 does not require Bizimana Appliances Ltd to publish the opening IFRS statement of financial position as the main objective of this financial statement is only to provide opening balances to enable the smooth preparation of the subsequent financial statements under the IFRS GAAPs.

Bizimana Appliances Ltd must use the same accounting principles applied in the opening statement of financial position for all periods presented in the IFRS financial statements.

End of Model Answer and Marking Guide