CERTIFIED PUBLIC ACCOUNTANT

ADVANCED LEVEL 1 EXAMINATION

FR3.3: ADVANCED FINANCIAL REPORTING

DATE: MONDAY 25, MAY 2026

MODEL ANSWER AND MARKING GUIDE

QUESTION ONE

MARKING GUIDE

General instructions to markers

Minimum marks awardable are 0.5 for numerical points and 1 for narrative points. The maximum mark for any single point is 2. An additional mark, up to a maximum of 1 per sub-part, may be awarded for any reasonable and well-argued point made by the candidate outside the model answer. Candidates may arrive at the CSOFP figures by alternative routes; consistent workings that reach the correct final amount should receive full marks. Marks are not deducted for arithmetical errors that do not affect the candidate's method (the own-figure principle). DNA (do not award) marks for simply aggregating the individual balances without adjustments, or for citing IFRS paragraph numbers without explaining their application.

Part (a) - Consolidated statement of financial position (35 marks)

Item / Point awarded	Marks	Max
W1 - Group structure: correctly identify Zeta as parent, Theta and Rho as subsidiaries and Iota as indirectly held associate; state the NCI percentages and the group's NCI measurement policy	2	**2**
W2 - Theta net assets at acquisition: correctly compute FRW 785m, including FV adjustment of FRW (15)m on PPE	2	
W2 - Theta net assets at reporting date: correctly compute FRW 1,011.75m, including reversal of excess depreciation on FV adjustment (FRW 6.75m over 4.5 years)	2	**4**
W3 - Rho net assets at acquisition (FRW 265m) and reporting date (FRW 300m); post-acquisition movement FRW 35m	2	**2**
W4 - Goodwill on Theta: FRW 311.25m with full workings (consideration + NCI at acquisition − FV of identifiable net assets)	2	
W4 - Goodwill on Rho: FRW 61m with full workings	1.5	**3.5**

Item / Point awarded	Marks	Max
W5 - Investment in associate: recognise that FRW 255m already reflects post-acq profits to 31 December 2024; add 20% × 178 = FRW 35.6m to give FRW 290.6m	3	**3**
W6 - Unrealised profit on intra-group inventory: correctly compute URP as 20% × (60 × 30/130) = FRW 2.77m	1.5	
W6 - Correctly identify Theta as upstream seller and allocate URP 75/25 between parent and NCI (FRW 2.08m / FRW 0.69m)	1.5	**3**
W7 - Identify all four corrections to Zeta's draft FS for the Amaru lease (reverse post-1 July depreciation; recognise gain on derecognition; recognise finance income for 6 months; reverse erroneous credit to revenue of FRW 38m)	3	**3**
W7 - Storage unit consolidation adjustment: PPE +10.4 and retained earnings +10.4 with reasoning	1.5	**1.5**
W8 - Consolidated retained earnings: correct starting point (Zeta's draft RE); correct additions of Theta and Rho post-acquisition movements; inclusion of group share of Iota's 2025 profit; corrections from W7 picked up	3	**3**
W9 - Non-controlling interests: NCI in Theta (including share of Iota's 2025 profit) and NCI in Rho; total FRW 381.14m with workings	2.5	**2.5**
W10 - Elimination of intra-group balances: management fees FRW 16m and storage rental FRW 9m	1.5	**1.5**
Goodwill on face of CSOFP at FRW 372.25m	0.5	**0.5**
Investment in associate on face of CSOFP at FRW 290.6m	0.5	**0.5**
Net investment in finance lease on face of CSOFP at FRW 248m (separate line item)	0.5	**0.5**

Item / Point awarded	Marks	Max
Consolidated PPE correctly stated at FRW 2,662.15m after all adjustments	1	**1**
Consolidated inventories after elimination of URP (FRW 632.23m)	0.5	**0.5**
Consolidated receivables after intra-group elimination (FRW 470m)	0.5	**0.5**
Consolidated payables after intra-group elimination (FRW 460m)	0.5	**0.5**
NCI presented on face of CSOFP within equity	0.5	**0.5**
Ordinary share capital at FRW 500m (parent only)	0.5	**0.5**
CSOFP balances (total assets FRW 4,925.23m = total equity and liabilities)	1	**1**
Additional mark for reasonable valid points or alternative sound treatment	-	**Up to 1**
Sub-total Part (a)		**35**

Part (b) - Office building leased to Amaru Traders Ltd (7 marks)

Item / Point awarded	Marks	Max
Identify the arrangement as a finance lease and explain the lessor accounting principle under IFRS 16 (derecognition of the underlying asset; recognition of the net investment in the lease at the fair value of the leased asset)	2	
Correctly compute the carrying amount of the building on 1 July 2025 as FRW 230m (= 240 − 10)	1	

Item / Point awarded	Marks	Max
Recognise net investment in the lease at fair value FRW 275m and the resulting gain of FRW 45m in profit or loss	1.5	
Correct journal for the first lease payment received in advance (FRW 38m)	0.5	
Finance income for the six months to 31 December 2025 (FRW 11m, with reasoning)	1	
Correct closing net investment in the lease of FRW 248m; recognition of current / non-current split	1	
Sub-total Part (b)		**7**

Part (c) - Storage unit leased to Theta (5 marks)

Item / Point awarded	Marks	Max
Identify that the current treatment (impairment to fair value) is inappropriate under both the cost and fair value models of IAS 40	1	
Explain correct treatment in Zeta's separate FS: reclassify to investment property under IAS 40 on 1 April 2025 at FRW 73.7m; choice of cost or fair value model consistently applied	1.5	
Identify that in the consolidated FS the property is owner-occupied (inter-group lease) and must be classified as PPE under IAS 40 paragraph 15	1.5	
Advise on the required reversal of the FRW 10.4m write-down in the consolidated FS; correct CA of FRW 70.4m at 31 December 2025	1	
Sub-total Part (c)		**5**

Part (d) - Contingent consideration in the acquisition of Rho (3 marks)

Item / Point awarded	Marks	Max
Include contingent consideration in the consideration transferred at its acquisition-date fair value under IFRS 3 (probability-weighted, discounted)	1	
Correct classification as a financial liability (cash settlement) and presentation on the face of the SOFP; contrast with equity classification for fixed-share settlement	1	
Subsequent remeasurement to fair value through profit or loss; contrast with measurement-period adjustments which are reflected through goodwill	1	
Sub-total Part (d)		**3**

(Total: 50 Marks)

MODEL ANSWER

Part (a) - Consolidated statement of financial position of the Zeta Group as at 31 December 2025

Before presenting the consolidated statement of financial position (CSOFP), the corrections required by parts (b), (c) and (d) are reflected, and all supporting workings are shown.

W1 Group structure

Zeta controls Theta (75% since 1 July 2021) and Rho (60% since 1 July 2025). Theta holds 20% of Iota since 1 January 2023 and exercises significant influence; Iota is therefore an associate of the group. Non-controlling interests are 25% in Theta and 40% in Rho. The group measures NCI at the proportionate share of the identifiable net assets of the acquiree at the acquisition date.

W2 Net assets of Theta

	FRW'm
At the acquisition date (1 July 2021):	
Ordinary share capital	200

	FRW'm
Retained earnings	600
Fair value adjustment on PPE (110 − 125)	(15.00)
Net assets at acquisition	**785.00**
At the reporting date (31 December 2025):	
Ordinary share capital	200.00
Retained earnings	820.00
Remaining FV adjustment (see note)	(8.25)
Net assets at reporting date	**1,011.75**
Post-acquisition movement	**226.75**

Note: the fair value adjustment was downward (FRW 15m). Over the 10-year remaining useful life the FRW 1.5m per annum reversal of excess depreciation erodes the adjustment. From 1 July 2021 to 31 December 2025 is 4.5 years; reversal to date = 1.5 × 4.5 = FRW 6.75m. Remaining adjustment at reporting date = (15) + 6.75 = FRW (8.25)m.

