CERTIFIED PUBLIC ACCOUNTANT

ADVANCED LEVEL 1 EXAMINATION

FR3.3: ADVANCED FINANCIAL REPORTING

DATE: TUESDAY 25, AUGUST 2026

MODEL ANSWER AND MARKING GUIDE

QUESTION ONE

MARKING GUIDE

Part (a) — Consolidated statement of cash flows (28 marks)

Item / Point awarded	Marks	Max
Consolidated statement of cash flows — half a mark for each correct figure on the face of the statement	11	**11**
Presentation — logical classification between operating, investing and financing activities, correct headings, and a complete reconciliation of opening to closing cash	2	**2**
Supporting workings (W1 – W12) — half a mark for each correct figure used or calculated in the workings supporting the statement	15	**15**
Sub-total Part (a)		**28**

Part (b) — Shaft 3 development asset (8 marks)

Item / Point awarded	Marks	Max
(i) Identifying that the property, plant and equipment allocated to the CGU, and the depreciation charged on it, fall outside the scope of IFRS 6	1	
(i) Correct value of the exploration and evaluation asset (70 + 90 = 160)	1	
(i) Half a mark for each correct side of the adjusting journal	1	
(i) Recognising that the entry is a reclassification within PPE, and that separate presentation of the exploration and evaluation asset is additionally required	1	**4**
(ii) Classification as tangible or intangible by nature, applied consistently through the development and production phases	1	
(ii) Separate presentation as a class of non-current asset, distinguished from production assets	1	
(ii) Disclosure of the accounting policy for exploration and evaluation expenditure	1	
(ii) Disclosure of the amounts of assets, liabilities, income, expense and operating and investing cash flows arising from exploration and evaluation activities	1	**4**
Sub-total Part (b)		**8**

Part (c) — Decommissioning provision (8 marks)

Item / Point awarded	Marks	Max
(i) IAS 37 recognition criteria — a present obligation arising from a past event	1	

Item / Point awarded	Marks	Max
(i) Obligation accrues as the shaft is constructed, so the full provision is recognised only on completion	1	
(i) Correct inflation of each year's estimated cost at 5%	1	
(i) Correct discounting at 8% and a total present value of 412.07	1	
(i) Half a mark for each correct side of the recognition journal, capitalising the provision within PPE in accordance with IAS 16	1	**5**
(ii) Correct unwinding of the discount at 8% (32.97)	1	
(ii) Half a mark for each correct side of the unwinding journal	1	
(ii) Explaining that unwinding in subsequent years is calculated on the increased carrying amount of the provision	1	**3**
Sub-total Part (c)		**8**

Part (d) — Cash-generating unit evaluation (6 marks)

Item / Point awarded	Marks	Max
Definition of a cash-generating unit under IAS 36 — the smallest identifiable group of assets generating cash inflows largely independent of those from other assets	1	
Shaft 3 is not yet productive and generates no cash inflows of its own, so it cannot satisfy the definition in its own right	1.5	
IFRS 6 sets a ceiling on the level of allocation (no larger than an operating segment); it does not authorise treating each shaft as a separate unit	1	
Shaft 3's future cash inflows will be interdependent with the existing mine through shared processing and infrastructure	1	
Consequence — the asset must be tested within the larger unit, so the conclusion that it is not impaired is not supported by the test performed	1	
Consequence — the judgement must be disclosed as a significant accounting judgement under IAS 1	0.5	**6**
Sub-total Part (d)		**6**

(Total: 50 Marks)

MODEL ANSWER

Part (a) — Consolidated statement of cash flows for the year ended 31 December 2015

		FRW million
Cash flows from operating activities		
Profit before tax		1 072
Adjustment for non-cash items:		
Increase in provisions (from SFP)		57

Depreciation (from P&L)		255
Loss on disposal of PPE (from P&L)		15
Gain on disposal of subsidiary (from P&L)		(100)
Interest income (from P&L)		(17)
Finance costs (from P&L)		110
Adjustment for movements in working capital		
Movement in inventory	W1	(16)
Movement in receivables	W2	(130)
Movement in payables	W3	109
Cash generated from operations		1 355
Interest paid	W4	(124)
Tax paid	W5	(407)
Net cash flows from operating activities		824
Cash flows from investing activities		
Purchase of property, plant and equipment	W6	(100)
Purchase of intangible assets	W7	(68)
Proceeds from sale of property, plant and equipment	W8	235
Proceeds from disposal of subsidiary	W9	420
Interest received (from P&L)		17
Net cash flows from investing activities		504
Cash flows from financing activities		
Payment of lease principal	W10	(80)
Payment of loan principal (599 – 540)		(59)
Dividends paid	W11	(100)
Net cash flows from financing activities		(239)
Net increase in cash and cash equivalents		1 089
Cash and cash equivalents at beginning of period		259
Cash and cash equivalents at end of period		1 348

Workings

W1 — Inventory			
	Dr		**Cr**
Balance B/Fwd	196		
		Subsidiary disposal	45
Purchases	16		
		Balance C/Fwd	167
	212		**212**

W2 — Receivables			
	Dr		**Cr**
Balance B/Fwd	295		
		Subsidiary disposal	70
Credit sales	130		
		Balance C/Fwd	355
	425		**425**

W3 — Payables			
	Dr		**Cr**
		Balance B/Fwd:	
		Trade	340
		Employee	136
Subsidiary disposal	40		
Balance C/Fwd:		Additional purchases	109
Trade	395		
Employee	150		
	585		**585**

