CERTIFIED PUBLIC ACCOUNTANT

ADVANCED LEVEL 1 EXAMINATIONS

A1.3: ADVANCED FINANCIAL REPORTING

DATE: TUESDAY 27, FEBRUARY 2024

INSTRUCTIONS:

1. **Time allowed: 3 hours 45 minutes** (15 minutes reading and 3 hours 30 minutes writing).
2. This examination has **two** sections**; A&B.**
3. Section **A** has **one compulsory question** while section **B** has **three optional questions** to choose **any two.**
4. In summary attempt **three questions**.
5. Marks allocated to each question are shown at the end of the question.
6. Show all your workings where necessary.
7. The question paper should not be taken out of the examination room.

SECTION A

QUESTION ONE

The following draft statements of financial position relate to Alpha Ltd, Bertin Ltd and Claver Ltd as at 30th June 2023. These are all public limited companies operating in the manufacturing sector and based in Rwanda.

	Alpha	Bertin	Claver
	FRW'million	FRW'million	FRW'million
Non-current assets			
Property, plant and equipment	87,000	73,000	36,400
Investments	116,000	36,000	-
Sub-total non-current assets	**203,000**	**109,000**	**36,400**
Current assets			
Inventory	27,500	16,960	7,560
Trade receivables	10,650	11,200	5,740
Cash	1,700	1,080	1,300
Sub-total current assets	**39,850**	**29,240**	**14,600**
Total assets	**242,850**	**138,240**	**51,000**
Equity and Liabilities			
Equity			
Ordinary share capital	20,000	16,000	7,000
Retained earnings	204,150	106,400	35,700
Sub-total equity	**224,150**	**122,400**	**42,700**
Non-current liabilities			
Long-term borrowings	5,600	3,760	1,860
Current liabilities			
Trade payables	13,100	12,080	6,440
Total equity and liabilities	**242,850**	**138,240**	**51,000**

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

(i) On 01st July 2021, Alpha acquired 80% of the ordinary share capital of Bertin Ltd paying FRW 116,000 million when the retained earnings of Bertin Ltd were FRW 64,000 million.

Earlier, on 01st July 2019, Bertin Ltd had acquired 75% of the ordinary share capital of Claver Ltd paying FRW 36,000 million. The retained earnings of Claver Ltd were FRW 16,800 million on 01st July 2019 and FRW 22,400 million on 01st July 2021.

(ii) On the date of acquisition, the book value of the net assets of the subsidiaries were not materially different from their fair values with the following exceptions that both relate to Bertin Ltd's net assets:

- At the date of acquisition, Bertin Ltd had inventory with a carrying amount of FRW 11,750 million which had a fair value of FRW 15,750 million. All this inventory was sold by 30th June 2023.
- Also, at the date of acquisition, Bertin Ltd had plant with a carrying amount of FRW 16,000 million and a fair value of FRW 28,000 million. This plant is being depreciated over a 4-year useful life on a straight-line basis (assume a full year depreciation is charged in the year of the asset's acquisition). The asset is still being used by Bertin Ltd at the end of the reporting period.

(iii) In the year to 30th June 2023, Bertin Ltd sold goods to Alpha at a selling price of FRW 5,000 million and Alpha Ltd sold goods to Claver Ltd at a selling price of FRW 6,000 million. All inter-company sales are made at a cost plus of 25%. Half of the goods purchased by Alpha Ltd and 25% of the goods purchased by Claver Ltd remained unsold at the year-end.

(iv) Bertin Ltd has levied a management fee of FRW 200 million per annum on Claver Ltd for the provision of management services which Claver Ltd has not yet paid and has not accrued it on 30th June 2023 in its financial statements.

(v) The non-controlling interests in Bertin Ltd are valued at their fair value on acquisition and includes their share of goodwill. On 01st July 2021, the fair value of the non-controlling interests in Bertin Ltd was FRW 28,500 million. The non-controlling interests in Claver Ltd are valued at their proportionate share of the net assets on acquisition in Claver Ltd and they are not credited with their share of goodwill.

(vi) Goodwill in respect of Bertin Ltd has been impaired by FRW 12,000 million since acquisition and the value of goodwill in Claver Ltd (in respect of Alpha Ltd) at 30th June 2023 was FRW 7,440 million.