W3 Net assets of Rho

	FRW'm
At the acquisition date (1 July 2025):	
Ordinary share capital	100
Retained earnings	165
Net assets at acquisition	**265**
At the reporting date:	
Ordinary share capital	100

	FRW'm
Retained earnings	200
Net assets at reporting date	**300**
Post-acquisition movement	**35**

W4 Goodwill on acquisition

Goodwill on Theta	**FRW'm**
Consideration transferred	900.00
Non-controlling interest at acquisition (25% × 785)	196.25
Fair value of identifiable net assets at acquisition	(785.00)
Goodwill - Theta	**311.25**

Goodwill on Rho	**FRW'm**
Consideration transferred	220.00
Non-controlling interest at acquisition (40% × 265)	106.00
Fair value of identifiable net assets at acquisition	(265.00)
Goodwill - Rho	**61.00**

Total goodwill carried in the CSOFP = 311.25 + 61.00 = FRW 372.25m. No impairment losses have been recognised in the current or any prior period.

W5 Investment in associate (Iota)

Theta's own books carry the investment in Iota at FRW 255m, reflecting Theta's share of post-acquisition profits up to 31 December 2024. The group must additionally recognise Theta's share of Iota's 2025 profit after tax of FRW 178m.

	FRW'm
Carrying amount in Theta's books at 31 December 2024	255.00
Add: share of Iota's profit for 2025 (20% × 178)	35.60
Investment in associate per CSOFP	**290.60**

W6 Unrealised profit on intra-group inventory

Theta sold goods to Zeta for FRW 60m at a mark-up of 30% on cost. Profit element = 60 × 30/130 = FRW 13.85m. 20% of these goods remain in inventory at year-end. Unrealised profit = 20% × 13.85 = FRW 2.77m. As Theta is the seller (upstream transaction), the URP reduces Theta's post-acquisition retained earnings and is allocated 75% to the parent and 25% to NCI.

W7 Corrections to Zeta's separate financial statements

The draft financial statements of Zeta include the following errors, which are corrected in the CSOFP:

The draft financial statements of Zeta include the office building in PPE at FRW 220m (= FRW 240m on 1 January 2025 less a full year's depreciation of FRW 20m). The FRW 38m rent received on 1 July 2025 has been erroneously credited to revenue. No lease accounting entries have been recorded. The following correcting journal entries are required at year-end to reflect the arrangement in accordance with IFRS 16.

Journal 1 - Reverse depreciation incorrectly charged from 1 July to 31 December 2025

The building should have been derecognised on 1 July 2025. Zeta instead continued to depreciate it for the second half of the year, charging FRW 10m (= FRW 20m × 6/12) to profit or loss. This is reversed so that the carrying amount immediately before derecognition is restored to FRW 230m.

Date	Account / Narrative	Dr (FRW'm)	Cr (FRW'm)
31 Dec 2025	Dr Property, plant and equipment - Office building	10	
	Cr Depreciation expense (P&L)		10

Journal 2 - Derecognise the building and recognise the net investment in the lease on 1 July 2025

On the lease commencement date the lessor derecognises the underlying asset at its carrying amount (FRW 230m) and recognises a net investment in the lease equal to the fair value of the leased asset (FRW 275m). The difference of FRW 45m is recognised as a gain on derecognition in profit or loss.

Date	Account / Narrative	Dr (FRW'm)	Cr (FRW'm)
1 Jul 2025	Dr Net investment in finance lease	275	
	Cr Property, plant and equipment - Office building		230
	Cr Gain on derecognition of leased asset (P&L)		45

Journal 3 - Reclassify the FRW 38m rental received from revenue to the net investment in the lease

The FRW 38m rent received on 1 July 2025 was erroneously credited to revenue on receipt. It should instead have been applied against the net investment in the lease as the advance payment for the first year. The erroneous revenue credit is reversed and the net investment is reduced accordingly.

Date	Account / Narrative	Dr (FRW'm)	Cr (FRW'm)
1 Jul 2025	Dr Revenue (P&L)	38	
	Cr Net investment in finance lease		38

Journal 4 - Recognise finance income accrued from 1 July to 31 December 2025

Finance income is recognised on a basis that reflects a constant periodic rate of return on the net investment in the lease. For the six months from 1 July to 31 December 2025, finance income is taken as FRW 11m (one-half of the FRW 22m finance component disclosed for 2026).

Date	Account / Narrative	Dr (FRW'm)	Cr (FRW'm)
31 Dec 2025	Dr Net investment in finance lease	11	
	Cr Finance income (P&L)		11

B. Consolidation adjustment for the Zeta Group

Zeta's draft books show the storage unit at FRW 60m at 31 December 2025, having taken it down from FRW 70.4m (its correct depreciated carrying amount) by recognising a FRW 10.4m impairment loss in profit or loss. Two separate sets of corrections are required: (i) in Zeta's separate financial statements to reclassify the asset to investment property and reverse the incorrect impairment treatment, and (ii) a consolidation adjustment to restore the asset as PPE at its depreciated historical cost because it is owner-occupied from the perspective of the group.

Depreciation schedule (for reference): cost FRW 88m; useful life 20 years straight-line; annual depreciation FRW 4.4m. Carrying amount on 1 January 2025 = 88 − (4.4 × 3) = FRW 74.8m. Carrying amount on 1 April 2025 (operating lease commences) = 74.8 − (4.4 × 3/12) = FRW 73.7m. Correct carrying amount on 31 December 2025 = 74.8 − 4.4 = FRW 70.4m

Under IAS 40, property held by Zeta to earn rentals from its subsidiary meets the definition of investment property in Zeta's own separate financial statements (Theta is a separate legal entity; the group-level owner-occupation test applies only to the consolidated financial statements). On 1 April 2025 the storage unit should have been reclassified from PPE to investment property at its then carrying amount of FRW 73.7m. Thereafter Zeta may apply either the cost model (continue depreciating, test for impairment under IAS 36 at recoverable amount) or the fair value model (remeasure to fair value each period through profit or loss, no depreciation). Under either model, the FRW 10.4m write-down recognised as an 'impairment loss' is incorrect.

Journal 1c - Reverse the incorrect impairment loss

The FRW 10.4m impairment charged to profit or loss is reversed and the carrying amount of the asset is restored to FRW 70.4m.

Date	Account / Narrative	Dr (FRW'm)	Cr (FRW'm)
31 Dec 2025	Dr Storage unit (PPE or investment property)	10.4	

Date	Account / Narrative	Dr (FRW'm)	Cr (FRW'm)
	Cr Impairment loss (P&L)		10.4
	(Being reversal of the FRW 10.4m impairment loss incorrectly recognised on 31 December 2025 to reduce the storage unit to a fair value of FRW 60m.)		

Journal 2c - Reclassify from PPE to investment property on 1 April 2025

This entry is strictly required only if the reclassification has not previously been recorded. It has no effect on profit or loss or on retained earnings; it is a balance-sheet reclassification at the carrying amount on the date of transfer.

Date	Account / Narrative	Dr (FRW'm)	Cr (FRW'm)
1 Apr 2025	Dr Investment property	73.7	
	Cr Property, plant and equipment - Storage unit		73.7
	(Being reclassification of the storage unit from PPE to investment property on commencement of the operating lease to Theta, at the carrying amount on the date of transfer, in accordance with IAS 40.)		

Note: if Zeta elects the fair value model of IAS 40 prospectively, the FRW 13.7m decline in fair value from the pre-lease carrying amount of FRW 73.7m to FRW 60m at year-end would be recognised as a fair-value loss in profit or loss (not an impairment), and no depreciation is charged for the nine-month period 1 April to 31 December 2025. If Zeta elects the cost model, depreciation of FRW 3.3m (= 4.4 × 9/12) is charged and the year-end carrying amount is FRW 70.4m, with an impairment test carried out only if indicators of impairment exist (none suggested here). In either case, the 'impairment loss' label and amount applied by Zeta are incorrect

Rho's revenue from UmuVIP Beverages (from part d): Rho's mis-application of IAS 19 must be corrected. The revenue correction affects Rho's profit or loss and retained earnings; for the purposes of the CSOFP, Rho's reported retained earnings of FRW 200m are taken as given. The conceptual correction is illustrated in part (d) below.