W4 — Interest Payable			
	Dr		**Cr**
		Balance B/Fwd	180
		Finance charge	110
Cash/Bank: Interest paid	124		
Balance C/Fwd	166		
	290		**290**

W5 — Tax			
	Dr		**Cr**
		Balance B/Fwd	339
		Additional tax	322
Subsidiary disposal	25		
Cash/Bank: Tax paid	407		
Balance C/Fwd	229		
	661		**661**

W6 — Property, Plant & Equipment			
	Dr		**Cr**
Balance B/Fwd	2 685		
Revaluation surplus	160		
Finance lease	120		
Cash/Bank: PPE additions	100		
		PPE disposal	250
		Depreciation	255
		Subsidiary disposal (W12)	200
		Balance C/Fwd	2 360
	3 065		**3 065**

W7 — Intangible Assets (including Goodwill)			
	Dr		**Cr**
Balance B/Fwd	384		
		Disposal of subsidiary (W12)	170
Cash/Bank: Intangible additions	68		
		Balance C/Fwd	282
	452		**452**

W8 — PPE Disposal			
	Dr		**Cr**
PPE disposal	250		
		P&L (loss)	15
		Cash/Bank: Sale proceeds	235
	250		**250**

W9 — Subsidiary Disposal			
	Dr		**Cr**
Goodwill disposed (W12)	170		
Gain on disposal	100		
Net assets	250		
		Disposal proceeds	420
		NCI share of net assets (250 × 40%)	100
	520		**520**

W10 — Lease obligation			
	Dr		**Cr**
		Balance B/Fwd	119
		Finance lease	120
Cash/Bank: Lease payments	80		
Balance C/Fwd	159		
	239		**239**

W11 — Dividends Payable			
	Dr		**Cr**
		Balance B/Fwd	119
		Additional dividends	112
Cash/Bank: Dividends paid	100		
Balance C/Fwd	131		
	231		**231**

W12 Disposed Goodwill

Cash consideration	200
Share exchange	
NCI for net assets	20
	220
Net assets	(50)
Adjusted total net assets	(50)
Goodwill on acquisition	**170**

Part (b) — Briefing note to the CFO: Shaft 3 development asset

(i) Journal entries required

IFRS 6 Exploration for and Evaluation of Mineral Resources permits the capitalisation of exploration and evaluation expenditure, but that expenditure does not extend to items of property, plant and equipment deployed on the activity. The PPE allocated to the cash-generating unit of FRW 100 million, and the depreciation of FRW 20 million charged on it, therefore fall outside the exploration and evaluation asset. The asset should comprise only the geological studies and exploratory drilling:

Geological studies	70
Exploratory drilling	90
Exploration and evaluation asset	**160**

The adjustment required to reinstate the net carrying amount of the production asset of FRW 80 million (100 – 20) is:

Dr: Property, plant and equipment	80
Cr: Shaft 3 development asset	80

Because the Shaft 3 development asset is presently included within property, plant and equipment as a single line item, this entry does not of itself change the total of PPE; it reclassifies FRW 80 million within it. A further presentational step is required, in that the exploration and evaluation asset of FRW 160 million must be shown separately from production assets, as set out below.

(ii) Presentation and disclosure requirements of IFRS 6

- Exploration and evaluation assets are classified as tangible or intangible according to their nature. That classification, established during the exploration phase, is applied consistently and carried through to the development and production phases.
- Capitalised exploration and evaluation expenditure is classified as a non-current asset and, where material, presented as a separate class of asset on the face of the statement of financial position, distinguished from production assets.
- The accounting policy adopted for exploration and evaluation expenditure, including the basis on which such expenditure is recognised as an asset, must be disclosed.
- The amounts of assets, liabilities, income and expense, and operating and investing cash flows arising from the exploration for and evaluation of mineral resources must be disclosed.
- Exploration and evaluation assets are not depreciated while in the exploration phase, and are assessed for impairment when facts and circumstances suggest that the carrying amount may exceed the recoverable amount.

Part (c) — Briefing note to the CFO: decommissioning provision

(i) Present value of the provision and its recognition

IAS 37 Provisions, Contingent Liabilities and Contingent Assets requires a provision to be recognised where there is a present obligation arising from a past event, it is probable that an outflow will be required, and the amount can be estimated reliably. The obligation to decommission a mine shaft may arise from legislation (a legal obligation) or from valid expectations created in third parties (a constructive obligation).

The obligation accrues as the shaft is constructed and is proportionate to the construction completed at each reporting date. The full estimated cost is therefore recognised only once Shaft 3 is complete, which is the basis on which the provision below is measured. Because settlement is two decades away, the estimated costs are inflated at 5% per year and discounted at 8%:

Year from completion	Cost	Inflated at 5%	DF at 8%	Present value
20	150	397.99	0.2145	85.39
21	180	501.47	0.1987	99.62
22	200	585.05	0.1839	107.61
23	170	522.16	0.1703	88.93
24	60	193.51	0.1577	30.52
Provision at completion				412.07

IAS 16 Property, Plant and Equipment requires the initial estimate of the costs of dismantling and removing an item and restoring the site to be included in the cost of that asset. The provision is therefore not charged to profit or loss on recognition, but capitalised within PPE:

Dr: Property, plant and equipment (Shaft 3) 412.07
Cr: Provision for decommissioning 412.07

(ii) Adjustment in the year immediately following completion

In each year after recognition the discount applied in measuring the provision is unwound, increasing the liability and giving rise to a finance charge. Assuming no change in the estimated inflation rate or discount rate, the unwinding in the first year after completion is 412.07 × 8% = 32.97:

Dr: Finance costs 32.97
Cr: Provision for decommissioning 32.97

This brings the carrying amount of the provision to 445.04 (412.07 + 32.97). The unwinding in each subsequent year is calculated on the increased carrying amount, so in the following year the charge will be 445.04 × 8% = 35.60.