(vii) In the year ended 30th June 2023, Alpha Ltd contributed 40% to the construction cost of a factory building in Rubavu. The factory and its operations are owned by Alpha Ltd and two other joint operators in which Alpha Ltd has a 40% shareholding. The other two joint operators hold 30% shareholding each. No separate entity exists under this joint operation as the assets, liabilities, revenues and costs are apportioned on the basis of the shareholdings held by each of the three joint operators.

The construction commenced on 01st July 2022 and was completed on 30th June 2023 at a total cost of FRW 15,000 million. The construction cost was fully funded by a 5-year loan note of an equivalent amount of FRW 15,000 million. The loan note which is an obligation to the joint operators (in their shareholding proportion) was issued on 01st July 2022 at an annual interest rate of 20% (to be settled on the redemption date of the loan). The individual financial statements of Alpha Ltd have not accounted for the investment in the joint operation and the associated loan.

(viii) Alpha Ltd entered into a 5-year "finance lease" arrangement as the "lessor" for a machine with a major customer (the "lessee") with the lease commencing on 01st July 2022. Under the terms of the lease, the lessee commits to pay FRW 1,000 million per annum commencing on 30th June 2023 and there is an implicit interest rate of 10% per annum. The present value of the lease payments for the lease arrangement was assessed on 01st July 2022 to be FRW 3,791 million which was also equivalent to the normal selling price of the asset. Ignore any unguaranteed residual value.

Alpha Ltd has not recognized any accounting treatment for the lease including the lease rental which was in transit by 30th June 2023. In addition, the machine is still maintained within the "property, plant and equipment" in Alpha Ltd's separate financial statements at the carrying amount of FRW 3,200 million.

Required:

(a) In accordance with the applicable International Financial Reporting Standards, **explain (with computations where applicable) how the following should be reported in the separate and consolidated financial statements of Alpha Ltd on the reporting date for:**

(i) The joint operation under Alpha's joint arrangement *(in note vii).* (8 Marks)

(ii) The leased machine by Alpha *(in note viii).* (8 Marks)

***Note**: In part (a)(ii), you are not expected to explain the accounting for leases by the lessee*

(b) Prepare the consolidated statement of financial position of the Alpha Ltd Group at 30th June 2023 in accordance with International Financial Reporting Standards.

(34 Marks)

***Note:** All calculations should be rounded to the nearest FRW millions (no decimal point)*

(Total: 50 Marks)

SECTION B

QUESTION TWO

Nexus is a public listed company on the Rwanda Stock Exchange which was incorporated twenty (20) years ago and all this time, the company has been extracting natural gas which is sold to the public in Rwanda. The directors of the company are uncertain about the importance of both the IASB's "Framework for the preparation and presentation of financial statements" (the Framework) and company law in corporate reporting. The directors' view is that accounting is based on transactions that are carried out by the company and these transactions are allocated to the company's accounting period by using the matching and prudence concepts. The argument put forward by the directors is that the Framework does not take into account the business and legal constraints within which companies operate.

During the preparation of the financial statements for the year ended 31st December 2023, the directors of Nexus, have shared with you two situations which have arisen in the current financial statements where they feel that the current accounting practice is not consistent with the Framework.

(a) Situation 1

Nexus has recently constructed a production plant for use in the extraction of natural gas. The plant is located in Gisenyi and the company commenced production at this plant one year ago (01st January 2023). An operating license was given to the company by the Government of Rwanda for the extraction of gas at this plant and the license requires Nexus to remove the plant at the end of its life. The estimated useful life of the plant is considered to be 20 years and depreciation of the plant is charged on a straight-line basis. The construction cost of the plant was FRW 2,000 million and the net present value at 01st January 2023 of the future costs to be incurred in order to return the extraction site to its original condition are estimated at FRW 500 million (based on discount rate of 5% per annum). It is estimated that 80% of the restoration costs relate to the removal of the facility while 20% relate to the rectification of the damage caused through the extraction of the natural gas. The experts have told the company that a provision for decommissioning has to be set up.

Required:

(i) Explain (with suitable computations) the appropriate accounting treatment for situation 1 as required by the IFRS accounting standards in the financial statements of Nexus for the year ended 31st December 2023

Note: *You are required to develop relevant extracts of the financial statements based on the explanation and calculations done above.* (8 Marks)

(ii) Discuss whether the accounting treatment for the decommissioning liability as proposed in (a) (i) above in Nexus' financial statements appears consistent with the "Framework". (2 Marks)

(b) Situation 2

Nexus has a factory building located in Huye which was purchased on 01st January 2023 for FRW 1,000 million and has an economic useful life of 10 years. On the same day, Nexus received a grant related to the building of FRW 200 million which was correctly reduced on the cost of the building in accordance to the applicable IFRS standards. Nexus has been formally advised by Rwanda Revenue Authority that the tax allowable that can be claimed for the factory building is 40% per annum on a reducing balance basis. The company's tax rate is 30%. In addition, there are other additional taxable temporary differences of FRW 300 million in respect of deferred tax liabilities at the year end.