W8 Consolidated retained earnings

	FRW'm
Zeta's retained earnings as drafted	2,150.00
Adjustments for finance lease to Amaru (net, W7)	28.00
Reversal of incorrect impairment on storage unit (W7)	10.40
Share of Theta's post-acquisition retained earnings - 75% × (226.75 − 2.77)	167.99
Share of Rho's post-acquisition retained earnings - 60% × 35	21.00
Share of Iota's 2025 profit via Theta - 75% × 35.60	26.70
Consolidated retained earnings	**2,404.09**

W9 Non-controlling interests

	FRW'm
NCI in Theta - 25% × (1,011.75 − 2.77)	252.24
NCI share of Iota's 2025 profit via Theta - 25% × 35.60	8.90
NCI in Theta	**261.14**
NCI in Rho - 40% × 300	120.00
Total non-controlling interests	**381.14**

W10 Elimination of intra-group balances

Management and treasury fees: Zeta billed Rho FRW 8m per month from 1 July 2025. The invoices for November and December 2025 (2 × 8 = FRW 16m) remain unpaid and must be eliminated - Dr Trade payables (Rho) FRW 16m; Cr Trade receivables (Zeta) FRW 16m.

Storage unit rental: Theta's rent for 1 April to 31 December 2025 (9 months × 12m/12 = FRW 9m) is accrued in the books of both companies and must be eliminated - Dr Trade payables (Theta) FRW 9m; Cr Trade receivables (Zeta) FRW 9m.

Soft drinks sales (Theta to Zeta): FRW 60m in revenue and cost of sales is eliminated from consolidated profit or loss; all amounts owed in respect of these purchases have been settled, so no receivable or payable remains to be eliminated in the CSOFP.

Consolidated statement of financial position of the Zeta Group as at 31 December 2025

	FRW'm
ASSETS	
Non-current assets	
Property, plant and equipment (1,850 + 720 + 310 − 220 − 8.25 + 10.4)	2,662.15
Goodwill (W4)	372.25
Investment in associate (W5)	290.60
Net investment in finance lease (W7)	248.00
Total non-current assets	**3,573.00**
Current assets	
Inventories (380 + 210 + 45 − 2.77 URP)	632.23
Trade and other receivables (295 + 140 + 60 − 16 − 9)	470.00
Cash and cash equivalents (155 + 75 + 20)	250.00
Total current assets	**1,352.23**
Total assets	**4,925.23**
EQUITY AND LIABILITIES	

	FRW'm
Equity attributable to owners of the parent	
Ordinary share capital	500.00
Consolidated retained earnings (W8)	2,404.09
Non-controlling interests (W9)	381.14
Total equity	**3,285.23**
Non-current liabilities	
Long-term borrowings (780 + 220 + 80)	1,080.00
Current liabilities	
Trade and other payables (310 + 130 + 45 − 16 − 9)	460.00
Other current liabilities (60 + 30 + 10)	100.00
Total liabilities	**1,640.00**
Total equity and liabilities	**4,925.23**

Part (b) - Office building leased to Amaru Traders Ltd (IFRS 16)

IFRS 16 Leases requires a lessor that classifies a lease as a finance lease to derecognise the underlying asset and recognise in its place a net investment in the lease, measured at the present value of the lease payments discounted at the interest rate implicit in the lease. The net investment equals the gross investment less unearned finance income; its initial carrying amount is equal to the fair value of the underlying asset at the commencement date. Any difference between the fair value of the asset and its previous carrying amount is recognised as a gain or loss in profit or loss on the commencement date.

On 1 July 2025 the carrying amount of the office building was FRW 230m (= 240 − 6/12 × 20). The fair value of the leased asset, as determined using the interest rate implicit in the lease, is FRW 275m. A gain of FRW 45m (= 275 − 230) is therefore recognised in profit or loss on the commencement date.

Subsequently, lease payments received are applied first against finance income (recognised on a pattern reflecting a constant periodic rate of return on the net investment) and the remainder against the net investment in the lease.

Journal entries in Zeta's separate financial statements

On 1 July 2025 (derecognition of the asset and recognition of the net investment in the lease):

Dr Net investment in lease   FRW 275m

    Cr Property, plant and equipment   FRW 230m

    Cr Gain on derecognition (P&L)   FRW 45m

On 1 July 2025 (first lease payment received in advance):

Dr Cash   FRW 38m

    Cr Net investment in lease   FRW 38m

On 31 December 2025 (finance income accrued for the six months to year-end - taken as one-half of the annualised finance component of FRW 22m):

Dr Net investment in lease   FRW 11m

    Cr Finance income (P&L)   FRW 11m

Net investment in lease at 31 December 2025 = 275 − 38 + 11 = FRW 248m. The amount expected to be recovered within 12 months is classified as current; the balance is classified as non-current.

Part (c) - Storage unit leased to Theta

Zeta's current treatment is not in accordance with IFRS. The reasoning is as follows.

In Zeta's separate financial statements the storage unit meets the definition of investment property under IAS 40 Investment Property from 1 April 2025 because it is held by Zeta to earn rentals. On that date, the asset should have been reclassified from PPE to investment property at its carrying amount, namely FRW 73.7m (= 88 − 88/20 × 3.25 years). Zeta may subsequently measure the asset under either the cost model or the fair value model. Under the cost model, the asset continues to be depreciated and is tested for impairment under IAS 36; fair value is disclosed but not reflected in the carrying amount. Under the fair value model, the asset is remeasured to fair value at each reporting date with gains and losses recognised in profit or loss; no depreciation is charged. The current treatment - recognising the decline to FRW 60m as an 'impairment loss' - is inappropriate under either model.

In the consolidated financial statements of the Zeta Group, the property is leased by a parent to a subsidiary, and is therefore owner-occupied by the group. IAS 40 paragraph 15 requires such a property to be classified as property, plant and equipment in the consolidated financial statements. The write-down recognised in Zeta's separate books must be reversed on consolidation; the consolidated carrying amount of the asset is its depreciated historical cost of FRW 70.4m (= 88 − 88/20 × 3.75 years) at 31 December 2025.

In conclusion, in Zeta's separate financial statements reclassify the storage unit to investment property on 1 April 2025 and apply either the cost or the fair value model consistently (IAS 40 paragraph 30 permits a free choice but requires consistency). In the consolidated financial statements reverse the FRW 10.4m write-down and continue to carry the unit as PPE at its depreciated historical cost.

Part (d) - Contingent consideration in the originally proposed acquisition of Rho

Under IFRS 3 Business Combinations, the consideration transferred in a business combination includes the fair value of any contingent consideration arrangement. On 1 July 2025 Zeta would have recognised the contingent obligation to pay up to FRW 50m (two payments of FRW 25m) at its acquisition-date fair value - determined by probability-weighting the expected cash flows at the likelihood of achieving the 10% ROCE target in each of 2026 and 2027, and discounting the result at an appropriate risk-adjusted rate. That fair value would have been added to the FRW 180m cash consideration in arriving at the total consideration transferred and, consequently, in computing goodwill.

Subsequent accounting depends on the classification of the contingent consideration. Because the proposal required settlement in cash, it meets the definition of a financial liability under IAS 32 Financial Instruments: Presentation. It is presented on the face of the statement of financial position as a liability (split between current and non-current based on the expected timing of settlement). Under IFRS 3 paragraphs 58–59 and IFRS 9 Financial Instruments, contingent consideration classified as a financial liability is remeasured to fair value at each reporting date, with changes in fair value (other than measurement-period adjustments arising from new information about facts and circumstances that existed at the acquisition date) recognised in profit or loss. Measurement-period adjustments, by contrast, are reflected retrospectively through goodwill.

Had the contingent consideration been settled in a fixed number of the acquirer's own equity instruments, it would instead have been classified as equity and would not be remeasured after initial recognition.