Part (d) — Evaluation of the cash-generating unit treatment

IAS 36 Impairment of Assets defines a cash-generating unit as the smallest identifiable group of assets that generates cash inflows which are largely independent of the cash inflows from other assets or groups of assets. The test is the independence of the cash inflows, not the way in which management chooses to organise its operations.

Shaft 3 is not yet productive. It will generate no cash inflows at all until 2017, and so cannot on its own satisfy the definition at the current reporting date. The directors' practice of treating each shaft as a separate operating unit is an operational convention; it does not establish that the shaft is a cash-generating unit for impairment purposes.

IFRS 6 does permit an entity to determine its own accounting policy for allocating exploration and evaluation assets to cash-generating units, but it does so by imposing a ceiling: no such unit may be larger than an operating segment. That is an upper limit on the level of aggregation, not authority to disaggregate to the level of an individual shaft.

In substance, the output of Shaft 3 will be processed through the same plant and infrastructure as the output of the existing mine, and will be sold into the same market through the same arrangements. Its cash inflows will not be independent of those of the wider mine. The appropriate unit is therefore the mine, or Ubutare's tin operating segment, rather than the individual shaft.

The consequences for the group are as follows:

- The impairment review performed does not support the conclusion reached. The asset must be tested as part of the larger unit, and the conclusion that Shaft 3 is not impaired must be reached again on that basis.
- Testing within the larger unit may in fact protect the carrying amount, because headroom in the producing mine can absorb the exploration and evaluation asset. The outcome may well be unchanged, but the reasoning supporting it would be defensible.
- IFRS 6 requires impairment testing when facts and circumstances indicate the carrying amount may not be recovered. The directors should document which indicators they have considered rather than relying on the CGU classification alone.
- The level at which exploration and evaluation assets are allocated, and the judgement exercised in reaching it, should be disclosed as a significant accounting judgement under IAS 1 Presentation of Financial Statements.

SECTION B

QUESTION TWO

MARKING GUIDE

Part (a) — Deferred tax and goodwill on the acquisition of Ghala (8 marks)

Item / Point awarded	Marks	Max
Half a mark for each correctly identified temporary difference between fair value and tax base (five items, including the nil difference on cash)	3.5	
Application of the Kenyan rate of 30% and identification of the balance as a deferred tax asset of 85.50	1.5	
		5
Fair value of identifiable net assets for goodwill purpose	1	
Adjustment of identifiable net assets for the deferred tax asset (1,050 + 85.50 = 1 135.50)	1	
Goodwill (1 400 – 1 135.50 = 264.50)	1	**3**
Sub-total Part (a)		**8**

Part (b) — Share appreciation rights (7 marks)

Item / Point awarded	Marks	Max
Identifying the scheme as cash-settled, so that the liability is remeasured to fair value at each reporting date with changes in profit or loss	1	
Number of managers expected to vest (15 – 2 = 13)	0.5	
2015 liability and expense (400 × 13 × 17 000 × 1/2 = 44 200)	1.5	
Cash paid on exercise (8 × 400 × 19 000 = 60 800)	1	
Closing liability on rights still outstanding (5 × 400 × 20 000 = 40 000)	1	
2016 expense as the balancing figure (40 000 + 60 800 – 44 200 = 56 600)	1	
Half a mark for each of the two ledger accounts, correctly presented and balanced	1	**7**
Sub-total Part (b)		**7**

Part (c) — Memorandum on the Kenyan tax deduction (10 marks)

Item / Point awarded	Marks	Max
(i) Definition of a deferred tax asset — income tax recoverable in future periods in respect of deductible temporary differences	1	

Item / Point awarded	Marks	Max
(i) Recognition condition — recognised to the extent that it is probable taxable profit will be available; reviewed at each reporting date; not discounted	1	**2**
(ii) Identifying that IAS 12, not IFRS 2, governs the tax consequences of a share-based payment	1	
(ii) The tax deduction is based on intrinsic value, whereas the IFRS 2 expense is fixed at grant-date fair value and is not revised for later share price movements	1	
(ii) The estimated future deduction is measured using the intrinsic value at the reporting date, apportioned over the elapsed portion of the vesting period, and revised at each reporting date	1	
(ii) Where the estimated deduction exceeds the cumulative expense, the deferred tax on the excess is recognised in equity rather than in profit or loss	1	**4**
(iii) Cumulative IFRS 2 expense (35 × 1/3 = 11.67)	1	
(iii) Estimated future tax deduction (45 × 1/3 = 15.00)	1	
(iii) Deferred tax asset (15.00 × 30% = 4.50)	1	
(iii) Allocation — 3.50 to profit or loss and 1.00 to equity	1	**4**
Sub-total Part (c)		**10**

(Total: 25 Marks)

MODEL ANSWER

Part (a) — Deferred tax and goodwill on the acquisition of Ghala

Deferred tax arising on acquisition

IAS 12 Income Taxes requires deferred tax to be recognised on the temporary differences between the fair values assigned to the identifiable assets and liabilities acquired in a business combination and their tax bases. Because the tax bases of Ghala's assets exceed the fair values assigned to them, the differences are deductible and give rise to a deferred tax asset:

	Fair value	Tax base	Temporary difference
Assets			
Property, plant and equipment	1 010	1 250	(240)
Financial assets	125	160	(35)
Inventories	50	52	(2)
Trade receivables	22	30	(8)
Cash and cash equivalents	34	34	–
Total assets	1 241	1 526	(285)
Liabilities			
Long term borrowings	135	135	–
Trade payables	56	56	–
Total liabilities	191	191	–
Net temporary difference			(285)
Deferred tax asset (285 × 30%)			85.50

The asset is recognised only to the extent that it is probable that taxable profit will be available against which the deductible differences can be utilised. Ghala has reported continuous growth in revenues and profits and that trend is expected to continue, so the condition is met.