In addition to the above, Nexus has correctly recognized a provision for a warranty of FRW 400 million within its liabilities at 31st December 2023 which is deductible for tax purposes. Due to the losses reported in the profit or loss for the past two years, the company has un-used tax losses of FRW 700 million at 31st December 2023. The economic environment has always been very unpredictable but Nexus expects to report profits in the future accounting periods.

The directors of Nexus have correctly accounted for all the transactions in *Situation 2* other than the deferred taxation implications since they are not sure of how to apply the relevant IFRS accounting standard.

Required:

(i) In accordance with IAS 12 *Income Taxes*, **show the calculations required for the deferred tax implications arising from the events in Situation 2 and determine the deferred tax balance that should be recognized in the statement of financial position as at 31st December 2023.** (6 Marks)

(ii) Discuss whether the accounting treatment for the deferred tax as proposed in (b) (i) above in Nexus' financial statements appears consistent with the framework (2 Marks)

(c) Nexus has a strategy of diversifying its business strategy to venture into other profitable business segments in Rwanda. On 01st January 2024, the directors of Nexus have approved the formation of a separate business line that will immediately commence the sale of insurance services to the general public. In the quarter January – March 2024, the company has issued a significant number of motor insurance contracts to companies and private individuals owning cars throughout Rwanda. As a result, Nexus will be required to apply IFRS 17 Insurance contracts for the first time in their financial statements for the year ended 31st December 2024. The directors of Nexus have approached you for guidance on the application of IFRS 17 to the insurance contracts agreed upon with their customers (the policyholders).

Required:

In accordance with IFRS 17 Insurance Contracts, **explain briefly the guidelines that Nexus should apply in recognizing and disclosing a group insurance contracts in the financial statements for the year ended 31st December 2024.** (7 Marks)

(Total: 25 Marks)

QUESTION THREE

(a) Kigali Soap Industries Limited (KSIL) is a listed company based in Rwanda that manufactures soap products sold in and outside Rwanda. In addition, to the local-based factories in Rwanda, KSIL operates with two other factories outside Rwanda. The two factories outside Rwanda include a factory in Mombasa (Kenya) and another factory in Arusha (Tanzania). KSIL prepares its financial statements to 31st December each year.

KSIL has senior management team in all the three countries and a large number of highly skilled employees in the production department. These employees are required to meet high targets on an annual basis. In order to retain this core team of employees, KSIL has commenced two schemes with details below:

The "Senior Management Team scheme"

KSIL introduced a share-based scheme for all members of its Senior Management Team (SMT) on 01st January 2021 referred to as the "SMT scheme". On 01st January 2021, KSIL granted 200 share options to each of the 50 senior management team (SMT) employees under the SMT scheme. In this scheme, each employee is entitled to a right to purchase KSIL ordinary shares at FRW 20,000 per share. The share options vest on 31st December 2023 if the employee under the SMT scheme remains in employment with KSIL throughout the three-year period. Additional details of the SMT scheme are below:

Date	Share price (FRW)	Fair value of option (FRW)	Expected number of employees for whom 200 options (each) will vest
01-Jan-21	20,000	20,000	46
31-Dec-21	25,000	9,500	45
31-Dec-22	28,000	10,000	48
31-Dec-23	29,500	11,000	47

Note: *Based on the information above, the actual number of employees that qualified for share options on 31st December 2023 was 47 employees.*

The "Producers Scheme"

On 01st January 2021, KSIL introduced the "Producers Scheme" as a share-based scheme specifically for the employees in the "production team". On 01st January 2021, under the "Producers Scheme", KSIL granted two (2) share-appreciation rights (SARs) to each of the 500 employees in the production department. Each SAR gives a right of a cash payment to the employee for every 10% increase in the company's share price from 01st January 2021 to the vesting date of the SARs. The SARs will vest on 31st December 2023 for employees who continue to work for KSIL throughout the three-year period. Payment will be due on 30th April 2024.