SECTION B

QUESTION TWO

MARKING GUIDE

The minimum mark awardable is 0.5 for numerical answers and 1 for narrative answers. Maximum marks for a single-point answer do not exceed 2. Markers may award additional marks for other reasonable and valid points not listed in the guide, subject to the maximum marks for the sub-question. DNA denotes 'Do Not Award'. Candidates may adopt an alternative sign convention in which outflows are treated as positive and the FCF is shown as a net asset/liability from the liability perspective; full marks should be awarded provided the underlying workings and conclusions are correct.

Part (a)(i) – Fulfilment cash flows and CSM (12 marks)

Marking point	Marks	Max
Identification of the general measurement model as the applicable measurement approach	0.5	
Explanation of components of insurance contract liability (FCF + CSM)	0.5	
Property portfolio – computation:		
Correct cash inflow and outflow per portfolio identified (premium 4,500; annual outflow (900))	0.5	
Correct PV of cash flows at 8% for each of Years 1–4 (half a mark each)	0.5 × 4	
PV of net cash flows correctly totalled to 1,519	0.5	
Inclusion of risk adjustment of (200) and FCF of 1,319 on recognition	0.5	
CSM on recognition of (1,319) - identified as eliminating day-one gain	1	
Subsequent to premium receipt – each correct figure (RA (200); FCF (2,981); sub-total (3,181); CSM (1,319); LRC (4,500))	0.5 × 5	**6**
Motor portfolio – computation:		
Correct cash inflow and outflow per portfolio identified (premium 2,000; annual outflow (1,250))	0.5	

Correct PV of cash flows at 5% for each of Years 1–2 (half a mark each)	0.5 × 2	
PV of net cash flows correctly totalled to (324)	0.5	
Inclusion of risk adjustment of (120) and FCF of (444) on recognition	0.5	
Identification of onerous contract; CSM = nil; loss of 444 recognised immediately in P&L	1.5	
Subsequent to premium receipt – each correct figure (RA (120); FCF (2,324); sub-total (2,444); CSM nil; LRC (2,444))	0.5 × 5	**6**
Total – Part (a)(i)		**12**

Part (a)(ii) – Journal entries (7 marks)

Marking point	**Marks**	**Max**
Property – identification that no journal entry is required at initial recognition (initial measurement = nil)	1	
Property – premium collection: Dr Bank 4,500 / Cr Insurance contract liability 4,500 (0.5 per side)	0.5 × 2	
Property – narrative identifying composition of the liability (FCF + CSM)	0.5	**2.5**
Motor – initial recognition: Dr Insurance service expense 444 / Cr Insurance contract liability 444 (0.5 per side)	0.5 × 2	
Motor – narrative identifying loss component within the LRC	0.5	
Motor – premium collection: Dr Bank 2,000 / Cr Insurance contract liability 2,000 (0.5 per side)	0.5 × 2	
Correct account nomenclature aligned with IFRS 17 (e.g. 'Insurance contract liability' rather than 'Unearned premium')	1	**4.5**
Total – Part (a)(ii)		**7**
DNA: generic 'deferred income / unearned premium reserve' accounts without IFRS 17 terminology		

Part (b) – Ethical evaluation (6 marks)

Marking point	Marks	Max
(i) Fundamental principles under threat		
Identification of integrity, with contextual explanation	1	
Identification of objectivity, with contextual explanation	1	
Identification of professional behaviour (or any other relevant principle correctly justified)		**2**
(ii) Type of ethical threat		
Correct identification of intimidation threat, with contextual explanation	1.5	
Identification of self-interest threat (bonus/employment)	0.5	**2**
(iii) Safeguards		
Escalation to those charged with governance (Audit Committee / Board)	0.5	
Consultation with external auditor or ICPAR ethics helpline	0.5	
Disassociation / presentation of correct figures for sign-off by principals	0.5	
Reference to decline, resignation, NOCLAR considerations, or contemporaneous documentation as last-resort safeguards	0.5	**2**
Total – Part (b)		**6**
Total – Question Two		**25**

MODEL ANSWER

Tau has issued two portfolios of insurance contracts within the scope of IFRS 17. Both portfolios have a coverage period in excess of one year and are not eligible for simplification under the premium allocation approach; accordingly, the general measurement model (GMM) is applied. Under the GMM, the insurance contract liability on initial recognition comprises two components: the fulfilment cash flows (FCF), being the risk-adjusted present value of the future cash flows arising from fulfilling the contracts, and the contractual service margin (CSM), being the unearned profit the entity expects to recognise as it provides insurance service over the coverage period. Where the FCF is a net outflow position at inception (i.e. the contracts are expected to be lossmaking), no CSM arises and the resulting loss is recognised immediately in profit or loss, with a loss component established within the liability for remaining coverage.

(i) Fulfilment cash flows and contractual service margin

Commercial Property All-Risk Portfolio (profitable)

On recognition, the present value of the expected future cash flows of the portfolio is determined by discounting the net cash flows at the applicable discount rate of 8%. Cash inflows are presented as positive and cash outflows as negative. Year 0 reflects the premium receipt undiscounted; Years 1–4 reflect the expected claim outflows.

Year	Cash in	Cash out	Net cash flow	Discount factor	PV of cash flows
0	4,500	–	4,500	1.000	4,500
1	–	(900)	(900)	0.926	(833)
2	–	(900)	(900)	0.857	(771)
3	–	(900)	(900)	0.794	(715)
4	–	(900)	(900)	0.735	(662)
Total	**4,500**	**(3,600)**	**900**		**1,519**

PV of net cash flows	1,519
Less: Risk adjustment for non-financial risk	(200)
Fulfilment cash flows	***1,319***
Contractual service margin (to eliminate day-one gain)	(1,319)
Initial measurement of the group of insurance contracts	**0**

Since the fulfilment cash flows represent a net inflow of FRW 1,319 million, the portfolio is expected to be profitable. A CSM of FRW 1,319 million is therefore recognised to eliminate the day-one gain, such that the initial measurement of the group of insurance contracts is nil, consistent with the 'no day-one profit' principle in IFRS 17. The CSM will be released to profit or loss over the four-year coverage period in proportion to the insurance service provided.

Subsequent to the receipt of all premiums, the premium inflow component of the measurement is no longer a future cash flow (it has been collected in cash) and therefore drops out of the FCF. The CSM is unchanged on a pure premium-collection event, as no insurance service has yet been provided.

Risk adjustment	(200)
Fulfilment cash flows (1,519 – 4,500)	(2,981)

Sub-total	*(3,181)*
Contractual service margin	(1,319)
Insurance contract liability after initial recognition	**(4,500)**

The insurance contract liability is therefore FRW 4,500 million (presented as a credit balance of (4,500)), representing the cash premium now held against future services to be rendered.

Commercial Motor Portfolio (onerous)

Applying the same approach, Year 0 reflects the premium inflow at a discount factor of 1.000 and Years 1–2 reflect the expected claim outflows discounted at the applicable rate of 5%.

Year	Cash in	Cash out	Net cash flow	Discount factor	PV of cash flows
0	2,000	–	2,000	1.000	2,000
1	–	(1,250)	(1,250)	0.952	(1,190)
2	–	(1,250)	(1,250)	0.907	(1,134)
Total	**2,000**	**(2,500)**	**(500)**		**(324)**

PV of net cash flows	(324)
Less: Risk adjustment for non-financial risk	(120)
Fulfilment cash flows	***(444)***
Contractual service margin (onerous – not recognised)	–
Initial measurement of the group of insurance contracts	**(444)**

The fulfilment cash flows represent a net outflow position of FRW 444 million (the precise figure is FRW 443.75 million, rounded to FRW 444 million for presentation). Since the FCF is a net liability at inception, the portfolio is onerous within the meaning of IFRS 17. No CSM arises; instead, a loss of FRW 444 million is recognised immediately in the insurance service result in profit or loss, and a corresponding loss component is established within the liability for remaining coverage.