Goodwill arising on acquisition

	FRW million
Consideration transferred	1 400.00
Fair value of identifiable assets acquired	1 241.00
Fair value of identifiable liabilities assumed	(191.00)
Deferred tax asset recognised on acquisition	85.50
Identifiable net assets acquired	**1 135.50**
Goodwill	**264.50**

Ikigega acquired the entire issued share capital of Ghala, so there is no non-controlling interest. Recognising the deferred tax asset increases the identifiable net assets acquired and therefore reduces the goodwill recognised.

Part (b) — Ikigega's share appreciation rights

The rights will be settled in cash, so IFRS 2 Share-based Payment requires a liability to be recognised and measured at the fair value of the rights. The liability is remeasured to fair value at each reporting date and at the date of settlement, with all changes taken to profit or loss. Of the 15 managers, 2 were expected to leave and did so, leaving 13 whose rights vest.

Year ended 31 December 2015			FRW '000
Liability and expense: 400 × 13 × 17 000 × 1/2			44 200
Dr: Staff costs	44,200		
Cr: Liability		44,200	
Year ended 31 December 2016			

Liability and expense: 400 × 13 × 20 000 × 2/2	104,000
Dr: Staff costs 104,000-44,200 59,800 Cr: Liability 59,800	
31 December 2016	
Liability	104,000
Cash paid on exercise: 8 × 400 × 19 000	(60 800)
Expected closing balance	**43,200**
Closing liability on rights outstanding: (15-2-8) × 400 × 20 000	40 000
Decrease in liability (Recorded in P/L)	**3,200**
Dr: Liability 3,200 Cr: P/L 3,200	
Total expense for 2016 59,800-3,200	**56,600**

Share appreciation rights liability (FRW '000)			
	Dr		**Cr**
31 Dec 2015: Balance c/f	44 200	31 Dec 2015: Expense for 2015	44 200
	44 200		**44 200**
		1 Jan 2016: Balance b/f	44 200
31 Dec 2016: Cash paid on exercise	60 800	31 Dec 2016: Expense for 2016	56 600
31 Dec 2016: Balance c/f	40 000		
	100 800		**100 800**

Share appreciation rights expense (FRW '000)			
	Dr		**Cr**
31 Dec 2015: SAR liability	44 200	31 Dec 2015: Profit or loss	44 200
31 Dec 2016: SAR liability	56 600	31 Dec 2016: Profit or loss	56 600
	100 800		**100 800**

The total charge to profit or loss over the life of the scheme is FRW 100 800 thousand, which equals the cash paid on exercise of FRW 60 800 thousand plus the liability of FRW 40 000 thousand still carried at 31 December 2016 in respect of the five managers who had not exercised.

Part (c) — Memorandum to the Board of Ghala

MEMORANDUM

To: The Board of Directors, Ghala Logistics Limited

From: Senior Accountant

Date: 31 December 2016

Subject: Deferred tax arising on the employee share option scheme

(i) What a deferred tax asset is, and when it may be recognised

A deferred tax asset is the amount of income tax recoverable in future periods in respect of deductible temporary differences, and of unused tax losses and tax credits carried forward. A deductible temporary difference is a difference between the carrying amount of an asset or liability and its tax base which will result in amounts that are deductible in determining taxable profit in future periods.

A deferred tax asset is recognised for all deductible temporary differences to the extent that it is probable that taxable profit will be available against which the difference can be utilised. The carrying amount is reviewed at each reporting date and reduced if sufficient taxable profit is no longer expected, and any such reduction is reversed if the position subsequently improves. Deferred tax assets are not discounted. Given Ghala's continuing growth in revenues and profits, the recognition condition is met.

(ii) How the deferred tax is measured, and why it differs from the IFRS 2 expense

It is IAS 12 Income Taxes, and not IFRS 2 Share-based Payment, that governs the tax consequences of a share-based payment. IFRS 2 determines the expense; IAS 12 determines the tax effect of it. The two are measured on different bases, and that is the source of the Board's difficulty.

Under IFRS 2, the expense for an equity-settled scheme is measured at the fair value of the options at the grant date and spread over the vesting period. That amount is fixed at grant and is not revised for subsequent movements in the share price. Ghala will therefore charge FRW 35 million in total, or FRW 11.67 million a year over three years.

Kenyan tax law, by contrast, gives a deduction measured by the intrinsic value of the options at the date they are exercised. The deduction is therefore driven by the share price at a future date, and its eventual amount is unknown at the reporting date.

IAS 12 requires the deferred tax to be based on the deduction the entity expects to obtain, estimated using the information available at the reporting date. Because the deduction depends on intrinsic value, the estimate is made using the intrinsic value at the reporting date, apportioned over the proportion of the vesting period that has elapsed. The estimate is revised at each reporting date as the share price moves, so the deferred tax asset will change even though the IFRS 2 expense does not. This is why a deduction that will not arise for two years already affects the current financial statements.