Relevant data is as follows:

Date	Share price (FRW)	Fair value of option (FRW)	Expected number of employees for whom 200 options (each) will vest
01-Jan-21	2,700	150,000	480
31-Dec-21	3,000	156,000	470
31-Dec-22	3,400	162,000	480
31-Dec-23	3,900	180,000	476

Note: *Based on the information above, the actual number of employees that qualified for two SARs each on 31st December 2023 was 476 employees.*

Required:

For each of the two share-based payment schemes**, calculate the amount that should be recognized in KSIL's profit or loss and statement of financial position for each of the three years to 31st December 2023**

Note: In supporting the calculations above, **you are expected to briefly explain the treatment of the change in the fair value of the share instrument to the expense calculation, and state where this calculated amount will be presented in the statement of financial position**.

(14 Marks)

(b) The accountant of KSIL is finalizing the company's financial statements for the year-ended 31st December 2023 and has the following items which remain non-accounted for:

(i) KSIL is being sued by an employee who lost an arm in an accident while at work on 15th December 2023. KSIL is denying the claim indicating that the employee was not following the safety procedures that were required to be used. Therefore, KSIL has disclosed a contingent liability of FRW 150 million for personal injuries to the employee. You are aware that in a court case that was settled recently for a similar injury, a company in Rwanda was made to compensate an injured employee with FRW 175 million. However, although the injury was similar to the case in KSIL, the actual circumstances of injury settled by the court are different from those in KSIL's case and in KSIL's legal expert's opinion, there is a very slim chance that KSIL will be found legally liable for the employee's accident by the court. (4 Marks)

(ii) KSIL commenced on 01st July 2023, a large contract to produce a special type of soap product for a government hospital which is expected to take ten (10) months to complete. In assessing the percentage of completion on 31st December 2023, KSIL has applied the "cost basis" in accordance with IFRS 15 *Revenue from contracts with customers*. On 31st December 2023, KSIL has recognized a profit of FRW 1,200 million on this contract and this is based on costs to date of FRW 3,000 million as a percentage of the total estimated costs of FRW 6,000 million. In February 2024, KSIL was informed that due to importation restrictions on the type of raw materials needed to produce the soap product under this contract, the cost of materials on this contract will cost an additional FRW 1,500 million more that the estimated total cost used in the calculation of the percentage of completion. KSIL cannot pass on the additional cost of the materials to the customer. (4 Marks)

(iii) On 15th February 2024, KSIL's auditors discovered a fraud in the stores department. A storekeeper who had been recruited in April 2023 had been stealing materials from the stores and raising false store dispatch notes to falsely support the stolen materials making it hard to identify any losses. The storekeeper was dismissed immediately the fraud was discovered in February 2024. Evidence shows that the total amount of the fraud to the date of its discovery was FRW 480 million of which FRW 420 million related to the loss made in the year ended 31 December 2023. The management of KSIL has assessed the loss to be material. (3 Marks)

Required:

Briefly explain and quantify how items (i) to (iii) above should be treated when completing the financial statements of KSIL for the year ended 31st December 2023.

Note: *The mark allocation in part (b) is shown against each of the three items above*

(Total: 25 Marks)

QUESTION FOUR

(a) Rwamine Ltd is incorporated in Rwanda while Kenmine Ltd is incorporated in Kenya. As part of the strategy to enhance the mining sector in the East African Community, both entities agreed to create a separate entity called Tazmine Ltd on 01st January 2023 which correctly qualified as a joint venture in accordance with the IFRS accounting standards. As a separate entity, Tazmine Ltd is incorporated and based in the Tanzania with its head-office in Arusha and has a mining site in Dodoma. On the incorporation of Tazmine Ltd, the two venturers Rwamine Ltd and Kenmine Ltd agreed to subscribe net assets for a 50% share each in the share capital of Tazmine Ltd. All the three companies are Government business entities (GBEs) in their respective countries and are engaged in the business of mining and supply of natural minerals.

Rwamine Ltd's contribution to Tazmine Ltd

On 01st January 2023, Rwamine Ltd contributed the following assets to the new company (Tazmine Ltd) in exchange for its shareholding in the joint venture:

	FRW million
Cash	1,000
Trade receivables – Dime Ltd	7,000
Intangible assets - contract with Dime Ltd	3,000
Property, plant & equipment	9,000
Total	**20,000**

The above assets form a cash-generating unit in its own right (i.e., a mining site based in Dodoma, Tanzania). The unit supplies mineral resources to a single customer called Dime Ltd. On 15th January 2023, Dime Ltd was declared bankrupt and the contract to supply minerals to Dime Ltd was cancelled. On 01st February 2023, the administrators for Dime Ltd provisionally agreed to pay a final settlement figure of FRW 5,000 million on 31st December 2023 and this amount also included a compensation for the cancellation of the contract. Rwamine Ltd expects Tazmine Ltd will receive 80% of the provisional amount.