Subsequent to the receipt of all premiums, the premium inflow ceases to be a future cash flow and drops out of the fulfilment cash flows:

Risk adjustment	(120)
Fulfilment cash flows ((1,190) + (1,134))	(2,324)
Sub-total	*(2,444)*

Contractual service margin	–
Insurance contract liability after initial recognition	**(2,444)**

The insurance contract liability is therefore FRW 2,444 million, within which the loss component of FRW 444 million remains and is released to profit or loss over the two-year coverage period in proportion to the reversal of the underlying cash flow expectations.

(ii) Journal entries in Tau's financial statements

Commercial Property All-Risk Portfolio

At initial recognition, the initial measurement of the group of insurance contracts is nil (FCF 1,319 offset by CSM (1,319)). Accordingly, no journal entry is required on initial recognition.

Journal entry following receipt of premiums:

	Dr (FRW m)	Cr (FRW m)
Bank	4,500	
Insurance contract liability		4,500
(being recognition of premiums received, giving rise to a liability of (4,500) comprising FCF (3,181) and CSM (1,319))		

Commercial Motor Portfolio

At initial recognition, the portfolio is onerous and the loss of FRW 444 million is recognised immediately in profit or loss, with a corresponding liability for remaining coverage.

Journal entry on initial recognition:

	Dr (FRW m)	Cr (FRW m)
Insurance service expense (loss on onerous contracts)	444	
Insurance contract liability		444
(being recognition of the onerous loss and corresponding loss component within the LRC)		

Journal entry following receipt of premiums:

	Dr (FRW m)	Cr (FRW m)
Bank	2,000	
Insurance contract liability		2,000

(being recognition of premiums received, bringing the liability to (2,444) including the loss component of (444))		

(b) Ethical evaluation under the IESBA International Code of Ethics

<u>(i) Fundamental principle(s) potentially under threat</u>

The IESBA Code identifies five fundamental principles: integrity, objectivity, professional competence and due care, confidentiality, and professional behaviour. In the circumstances described, three of these principles are under threat:

Integrity: The Director of Finance is requesting that the analysis be presented in a manner that misrepresents the performance of the Motor portfolio. Integrity requires the professional accountant to be straightforward and honest in all professional and business relationships and not to knowingly be associated with reports, returns, communications or other information that contain materially false or misleading statements. Aggregating the onerous portfolio with the profitable portfolio so that the loss is not separately identifiable would cause the financial statements to be misleading.

Objectivity: Objectivity requires that professional or business judgement is not compromised by bias, conflict of interest or the undue influence of others. The Director's instruction, backed by an implied threat to employment, directly seeks to compromise the candidate's professional judgement in the preparation of the analysis.

Professional behaviour: This principle requires compliance with relevant laws and regulations and the avoidance of any conduct that might discredit the profession. Presenting misleading financial information in the financial statements of a listed entity would constitute non-compliance with IFRS 17 disclosure requirements and with the Rwandan capital markets regulatory regime, and would bring both the candidate and the profession into disrepute.

<u>(ii) Specific category of ethical threat</u>

The IESBA Code classifies threats to compliance with the fundamental principles into five categories: self-interest, self-review, advocacy, familiarity, and intimidation. The candidate is exposed principally to an intimidation threat, arising from the Director of Finance's explicit statement that the candidate should 'update your curriculum vitae' if the numbers are not presented in a more favourable light. This is a direct threat to the candidate's continued employment and is intended to deter the candidate from acting objectively. A secondary self-interest threat also exists indirectly, in that the candidate has a personal financial interest in retaining the employment and the remuneration attached to it.

<u>(iii) Safeguards available</u>

The IESBA Code requires that, where threats to the fundamental principles are identified, the accountant applies safeguards to eliminate the threats or reduce them to an acceptable level. Where no such safeguards are available, the accountant must decline or discontinue the specific professional activity. The safeguards available in the present circumstances include the following:

• **Escalation within the entity:** The matter should be raised with those charged with governance. In the case of a listed entity such as Tau, this would include escalation to the Audit and Risk Committee and, if necessary, to the Board of Directors. The Audit and Risk Committee has an express mandate to consider matters affecting the integrity of financial reporting.

• **Consultation with the external auditor:** The external auditor may be consulted on the appropriate accounting treatment under IFRS 17; the auditor is independently required to consider whether the financial statements are free from material misstatement.

• **Consultation with ICPAR:** The candidate may seek confidential advice from ICPAR's ethics helpline on the appropriate course of action, without breaching the duty of confidentiality owed to the employer.

• **Disassociation:** As a relatively junior accountant, the candidate may disassociate themselves from the revised information by presenting the correct figures for the Director's own review and sign-off, on the basis that the candidate's work should in any event be subject to review by their principals.

• **Documentation:** The candidate should document the instruction received, the professional response given, and the reasoning applied, in order to maintain a contemporaneous record that demonstrates compliance with the Code.

If, following the application of these safeguards, the Director of Finance persists in requiring the misleading presentation and no resolution can be achieved through governance channels, the candidate should decline to produce the revised analysis. If the matter remains unresolved, the candidate should consider resignation from the employment, having first taken appropriate legal and professional advice. Resignation alone does not discharge the candidate's professional obligations; consideration must also be given to whether disclosure to a regulator or to the incoming accountant is required under the non-compliance with laws and regulations (NOCLAR) provisions of the IESBA Code.

QUESTION THREE

MARKING GUIDE

(a) (i) Differences in accounting treatment (7 Marks)

Award **one mark** for commenting on the SME treatment of each of the five specific elements, up to a maximum of five marks, plus **one mark** for the format of the memo (if not already awarded), plus **one further mark** for a well-developed general introduction to the SME framework or for a well-articulated practical implication for Psi.

Mark allocation point	Marks	Maximum
Memo format (addressed to Director of Finance, from Senior Accountant, with clear subject line) - award once for the whole question	1	1
General introduction: origin of IFRS for SMEs (2009, amended 2015), self-contained document, simplified requirements (up to 1 mark)	0.5 – 1	1
Borrowing costs - SME expenses vs IAS 23 capitalisation on qualifying assets, plus practical implication for Psi	0.5 – 1	1
Development costs - SME expenses vs IAS 38 capitalisation where criteria met, plus practical implication for Psi	0.5 – 1	1
Financial instruments - SME incurred loss vs IFRS 9 ECL; simplified derecognition/disclosure, plus practical implication for Psi's trade receivables	0.5 – 1	1
Goodwill and indefinite-life intangibles - SME amortisation (useful life or 10 years) vs annual impairment test under full IFRS	0.5 – 1	1
Investments in associates and joint ventures - SME three-model choice vs equity method only under full IFRS	0.5 – 1	1
Any other valid recognition/measurement difference relevant to Psi, well explained with practical implication (e.g. revenue, PPE, leases) up to 1 mark per point	0.5 – 1	1
Maximum for part (a)(i)		**7**

(a) (ii) Additional disclosures under full IFRS (8 Marks)

Award up to two marks per disclosure area: one mark for identification of the additional disclosure area, and one further mark for a critical assessment of its applicability to Psi (including correctly identifying where a disclosure is **not** applicable).

Mark allocation point	Marks	Maximum
Earnings per share (IAS 33) - correctly identified as NOT applicable to Psi as a non-listed company (1 mark for identification, 1 for critical reasoning)	0.5 – 2	2
Interim financial reporting (IAS 34) - identification + applicability via parent's JSE listing obligations	0.5 – 2	2
Segment reporting (IFRS 8) - identification + applicability (not strictly mandatory at standalone level, but group-driven review of segments likely)	0.5 – 2	2
Insurance contracts (IFRS 17) - identification + correctly identified as NOT relevant to a wholesale business	0.5 – 2	2
Assets held for sale and discontinued operations (IFRS 5) - identification + applicability where Psi plans disposals	0.5 – 2	2
Any other valid additional disclosure (e.g. IFRS 1 transition reconciliations, IFRS 7 financial instruments disclosures, IFRS 13 fair value hierarchy, IAS 24 related parties) with commentary on applicability to Psi	0.5 – 2	2
Maximum for part (a)(ii)		**8**

(b) Cash flow hedge - journal entries (10 Marks)

Award marks as set out below. Half a mark for each correct figure used in the effectiveness calculations; up to one mark for each correct journal entry or principle demonstrated. Maximum of 10 marks.