Where the estimated future deduction exceeds the cumulative expense recognised to date, the excess is regarded as relating to an equity item rather than to the expense. The deferred tax attributable to that excess is recognised directly in equity, and only the deferred tax attributable to the expense is recognised in profit or loss.

(iii) The deferred tax asset at 31 December 2016 and its allocation

One year of the three-year vesting period has elapsed:

	FRW million
Cumulative IFRS 2 expense recognised (35 × 1/3)	11.67
Estimated future tax deduction (45 × 1/3)	15.00
Excess of estimated deduction over cumulative expense	**3.33**
Deferred tax asset (15.00 × 30%)	**4.50**
Recognised in profit or loss (11.67 × 30%)	3.50

Recognised in equity (3.33 × 30%)	1.00

The entry required at 31 December 2016 is:

Dr: Deferred tax asset	4.50
Cr: Income tax expense (profit or loss)	3.50
Cr: Equity	1.00

The asset will be remeasured at 31 December 2017 and again at 31 December 2018 using the intrinsic value at each of those dates, and the final position will be trued up when the options are exercised and the actual deduction becomes known.

QUESTION THREE

MARKING GUIDE

General instructions to markers

Part (a) — Interim reporting (9 marks)

Item / Point awarded	Marks	Max
(i) Seasonal revenue may not be anticipated at an interim date where anticipation would not be appropriate at the year end; recognise only revenue earned, and disclose the seasonality	1.5	
(i) The bonus is a legal obligation under the employment contracts and can be reliably estimated, so a proportion is accrued	1.5	
(i) No provision for the refurbishment — no present obligation exists at 30 June 2017 and costs may not be smoothed across interim periods	1.5	
(i) Income tax measured using the estimated weighted average annual effective tax rate applied to interim pre-tax income	1.5	
(i) The inventory write-down is recognised in the first interim period; an expected reversal does not permit its omission	1	**7**
(ii) Half a mark for each of the four primary statements with the current and comparative periods correctly stated	2	**2**
Sub-total Part (a)		**9**

Part (b) — Lease of warehouse equipment (8 marks)

Item / Point awarded	Marks	Max
(i) Recognising that the payment made on the commencement date is excluded from the lease liability	1	
(i) Correct present value of the six remaining payments (246.68)	1	**2**

Item / Point awarded	Marks	Max
(ii) Including the liability, the payment made at commencement and the initial direct costs, and deducting the lease incentive	1	
(ii) Correct initial carrying amount of the right-of-use asset (323.68)	1	**2**
(iii) Correct annual depreciation charge (323.68 ÷ 7 = 46.24)	1	
(iii) Interest correctly charged at 12% on the liability remaining after each payment	1	
(iii) Half a mark for each correctly calculated pair of closing balances, up to	2	**4**
Sub-total Part (b)		**8**

Part (c) — Non-financial reporting (8 marks)

Item / Point awarded	Marks	Max
(i) Half a mark for each reasonable observation on the shortcomings of traditional financial reporting and why investors seek non-financial information	3	**3**
(ii) IFRS Practice Statement 1 Management Commentary and its content	1	
(ii) GRI Standards and the basis on which they operate	1	
(ii) Integrated reporting — purpose, content elements and guiding principles	1	**3**
(iii) Identification of the capitals most significant to Ruguriro	1	
(iii) Explanation of the choice by reference to the business described in the scenario	1	**2**
Sub-total Part (c)		**8**

MODEL ANSWER

Part (a) — Interim report for the six months ending 30 June 2017

(i) Treatment of the five matters under IAS 34

1. Seasonality of revenue

IAS 34 Interim Financial Reporting provides that revenue received seasonally, cyclically or occasionally within a financial year shall not be anticipated or deferred at an interim date if anticipation or deferral would not be appropriate at the end of the financial year. Anticipating December trade would plainly not be appropriate at 31 December, and so it is not permitted at 30 June. Only the revenue actually earned in the six months to 30 June 2017 may be recognised. The interim report should instead disclose the seasonality of the business, and IAS 34 encourages entities whose trade is highly seasonal to present the results for the twelve months ending on the interim date, with comparatives, as additional information.

2. Annual staff bonus

A bonus is anticipated for interim reporting purposes if, and only if, it is a legal obligation or past practice has created a constructive obligation which the entity has no realistic alternative but to settle, and a reliable estimate of the amount can be made. Here the bonus is provided for in the employment contracts, so a legal obligation exists, and the profit target has been met in each of the last six years and is expected to be met again. Both conditions are satisfied, and a proportion of the expected bonus should therefore be accrued in the six months to 30 June 2017.

3. Planned refurbishment of the warehouses

No provision may be recognised. At 30 June 2017 no contracts had been signed and Ruguriro could still avoid the expenditure, so there is no present obligation arising from a past event and the IAS 37 recognition criteria are not met. The finance director's proposal is an attempt to smooth the charge across the year, which IAS 34 does not permit: costs that would not be provided for at the year end may not be provided for at an interim date. The cost will be recognised in the second half of the year as the work is carried out.

4. Income tax for the interim period

Income tax expense for an interim period is recognised on the basis of the best estimate of the weighted average annual effective income tax rate expected for the full financial year, applied to the pre-tax income of the interim period. That estimate is revised in later interim periods if the expected annual rate changes, with the effect reflected in the period of revision. Where different rates apply to different categories of income, a separate estimated rate is applied to each category.