When the news regarding the cancelled contract with Dime Ltd were made public, an offer from a potential buyer of FRW 16,000 million to buy the "mining site" was received. Tazmine Ltd would be required to pay the disposal costs estimated at FRW 1,000 million.

The mining site has an estimated useful life of four (4) years on 01st January 2023. It has been agreed with the Government of Tanzania that the mining site will be dismantled on 31st December 2026. The estimated cost of dismantling the site is FRW 5,000 million (as the cost amount on 31st December 2026).

The Directors of Rwamine Ltd and Tazmine Ltd are currently in the final stage of negotiating a new contract to supply minerals to another customer based in USA. With this potential new contract, the future net cash flows (undiscounted) for four years expected to be generated from the cash-generating unit (the mining site) are as follows:

	FRW million
31st December 2023	6,000
31st December 2024	7,000
31st December 2025	8,000
31st December 2026	8,000
Total	**29,000**

The dismantling cost has not been provided for in the above figures for the future expected cash flows. All the cash flows are assumed to be at the year-end date and the following discount rates based on a rate of 6% (as applied by all the companies) apply where appropriate:

Year-end	Discount rate (6%)
31st December 2023	0.943
31st December 2024	0.890
31st December 2025	0.840
31st December 2026	0.792

Kenmine Ltd's contribution of net assets to Tazmine Ltd

Kenmine Ltd has contributed the following assets to the new company (Tazmine Ltd) in exchange for its shareholding in the joint venture:

	FRW million
Cash	5,000
Intangible asset	2,000
Inventory - at cost	3,000
Property, plant & equipment	10,000
Total	**20,000**

These assets make up the assets managed by Tazmine Ltd at its head-office in Arusha.

Kenmine Ltd had entered into a contract with a sales agent entity in Kenya whereby a fixed commission fee would be paid to the agent for every new domestic customer brought in by the agent. On the formation of Tazmine Ltd (01st January 2023), the contract with the sales agent entity was terminated and a compensation of FRW 500 million was paid to the agent. The compensation cost is included in the intangible asset figure above because the directors believe this represents an economic related to the future reduced cost of gaining retail customers.

Additionally, on 01st January 2023, a contract was signed whereby Tazmine Ltd was to supply diamonds at their fair value to a major retailer company in France for a period of four (4) years. On signing the contract, the retailer paid a non-refundable cash deposit of FRW 1,500 million for this, provided license to buy diamonds and this amount has been added in the cash contributed by Kenmine Ltd to Tazmine Ltd. The retailer is under no obligation to buy diamonds from Tazmine Ltd but Tazmine Ltd cannot supply diamonds to any company in France. The directors intend to recognize the deposit received from the retailer in the profit or loss within the first financial statements of Tazmine Ltd. In the figures above representing

Kenmine Ltd's contribution towards Tazmine Ltd, the deposit from the retailer has been offset from intangible assets.

Required:

In accordance with the International Financial Reporting Standards**, prepare the opening statement of financial position for Tazmine Ltd at 01st January 2023 supported by a discussion of the nature of accounting treatment applied and the accounting adjustments made to the values of items presented in the statement of financial position.**

Note: *All figures used should be in FRW million and no decimal point.* (20 Marks)

(b) Annual report – extract

You have accessed the combined draft 2023 Annual report prepared by the directors of the two companies, Rwamine Ltd and Kenmine Ltd and an extract on "challenges faced by the companies" is hereby copied below:

"Rwanine Ltd and Kenmine Ltd are currently suffering a degree of stagnation in their business development. The domestic and international markets of the two companies are being maintained but the companies are not attracting any new customers. New competitors have taken a significant market share of the two companies and in the year ended 31st December 2023, they have been a loss of 20% - 25% market share to the competitors. In addition, the companies have received a significant amount of negative publicity because of their poor environmental record in the process of their mining activities. These accusations are currently being investigated by environmental regulators in Rwanda, Kenya and several countries where the mineral products are sold"

Required:

Explain to the Directors of Rwamine Ltd and Kenmine Ltd five (5) advantages of producing a separate environmental report. (5 Marks)

(Total: 25 Marks)

End of question paper