Mark allocation point	Marks	Maximum
Journal 1 - 2 April 2024: Dr Hedge instrument asset 5,000 / Cr Cash 5,000 (identification and both sides of the journal)	1	1
31 Dec 2024 workings - correct values used to calculate change in contract value (484 × 1,000 − 450 × 1,000 = 34,000) and	0.5 – 2	2

Mark allocation point	Marks	Maximum
change in asset cost (480 × 1,000 − 445 × 1,000 = 35,000) - 0.5 per correct figure		
31 Dec 2024 - correct identification of the effective portion (lower of 34,000 and 35,000 = 34,000) and nil ineffective portion	1	1
Journal 2 - 31 Dec 2024: Dr Hedge instrument asset 34,000 / Cr OCI (cash flow hedge reserve) 34,000	1	1
15 Jan 2025 workings - correct change in contract value (472 × 1,000 − 484 × 1,000 = −12,000) and change in asset cost (472 × 1,000 − 480 × 1,000 = −8,000) - 0.5 per correct figure	0.5 – 2	2
15 Jan 2025 - correct identification of the effective portion (8,000) and the ineffective portion (4,000) charged to profit or loss	1	1
Journal 3 - 15 Jan 2025: Dr OCI 8,000 + Dr P&L 4,000 / Cr Hedge instrument asset 12,000 - split between OCI and P&L correctly presented	1	1
Journals 4 and 5 - 15 Jan 2025: recognition of inventory at spot (Dr Inventory 472,000 / Cr Cash 472,000) and derecognition of hedge instrument (Dr Cash 27,000 / Cr Hedge instrument asset 27,000), or the physical-exercise equivalent	1	1
Journal 6 - 15 Jan 2025: basis adjustment of the cash flow hedge reserve into inventory (Dr OCI - cash flow hedge reserve 26,000 / Cr Inventory 26,000); candidates who recycle to P&L on consumption of inventory should also receive full marks	1	1
Any other valid presentation or reasonable simplification internally consistent with the candidate’s treatment - marker’s discretion	0.5 – 1	1
Maximum for part (b)		**10**

Total - Question One		**25**

MODEL ANSWER

MEMORANDUM

To: **Director of Finance, Psi Building Materials Ltd**

From: Senior Accountant

Copy: Gamma Milling Ltd – Finance function

Date: 28 February 2025

Subject: Differences between IFRS for SMEs and full IFRS, and accounting for Gamma's cash flow hedge

<u>(a) (i) Differences in accounting treatment - full IFRS vs IFRS for SMEs</u>

The IFRS for Small and Medium-sized Entities (SMEs) was issued by the IASB in 2009 and amended in 2015. While the SMEs Standard is a single self-contained document based on the accounting principles found in current IFRSs, full IFRS consists of a set of separate standards on specific accounting topics and issues. The requirements in the SME Standard have been simplified to be more appropriate for smaller entities; accordingly, a number of recognition and measurement differences arise when an entity transitions from IFRS for SMEs to full IFRS. The differences in accounting treatment most significant to Psi are set out below.

1. Borrowing costs

Under full IFRS (IAS 23), borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset must be capitalised as part of the cost of that asset. Under IFRS for SMEs, borrowing costs cannot be capitalised and must be expensed to profit or loss in the year in which they arise. **Practical implication for Psi:** where Psi finances the construction of a new warehouse or similar qualifying asset, interest on the related borrowings will now be capitalised rather than expensed.

2. Development costs

Under IAS 38, development costs must be distinguished from research costs and capitalised as intangible assets where the criteria for capitalisation are met. Under IFRS for SMEs, development costs are treated the same as research costs and expensed in the period in which they are incurred. **Practical implication for Psi:** the group may impose a standard policy; any internally generated systems or processes that meet the IAS 38 development-phase criteria will now be capitalised.

3. Financial instruments

Full IFRS (IFRS 9) applies the forward-looking *expected credit loss (ECL)* model to trade receivables and other financial assets measured at amortised cost. IFRS for SMEs requires an *incurred loss* approach for impairment and simplifies the derecognition and disclosure requirements. **Practical implication for Psi:** Psi must build an ECL model for its trade receivables portfolio (contractors and retailers) using historical default data adjusted for forward-looking information.

4. Goodwill and other indefinite-life intangibles

Under IFRS for SMEs, goodwill and other intangible assets with indefinite useful lives are amortised over their useful lives, or over 10 years where useful life cannot be reliably estimated. Under full IFRS, intangible assets with indefinite useful lives (including goodwill) are not amortised; instead, they are tested for impairment each year. **Practical implication for Psi:** any goodwill or indefinite-life intangible assets (including goodwill recognised by Thembekile on the acquisition of Psi) will cease to be amortised and will instead be subject to an annual impairment test.

5. Investments in associates and joint ventures

The SME Standard permits an entity to account for investments in associates using any of three models - the equity method, the cost model, or the fair value model - with the chosen model applied to all investments in associates. Full IFRS requires investments in associates to be accounted for using the equity method in an investor's primary financial statements. **Practical implication for Psi:** if Psi holds investments in associates or joint ventures, the accounting policy must be changed to the equity method only.

(a) (ii) Additional disclosures under full IFRS and applicability to Psi

Because the requirements of IFRS have been simplified in the SME Standard, full IFRS imposes a number of additional disclosures that are not present in IFRS for SMEs. The principal additional disclosures, together with a critical assessment of their applicability to Psi, are set out below.

1. Earnings per share (IAS 33)

Full IFRS requires the disclosure of basic and diluted earnings per share for entities whose ordinary shares are publicly traded. Given that Psi is not a listed company and does not have publicly traded shares, an EPS disclosure will **not** be required in Psi's own financial statements. EPS is therefore relevant only at the consolidated level of the parent Thembekile.

2. Interim financial reporting (IAS 34)

IAS 34 prescribes the minimum content of interim financial reports and the recognition and measurement principles that should be applied. Although IFRS for SMEs does not require interim reporting, Psi will be required to produce interim reporting packs in line with the parent's listing obligations on the Johannesburg Stock Exchange, which mandate interim disclosures for the listed group.

3. Segment reporting (IFRS 8)

IFRS 8 requires operating segment disclosures for entities whose debt or equity instruments are traded in a public market. Psi's standalone financial statements do not strictly require IFRS 8 disclosures; however, Psi will need to review its operating model to identify the discrete segments into which the company is split for internal management and reporting purposes. This may be driven by the new parent, who may wish to segment Psi's operations in a manner that is more useful for managing the group (for Example, by product line - cement, steel, roofing - or by geographic region within Rwanda).

4. Insurance contracts (IFRS 17)

IFRS for SMEs does not permit entities issuing insurance contracts to apply the standard, and so the insurance disclosures under full IFRS do not arise in the SME framework. The requirement in terms of insurance contracts is **not relevant** to Psi as a wholesale business; it is not applicable.

5. Assets held for sale and discontinued operations (IFRS 5)

IFRS 5 requires assets or disposal groups classified as held for sale to be presented separately on the face of the statement of financial position, measured at the lower of carrying amount and fair value less costs to sell. Any plans by Psi to dispose of assets will need to be reflected in the financial statements by splitting those assets from PPE (or the equivalent category) and disclosing them separately as assets held for sale, together with the related disclosures.

(b) Accounting for Gamma's cash flow hedge under IFRS 9

Under IFRS 9, where a hedge qualifies for cash flow hedge accounting the effective portion of the gain or loss on the hedging instrument is recognised in other comprehensive income (OCI) and accumulated in a separate component of equity (the cash flow hedge reserve). The ineffective portion is recognised in profit or loss. When the hedged forecast purchase occurs and results in the recognition of a non-financial asset (the wheat inventory), the amount accumulated in the cash flow hedge reserve is removed from equity and included directly in the initial cost of the inventory (a 'basis adjustment').