5. Inventory write-down expected to reverse

Measurement at an interim date follows the same principles as measurement at the year end. Inventories are measured at the lower of cost and net realisable value at 30 June 2017, so the write-down of FRW 42 million must be recognised in full in the first interim period. The expectation that prices will recover before December does not permit the loss to be omitted or deferred. If net realisable value does subsequently recover, the reversal is recognised in the later interim period in which it occurs.

(ii) Current and comparative periods to be presented

Statement	**Current**	**Comparative**
Statement of financial position	End of the current interim period (30 June 2017)	End of the immediately preceding financial year (31 December 2016)
Statement of profit or loss and other comprehensive income	Current interim period and cumulatively for the year to date	Comparable interim period and year to date of the immediately preceding financial year
Statement of changes in equity	Cumulatively for the current financial year to date	Comparable year to date of the immediately preceding financial year
Statement of cash flows	Cumulatively for the current financial year to date	Comparable year to date of the immediately preceding financial year

Part (b) — Lease of warehouse equipment

(i) Lease liability at commencement, 1 January 2012

The payment of FRW 60 million made on 1 January 2012 falls due at the commencement date and is therefore not part of the lease liability, which comprises the present value of the lease payments not paid at that date, namely the six remaining instalments:

Payment date	**Payment**	**DF at 12%**	**Present value**
1 January 2013	60.00	0.8929	53.57
1 January 2014	60.00	0.7972	47.83
1 January 2015	60.00	0.7118	42.71
1 January 2016	60.00	0.6355	38.13
1 January 2017	60.00	0.5674	34.04
1 January 2018	60.00	0.5066	30.40
Lease liability at 1 January 2012			246.68

(ii) Initial carrying amount of the right-of-use asset

	FRW million
Lease liability at commencement	246.68
Lease payment made at the commencement date	60.00
Initial direct costs	25.00
Lease incentive received	(8.00)
Right-of-use asset at 1 January 2012	**323.68**

(iii) Carrying amounts over the seven-year lease term

The right-of-use asset is depreciated on a straight-line basis over the seven-year useful life: 323.68 ÷ 7 = 46.24 a year.

Lease liability				
Year	Opening 1 January	Payment 1 January	Interest at 12%	Closing 31 December
2012	246.68	–	29.60	**276.28**
2013	276.28	(60.00)	25.95	**242.23**
2014	242.23	(60.00)	21.87	**204.10**
2015	204.10	(60.00)	17.29	**161.39**
2016	161.39	(60.00)	12.17	**113.56**
2017	113.56	(60.00)	6.44	**60.00**
2018	60.00	(60.00)	–	**–**

The interest charge for 2017 is taken as the balancing figure to clear the liability, absorbing rounding differences of 0.01.

Right-of-use asset			
Year	Opening 1 January	Depreciation	Closing 31 December
2012	323.68	(46.24)	**277.44**
2013	277.44	(46.24)	**231.20**
2014	231.20	(46.24)	**184.96**
2015	184.96	(46.24)	**138.72**
2016	138.72	(46.24)	**92.48**
2017	92.48	(46.24)	**46.24**
2018	46.24	(46.24)	**–**

Part (c) — Briefing to the board on non-financial reporting

(i) Why investors seek non-financial information

- The financial statements are backward-looking and report a single period. They say little about Ruguriro's capacity to create value over the medium and longer term, which is precisely the question a prospective investor in a regional expansion must answer.
- Only items meeting the definition and recognition criteria of an asset are recognised. Much of what will determine future performance — the strength of the Ruguriro brand, the skills of the workforce, the relationships with smallholder farmers — is internally generated and never appears in the statement of financial position.
- The financial statements do not report externalities such as water and energy consumption or dependence on agricultural output, yet these can crystallise into financial effects through regulation, taxation, input costs or reputational damage.
- Investors need to assess risk as well as return. The security of the supply chain and the durability of the farmer relationships are among the principal risks to the expansion, and neither is visible in the audited figures.
- Non-financial information supports the assessment of stewardship and allows comparison between entities on matters increasingly linked to the cost of capital.

(ii) Guidance available

- IFRS Practice Statement 1 Management Commentary is non-mandatory guidance issued by the IASB for a narrative report accompanying the financial statements. It addresses the nature of the business, management's objectives and strategies, the resources, risks and relationships on which the entity depends, the results of operations and prospects, and the performance measures management uses.
- The GRI Standards provide a widely adopted framework for sustainability reporting, built on reporting the entity's most material economic, environmental and social impacts. They comprise universal standards applicable to all entities, sector standards, and topic standards selected according to materiality.

- Integrated reporting brings financial and non-financial information together in a single report explaining how the organisation creates value over the short, medium and long term. An integrated report is organised around content elements covering the organisational overview and external environment, governance, business model, risks and opportunities, strategy and resource allocation, performance, outlook, and the basis of preparation. It is prepared under guiding principles including strategic focus and future orientation, connectivity of information, stakeholder relationships, materiality, conciseness, reliability and completeness, and consistency and comparability.

(iii) The capitals most significant to Ruguriro

Integrated reporting describes six capitals: financial, manufactured, intellectual, human, social and relationship, and natural. Those most significant to Ruguriro are:

- Social and relationship capital. Ruguriro sources a substantial part of its fresh produce directly from smallholder farmers, so the durability of those relationships determines the security, quality and cost of supply. Customer loyalty and community standing also underpin the retail proposition and would be central to any regional expansion.
- Natural capital. The warehouses and stores consume water and energy, and the business depends on agricultural output that is itself exposed to climate, rainfall and soil conditions. Disruption here feeds directly into availability and margin.
- Human capital. Retail is labour intensive and Ruguriro employs store staff across every province. Their skills, retention and motivation drive service quality and operating cost, and the annual bonus scheme indicates that management already treats this as a performance lever.
- Intellectual capital. The founders intend to export the business model itself. The brand and the operating know-how are therefore the principal assets supporting the case for listing, yet neither is recognised in the financial statements.

Manufactured capital, in the form of the stores and regional warehouses, and financial capital are already largely visible in the financial statements, and so add the least incremental information for investors.

QUESTION FOUR

MARKING GUIDE

Part (a) — Revenue under IPSAS 23 (10 marks)

Item / Point awarded	Marks	Max
Fuel levy — the taxable event is the importation of fuel, so revenue is recognised when fuel is imported and not when the levy is remitted	1	
Fuel levy — revenue of 68 400 recognised, including a receivable of 5 700 for December imports	1	
Fuel levy — the 4 200 received in advance is a liability, the taxable event not having occurred	1	**3**
Capital transfer — identifying that the obligation to return unspent funds is a condition and not merely a restriction	1	

Item / Point awarded	Marks	Max
Capital transfer — on receipt an asset and an equal liability are recognised	1	
Capital transfer — revenue of 4 500 recognised as the condition is satisfied	1	
Capital transfer — liability of 7 500 carried forward at 31 December 2017	1	**4**
Services in kind — IPSAS 23 permits but does not require recognition	1	
Services in kind — if recognised, revenue and an equal expense, or capitalisation within the cost of the bypass, at a fair value of 800	1	
Services in kind — the nature and type of major classes must be disclosed whether or not they are recognised	1	**3**
Sub-total Part (a)		**10**

Part (b) — Impairment of the Nyabihu section (10 marks)

Item / Point awarded	Marks	Max
(i) Scope — IAS 36 applies to cash generating assets, IPSAS 21 to assets held primarily for service delivery	1	
(i) Value in use under IPSAS 21 is the present value of the remaining service potential, not of future cash flows	1	
(i) IPSAS 21 applies to individual assets and does not adopt a service-generating unit, whereas IAS 36 requires grouping into cash generating units	1	
(i) Market price decline is excluded as an indicator, and explanation that recoverable amount under IAS 36 is meaningless for an untolled road — discounted cash flows would be nil and there is no market for a public highway	1	**4**
(ii) Carrying amount at 31 December 2017 (4 800 – 10 × 120 = 3 600)	1.5	
(ii) Identifying the restoration cost approach as the appropriate measure, the asset having been damaged and the cost of restoration being measurable	1.5	
(ii) Depreciated replacement cost (6 000 × 30/40 = 4 500)	1	
(ii) Recoverable service amount (4 500 – 1 200 = 3 300)	1	
(ii) Impairment loss of 300, with half a mark for each correct side of the journal	1	**6**
Sub-total Part (b)		**10**

Part (c) — First-time adoption of accrual IPSAS (5 marks)

Item / Point awarded	Marks	Max
Half a mark for each reasonable observation on the financial reporting and practical implications of the transition, drawn from the matters set out in the model answer or any other relevant point	5	**5**
Sub-total Part (c)		**5**

(Total: 25 Marks)

MODEL ANSWER

Part (a) — Revenue for the year ended 31 December 2017

1. Fuel levy

IPSAS 23 defines taxes as economic benefits compulsorily paid or payable to public sector entities in accordance with laws or regulations, established to provide revenue to government. An asset in respect of taxes is recognised when the taxable event occurs and the recognition criteria are met.

The taxable event for the levy is the importation of fuel into Rwanda. Revenue is therefore recognised as fuel is imported, and not by reference to the date on which the levy is remitted to Umuhanda.

	FRW million
Revenue recognised for the year (levy on 2017 imports)	**68 400**
Of which received during 2017	62 700
Receivable at 31 December 2017 (December imports)	5 700

The FRW 4 200 million received in December 2017 in respect of fuel expected to be imported in January 2018 is an advance receipt. The taxable event has not yet occurred, so no revenue may be recognised. The amount is recognised as a liability at 31 December 2017 and released to revenue as the fuel is imported.

2. Capital transfer

IPSAS 23 distinguishes between a restriction and a condition. A restriction merely stipulates the purpose for which a transferred asset must be used; a breach does not oblige the entity to return the asset, and revenue is recognised in full on receipt. A condition requires the entity both to use the asset in a specified way and to return the asset, or an equivalent amount, if that requirement is not met.

The agreement obliges Umuhanda to return any amount not applied to the bypass by 31 December 2019. That is a condition, and it gives rise to a present obligation on receipt of the funds:

Dr: Cash	12 000
Cr: Liability — transfer with conditions	12 000

The liability is reduced, and revenue recognised, as the condition is satisfied — that is, as the funds are applied to the construction of the bypass:

Dr: Liability — transfer with conditions	4 500
Cr: Transfer revenue	4 500

Umuhanda therefore recognises transfer revenue of FRW 4 500 million for the year ended 31 December 2017 and carries forward a liability of FRW 7 500 million.

3. Services in kind

IPSAS 23 permits, but does not require, an entity to recognise services in kind. Recognition is optional because of the practical difficulty of measuring such services reliably and of demonstrating control over them.