Effectiveness is assessed at each reporting date by comparing the cumulative change in the fair value of the hedging instrument (based on the future rate) with the cumulative change in the cost of the hedged item (based on the spot rate). The effective portion recognised in OCI is the *lower* of the two cumulative changes; any excess on the hedging instrument is ineffective and is taken to profit or loss.

Working schedule

Assessment of hedge effectiveness at 31 December 2024:

Hedging instrument (forward):	**FRW**
Value of contract at 31 Dec 2024 (484 × 1,000)	484,000

Less: value of contract at 2 April 2024 (450 × 1,000)	(450,000)
Gain on hedging instrument	**34,000**
Hedged item (asset):	
Cost of asset at 31 Dec 2024 (480 × 1,000)	480,000
Less: cost of asset at 2 April 2024 (445 × 1,000)	(445,000)
Increase in cost of asset	**35,000**

The cumulative gain on the hedging instrument (34,000) is lower than the cumulative increase in the cost of the asset (35,000). The hedge is therefore fully effective and the entire 34,000 gain is recognised in OCI.

Assessment of hedge effectiveness at 15 January 2025:

Hedging instrument (forward):	**FRW**
Value of contract at 15 Jan 2025 (472 × 1,000)	472,000
Less: value of contract at 31 Dec 2024 (484 × 1,000)	(484,000)
Loss on hedging instrument	**(12,000)**
Hedged item (asset):	
Cost of asset at 15 Jan 2025 (472 × 1,000)	472,000
Less: cost of asset at 31 Dec 2024 (480 × 1,000)	(480,000)
Decrease in cost of asset	**(8,000)**

The cumulative loss on the hedging instrument (12,000) is greater than the decrease in the cost of the asset (8,000). The hedge is therefore only partially effective: 8,000 is the effective portion and is recognised in OCI, and the excess of 4,000 (12,000 − 8,000) is the ineffective portion and is recognised in profit or loss.

Journal entries

1. **2 April 2024 - acquisition of the call option**

Account	**Dr (FRW)**	**Cr (FRW)**
Dr Hedge instrument asset	5,000	
Cr Cash		5,000

Being the transaction fee paid on acquisition of the option. At inception the hedge has no intrinsic value, so the only entry made is to recognise the transaction cost in the contract asset account.

2. **31 December 2024 - gain on hedging instrument (fully effective)**

Account	Dr (FRW)	Cr (FRW)
Dr Hedge instrument asset	34,000	
Cr Other comprehensive income - Cash flow hedge reserve		34,000

Being the gain on the hedging instrument at 31 December 2024 recognised in OCI and accumulated in the cash flow hedge reserve. The gain of 34,000 is lower than the 35,000 increase in the cost of the hedged item, so the hedge is fully effective.

3. **15 January 2025 - loss on hedging instrument (partially effective)**

Account	Dr (FRW)	Cr (FRW)
Dr Other comprehensive income - Cash flow hedge reserve	8,000	
Dr Profit or loss (ineffective portion)	4,000	
Cr Hedge instrument asset		12,000

Being the loss on the hedging instrument at 15 January 2025. The effective portion of 8,000 (equal to the decrease in the cost of the hedged item) is charged to OCI; the excess of 4,000 is the ineffective portion and is charged to profit or loss.

4. **15 January 2025 - purchase of wheat inventory at spot**

Account	Dr (FRW)	Cr (FRW)
Dr Inventory (472 × 1,000)	472,000	
Cr Cash		472,000

Being the recognition of the wheat inventory at the spot price. For presentation purposes, the cash paid on exercise of the option plus the cash proceeds from settling the in-the-money option is shown net as the spot price on delivery.

5. **15 January 2025 - settlement and derecognition of the hedge instrument**

Account	Dr (FRW)	Cr (FRW)
Dr Cash	27,000	
Cr Hedge instrument asset		27,000

Being the derecognition of the hedge instrument asset. At settlement the carrying amount of the hedge asset is 5,000 + 34,000 − 12,000 = 27,000, which is received in cash on exercise. Candidates may alternatively present physical exercise (Dr Inventory at strike + Cr Cash at strike + Cr Hedge asset) and the economic outcome is identical.

6. **15 January 2025 - basis adjustment of cash flow hedge reserve into inventory**

Account	Dr (FRW)	Cr (FRW)
Dr Other comprehensive income - Cash flow hedge reserve	26,000	
Cr Inventory		26,000

Being the removal of the cumulative balance in the cash flow hedge reserve (34,000 – 8,000 = 26,000) and its inclusion as an adjustment to the initial cost of the inventory, in accordance with IFRS 9. Candidates who instead recycle the reserve to profit or loss when the inventory is consumed (rather than basis-adjust into inventory) should also be awarded full marks.

Net effect on inventory

Inventory recognised at spot (entry 4)	472,000
Less: basis adjustment from cash flow hedge reserve (entry 6)	(26,000)
Initial carrying amount of inventory	**446,000**

The economic outcome of the hedge is confirmed as follows: Gamma has paid a total of FRW 450,000 in net cash over the life of the hedge (premium of FRW 5,000 at inception, net cash of FRW 472,000 on delivery, less cash of FRW 27,000 received on settlement of the hedge instrument). Of this total cost, FRW 446,000 is carried in inventory and FRW 4,000 has been charged to profit or loss as the ineffective portion of the hedge. The hedge has therefore substantially achieved its objective of locking Gamma's effective cost of wheat at the strike price of FRW 450 per bushel.

Signed: Senior Accountant

End of memorandum.

QUESTION FOUR

MARKING GUIDE

(a) Schedules under IPSAS 39 (10 Marks)

Award **half a mark** for each correct figure used in the schedules (up to 7 marks), and **half a mark** for each correctly identified amount in the financial statements (up to 3 marks). Additionally, award **one mark** for correctly identifying that IPSAS 39 requires remeasurements to be recognised directly in net assets/equity (absorbed within the 10-mark cap).

Mark allocation point	Marks	Maximum
Movement in defined benefit obligation - interest on obligation (31,500); current service cost used (36,000); benefits paid (31,800); sub-total (385,700); remeasurement loss as balancing figure (34,300); opening and closing obligation amounts correctly brought forward - 0.5 per correct figure	0.5 – 3.5	3.5
Movement in fair value of plan assets - interest on assets (28,350); contributions (28,620); benefits paid (31,800); sub-total (340,170); remeasurement gain as balancing figure (35,830); opening and closing asset amounts correctly brought forward - 0.5 per correct figure	0.5 – 3.5	3.5
Statement of financial performance - current service cost (36,000); net interest on net defined liability (3,150); net expense (39,150) - 0.5 per correct figure	0.5 – 1.5	1.5
Net assets/equity - remeasurement loss (34,300); remeasurement gain (35,830); net remeasurement (1,530 gain) - 0.5 per correct figure	0.5 – 1	1
Statement of financial position - net defined benefit liability (44,000) correctly calculated and presented as a non-current liability	0.5	0.5
Identification that IPSAS 39 requires remeasurements to be recognised directly in net assets/equity (public-sector equivalent of OCI)	1	1

Mark allocation point	Marks	Maximum
Maximum for part (a)		**10**

(b) DC disclosures and DB accounting steps (7 Marks)

Award up to 3 marks for the disclosure requirements for defined contribution plans, and up to 4 marks for the steps to account for defined benefit plans.

Mark allocation point	Marks	Maximum
DC disclosures: total amount contributed by employer shown within operating expenses (1 mark)	1	1
DC disclosures: exclusion of amounts contributed by employees themselves (1 mark)	1	1
DC disclosures: recognition of a short-term liability where amounts deducted/expensed but not yet remitted to the fund (1 mark)	1	1
DB step 1 - determining the Scheme's deficit or surplus (reference to projected unit credit method and offsetting plan assets against obligation)	1	1
DB step 2 - determining the net defined benefit liability or asset, including application of any asset ceiling adjustment	1	1
DB step 3 - determining the amounts recognised in the statement of financial performance (current service cost, past service cost/settlements, net interest)	1	1
DB step 4 - determining the remeasurements to be recognised in net assets/equity (actuarial gains/losses, return on plan assets excl. net interest, change in asset ceiling)	1	1
Application of the steps to the Rwanda Public Service Pension Scheme context (e.g. reference to the Government as employer, RSSB as trustee)	0.5 – 1	1

Mark allocation point	Marks	Maximum
Maximum for part (b)		**7**

(c) Social benefits under IPSAS 42 (8 Marks)

Award up to 2 marks for the definitions of social benefits and social risks (1 mark each), and up to 6 marks for observations on the application of IPSAS 42 to the Ubudehe Support Programme.