Should Umuhanda elect to recognise the design services, it would recognise revenue at their fair value of FRW 800 million together with an equal amount as either an expense or, because the services form part of the cost of an asset under construction, as part of the cost of the bypass.

Should it elect not to recognise them, which is consistent with its existing policy, no amounts are recorded. In either case IPSAS 23 requires disclosure of the nature and type of major classes of services in kind received. Umuhanda should therefore disclose the design services whichever election it makes.

Part (b) — Impairment of the Nyabihu road section

(i) Differences between IPSAS 21 and IAS 36

- Scope. IAS 36 deals with cash generating assets, held with the primary objective of generating a commercial return. IPSAS 21 deals with non-cash generating assets, held primarily for service delivery. The Nyabihu section is not tolled and is held to deliver a service, so IPSAS 21 applies.
- Value in use. Under IAS 36 value in use is the present value of the future cash flows expected from the asset. Under IPSAS 21 it is the present value of the asset's remaining service potential, measured by one of three approaches: depreciated replacement cost, restoration cost, or service units.
- Cash generating units. IAS 36 requires assets to be grouped into cash generating units where the recoverable amount of an individual asset cannot be determined. IPSAS 21 applies to individual assets. The IPSASB considered and rejected an equivalent "service-generating unit", on the basis that the service potential of an individual asset can be identified and that grouping would introduce undue complexity.
- Indicators of impairment. IPSAS 21 excludes a decline in market price as an external indicator, because non-cash generating assets do not typically have an active market. It also does not require assets carried under the revaluation model to be assessed annually where a regular process of revaluation is followed.

The recoverable amount used in IAS 36 is not an appropriate measure for the Nyabihu section. Value in use measured as discounted future cash flows would be nil, because the section is not tolled and generates no cash inflows, and fair value less costs of disposal is meaningless because there is no market for a section of public highway. Applying IAS 36 would therefore imply that an asset which continues to carry traffic is wholly impaired. The asset must instead be measured by reference to its remaining service potential.

(ii) Impairment loss at 31 December 2017

Carrying amount	**FRW million**
Cost (2008)	4 800
Annual depreciation (4 800 ÷ 40 years)	120
Accumulated depreciation (10 years, 2008 to 2017)	(1 200)
Carrying amount at 31 December 2017	**3 600**
Remaining useful life	30 years

The section has suffered physical damage which can be made good, and the cost of restoring it to its pre-landslide condition is capable of reliable estimate. Of the three approaches permitted by IPSAS 21, the restoration cost approach is therefore the appropriate one. Depreciated replacement cost alone would not capture the effect of the damage, and the service units approach is used where the loss of service potential is measured by a reduction in the number of service units rather than by a cost of restoration.

Recoverable service amount — restoration cost approach	**FRW million**
Current cost of replacing the section	6 000
Depreciated replacement cost before impairment (6 000 × 30/40)	4 500
Less: estimated cost of restoration	(1 200)
Recoverable service amount	**3 300**
Carrying amount	3 600
Impairment loss	**300**

The entry required at 31 December 2017 is:

Dr: Impairment loss — road network (surplus or deficit) 300
Cr: Accumulated impairment — road network300

The revised carrying amount of FRW 3 300 million is depreciated over the remaining useful life of 30 years, giving a revised annual charge of FRW 110 million. IPSAS 21 requires the impairment to be reversed, to the extent that the recoverable service amount recovers, if the indicators that gave rise to it cease to exist or decrease — for example once the embankment has been rebuilt.

Part (c) — First-time adoption of accrual IPSAS

Financial reporting implications

- Assets and liabilities not previously recorded must be identified, measured and recognised. For Umuhanda the road network itself is the dominant item, together with bridges, culverts and other structures. IPSAS 33 First-time Adoption of Accrual Basis IPSAS provides transitional relief of up to three years for recognising and measuring certain classes of asset, which Umuhanda is likely to need.
- Measurement of the network is the single largest exercise. Roads have no market, so deemed cost or depreciated replacement cost must be used, requiring engineering input, condition surveys and asset registers that may not currently exist.

- Revenue is recognised on a different basis. As part (a) shows, the levy is recognised when the taxable event occurs rather than when cash is received, so receivables and advance receipts appear in the statement of financial position for the first time, and conditional transfers give rise to liabilities rather than immediate revenue.
- Depreciation and impairment enter the statement of financial performance for the first time. Reported deficits may therefore increase even though nothing has changed in the underlying cash flows, and this will need to be explained to Parliament.
- An opening statement of financial position must be prepared at the date of adoption, with comparative information where practicable, together with disclosure of the effect of the transition on the amounts previously reported.

Practical implications

- Asset registers, condition data and valuations must be assembled for the entire network. This is the most time-consuming and expensive element of the transition and requires engineering as well as accounting resource.
- Accounting systems and the chart of accounts must be reconfigured for accrual reporting, and controls established over accruals, receivables and payables that a cash system does not require.
- Staff will require training, and Umuhanda may need to recruit accountants with accrual and IPSAS experience.
- New estimates and judgements are introduced — useful lives, residual values, impairment indicators and restoration costs — each of which must be documented and supported for audit.
- Budgets are likely to remain on a cash basis. Umuhanda must therefore be able to present a comparison of budget and actual amounts under IPSAS 24 and to explain the basis differences to Parliament and to its development partners.
- Users of the financial statements, including Parliament and the development partner funding the bypass, will need to be told why the reported results differ from the cash outturn they are accustomed to seeing.