Mark allocation point	Marks	Maximum
Definition of social benefits - cash transfers to individuals/households meeting eligibility criteria, mitigating social risks	0.5 – 1	1
Definition of social risks - events/circumstances related to characteristics of individuals/households (age, health, poverty, employment) that adversely affect welfare	0.5 – 1	1
Scope clarification - services are NOT social benefits; only cash transfers fall within IPSAS 42	0.5 – 1	1
Examples of social benefits (state retirement, disability, income support, unemployment) identified or applied to the Ubudehe Programme	0.5 – 1	1
Recognition principle - expense and liability recognised for the next social benefit payment; liability is short-term; discounting not normally required	0.5 – 2	2
Past event / recognition trigger - eligibility criteria for the next benefit have been met (e.g. reaching retirement age, satisfying unemployment waiting period)	0.5 – 1	1
General approach - default method; applies to most jurisdictions and the only approach that must be used	0.5 – 1	1
Insurance approach - optional; criteria (fully funded from contributions + arm's length / IFRS 17-like management); accounting follows IFRS 17	0.5 – 2	2

Mark allocation point	Marks	Maximum
Application to the Ubudehe Support Programme - not eligible for insurance approach (no contributions, funded from Consolidated Fund); general approach therefore applies	0.5 – 1	1
Any other valid observation on IPSAS 42 (disclosures, characteristics of the scheme, demographic/economic factors) - up to 1 mark	0.5 – 1	1
Maximum for part (c)		**8**

Total - Question Two		**25**

MODEL ANSWER

(a) Schedules for the Rwanda Public Service Pension Scheme

Under IPSAS 39, the discount rate applied at the start of the period is used to calculate net interest on the net defined benefit liability and on each of its components (the obligation and the plan assets). The opening discount rate of 9% is therefore applied. Remeasurement differences are the balancing figures that reconcile the opening and closing valuations to the amounts explained by interest, service cost, contributions and benefits. Under IPSAS 39, remeasurements are recognised directly in net assets/equity (the public sector equivalent of other comprehensive income).

Movement in the present value of the defined benefit obligation

	FRW Million
Present value of obligation on 1 January 2025	350,000
Add: interest on obligation (350,000 × 9%)	31,500
Add: current service cost	36,000

	FRW Million
Less: benefits paid	(31,800)
Sub-total	**385,700**
Remeasurement loss recognised in net assets/equity (balancing figure)	34,300
Present value of obligation on 31 December 2025	**420,000**

Movement in the fair value of plan assets

	FRW Million
Fair value of plan assets on 1 January 2025	315,000
Add: interest on plan assets (315,000 × 9%)	28,350
Add: contributions paid into the Scheme	28,620
Less: benefits paid	(31,800)
Sub-total	**340,170**
Remeasurement gain recognised in net assets/equity (balancing figure)	35,830
Fair value of plan assets on 31 December 2025	**376,000**

Amounts recognised in the financial statements

Statement of financial performance:

Current service cost	36,000
Net interest on the net defined benefit liability (35,000 × 9%)	3,150
Net expense for the period	**39,150**

Net assets/equity (remeasurement):

Remeasurement loss on the defined benefit obligation	(34,300)

Remeasurement gain on plan assets	35,830
Net remeasurement gain recognised in net assets/equity	**1,530**

Statement of financial position (non-current liabilities):

Net defined benefit liability (420,000 − 376,000)	**44,000**

(b) Disclosure requirements and accounting steps under IPSAS 39

Disclosures for defined contribution schemes

The disclosures required for defined contribution plans in the employer's financial statements are *limited*. The Government as employer is required to disclose, within operating expenses, the total amount contributed on the employees' behalf by the Government. This excludes any amounts contributed by the employees themselves (which are not an expense of the employer). In addition, where amounts have been deducted from employees or expensed by the employer at the reporting date but not yet remitted to the fund, a short-term liability should be recognised on the statement of financial position.

Steps to account for defined benefit schemes

Accounting by the Government for the Rwanda Public Service Pension Scheme involves the following steps, which should be applied in order at each reporting date:

1. **Determine the Scheme's deficit or surplus**. Use the projected unit credit method to make a reliable actuarial estimate of the present value of the defined benefit obligation, and compare this with the fair value of the plan assets held by the trustees.
2. **Determine the net defined benefit liability or asset**. Take the deficit or surplus from step 1 and, where applicable, apply any asset ceiling adjustment to derive the amount to be recognised on the statement of financial position.
3. **Determine the amounts to be recognised in the statement of financial performance**. These comprise the current service cost, any past service cost (plan amendments) and settlements, and the net interest on the net defined benefit liability (calculated by applying the opening discount rate to the opening net liability).
4. **Determine the remeasurements** of the net defined benefit liability to be recognised in net assets/equity. Remeasurements comprise actuarial gains and losses on the obligation, the return on plan assets excluding amounts included in net interest, and any change in the effect of the asset ceiling.

(c) Accounting for social benefits under IPSAS 42 - the Ubudehe Support Programme

Definitions

Social benefits are cash transfers provided by public sector entities to specific individuals and/or households who meet eligibility criteria, in order to mitigate the effect of social risks and to address the needs of society as a whole. Services provided by the public sector are not social benefits; only cash transfers fall within the scope of IPSAS 42.

Social risks are events or circumstances that relate to the characteristics of individuals and/or households - for example, age, health, poverty and employment status - and that may adversely affect the welfare of individuals or households, either by imposing additional demands on their resources or by reducing their income.

Examples of social benefits include state retirement benefits, disability benefits, income support and unemployment benefits. The Ubudehe Support Programme falls squarely within this scope because it provides cash transfers to individuals and households meeting eligibility criteria (classification in the lowest Ubudehe economic categories, or registered unemployed status), in order to mitigate the social risks of poverty and unemployment.

Principles and requirements of IPSAS 42

IPSAS 42 requires an entity to recognise an expense and a liability for the next social benefit payment. Specifically, the standard establishes principles and requirements for: (a) the recognition of expenses and liabilities for social benefits; (b) the measurement of those expenses and liabilities; (c) the presentation of information about social benefits in the financial statements; and (d) the determination of what information to disclose in order to enable users of the financial statements to evaluate the nature and financial effects of the social benefits provided by the reporting entity.

Approaches permitted

IPSAS 42 permits two approaches to accounting for social benefits:

1. **General approach** - likely to apply to most jurisdictions and the only approach that needs to be used. A liability is recognised when the entity has a present obligation for an outflow of resources that results from a past event and the amount can be measured reliably. For social benefits, the past event is that all eligibility criteria for the next benefit payment have been met (for example, reaching retirement age for a state old age pension, or becoming unemployed and satisfying any waiting period). The liability is limited to the *next payment only*, and discounting is therefore generally not required.
2. **Insurance approach** - optional, and permitted only where the social benefit is intended to be fully funded from contributions and there is evidence that the entity manages the scheme in the same way as an issuer of insurance contracts. Where it is applied, the accounting follows IFRS 17 *Insurance Contracts* (or the relevant national equivalent).

Application to the Ubudehe Support Programme: because the programme is not linked to any contributions by beneficiaries and is funded directly from the Consolidated Fund, it does not meet the criteria for the insurance approach. The Government should therefore apply the general approach, recognising an expense and a short-term liability equal to the next monthly payment due to each beneficiary who has, at the reporting date, met all of the eligibility criteria.

End of Model Answers and Marking Guide