CPA

Certified Public Accountant Examination

Stage: Intermediate Level I1.2

Subject Title: Financial Reporting

Examination Format Revision Pack

iCPAR

INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS OF RWANDA

Driving Sustainable Performance

BLANK

I 1.2 FINANCIAL REPORTING

INTERMEDIATE LEVEL

EXAMINATION FORMAT REVISION QUESTIONS & SOLUTIONS

NOTES:
You are required to answer Questions 1, 2 **and** 3. You are also required to answer **either** Question 4 **or** 5.
(If you provide answers to both Questions 4 and 5, you must draw a clearly distinguishable line through the answer not to be marked. Otherwise, only the first answer to hand for Questions 4 or 5 will be marked.)

PRO-FORMA STATEMENT OF COMPREHENSIVE INCOME BY NATURE, STATEMENT OF COMPREHENSIVE INCOME BY FUNCTION AND STATEMENT OF FINANCIAL POSITION ARE PROVIDED.

TIME ALLOWED:
3.5 hours, plus 10 minutes to read the paper.

INSTRUCTIONS:
During the reading time you may write notes on the examination paper but you may not commence writing in your answer book.

Please read each Question carefully.
Marks for each question are shown. The pass mark required is 50% in total over the whole paper.

You are reminded that candidates are expected to pay particular attention to their communication skills and care must be taken regarding the format and literacy of the solutions.

The marking system will take into account the content of your answers and the extent to which answers are supported with relevant legislation, case law or examples, where appropriate.
List on the cover of each answer booklet, in the space provided, the number of each question(s) attempted

BLANK

1. Black Ltd has a number of subsidiaries, one of which, White Ltd., was acquired during the year ended 31 December 2010.

The draft consolidated financial statements for the year ended 31 Dec. 2010 are as follows:

Consolidated Statement of Comprehensive Income of Black Ltd for the year ended 31 December 2010

	Rwf bn
Operating profit	1,890
Loss on disposal of property, plant and equipment	-85
Interest	-210
	1,595
Share of profits of associates	110
Profit on ordinary activities before taxation	1,705
Taxation	-410
	1,295
Profit attributable to:	
Owners of Black Ltd	985
Non-controlling interest	310
Group profit	1,295

Statements of Financial Position are as follows:

	Black Ltd Consolidated		White Ltd. at acquisition
	at 31/12/2010	at 31/12/2009	
	Rwf Bn	Rwf Bn	Rwf Bn
Assets			
Non-current assets			
Property, plant and equipment (note 2)	2,440	1,400	460
Intangibles	460		420
Investment in associates	380	330	
	3,280	2,150	460
Current assets			
Inventories	685	600	180
Trade and other receivables	310	260	85
Cash and cash equivalents	0	60	15
Total assets	4,275	3,070	740

Equity and liabilities			
Rwf1,000 ordinary shares	450	400	350
Share premium	250	100	80
Retained earnings	1,595	810	210
	2,295	1,310	640
Non-controlling interest	250	210	
	2,545	1,520	640
Non-current liabilities			
Long term loans	1,100	1,100	
Current liabilities			
Bank overdraft	80		
Trade payables	210	190	80
Taxation	340	260	20
Total Equity and Liabilities	4,275	3,070	740

Additional information:

1) Black Ltd acquired 80% of the ordinary shares of White Ltd on 1 July 2009 for Rwf400 billion in cash and issued 25 million Rwf1,000 ordinary shares with a market value of Rwf100bn. At the date of acquisition, White Ltd's assets and liabilities were recorded at their fair value, with the exception of some plant which had a fair value of Rwf100m below its carrying value.
2) During the year, Black Ltd made a further issue of ordinary shares, again, at a premium above nominal value.
3) The property, plant and equipment sold during the year had a carrying value of Rwf140 billion. Total depreciation charges for the year were Rwf209 billion (Bn).

REQUIRED:

a) Prepare a consolidated statement of cash flows in accordance with IAS 7 Statement of Cash Flows for the year ended 31 December 2010.

(21 marks)
Presentation (1 mark)

b) Activity Ltd operates in the manufacture of designer frames for spectacles and prepares its financial statements to 31 December each year. On 1 January 2012, Activity Ltd acquired 100% of Noddy Ltd, a niche manufacturer of frames for children's spectacles. Legal fees of Rwf100,000,000 were incurred in respect of the acquisition. The shareholders of Noddy Ltd valued the company at Rwf58 billion based upon future growth plans, profit projections and the recognition of increased demand for the 'Noddy' brand. The financial controller of Activity Ltd took a more prudent view of the value of Noddy Ltd and believes the fair value to be between Rwf46 billion to Rwf56 billion of which Rwf10 billion is related to the brand name, 'Noddy'. The financial controller is prepared to pay the full purchase price only if profits from the sale of 'Noddy' frames to opticians and other distributors of glasses reach predetermined forecast levels. The agreed purchase price amounted to Rwf40 billion, payable at the date of acquisition, plus two potential further payments.

The first payment of Rwf8 billion is due in two years' time on 31 December 2013, a payment which is guaranteed in cash with no conditions in relation to performance. The second payment is contingent on certain projected profit targets being successfully met. At the date of acquisition it was estimated that the fair value of the contingent consideration was Rwf4 billion. You may assume that Activity Ltd has a cost of capital equal to its borrowing costs of 5%. The discount factor at 5% for two years is 0.907.

REQUIRED:

With reference to relevant International Financial Reporting Standards, discuss how the above items should be dealt with in the financial statements of Activity Ltd for the year ended 31 December 2012.

(8 marks)
(Total: 30 Marks)

2. Tobias Ltd purchased 70% of the issued share capital of Brandon Ltd. and 40% of the issued share capital of Emma Ltd. on 1 May 2010. Details of the purchase consideration at that date are as follows:

   Brandon Ltd a share exchange of two shares in Tobias Ltd for every three shares in Brandon Ltd. plus an issue to the shareholders of Brandon Ltd. of 7% loan stock redeemable at par on 30 April 2014, on the basis of Rwf100,000 loan note for every 500 shares held in Brandon Ltd.

   Emma Ltd.: a share exchange of one share in Tobias Ltd for every five shares in Emma Ltd. plus Rwf1,000 cash per share.

   The market value of a share in Tobias Ltd at 1 May 2010 was Rwf5,000 per share.

The draft Statements of Comprehensive Income for the three companies for the year ended 31 December 2010 are as follows:

	Tobias Ltd	Brandon Ltd.	Emma Ltd.
	Rwf m	Rwf m	Rwf m
Revenue	42,000	30,000	25,000
Cost of sales	-10,000	-14,000	-14,000
Gross profit	32,000	16,000	11,000
Operating expenses	-14,000	-8,500	-7,270
Operating profit	18,000	7,500	3,730
Finance costs	-4,000	-	-
Profit on ordinary activities	14,000	7,500	3,730
Taxation	-3,200	-3,000	-1,400
Profit on ordinary activities after taxation	10,800	4,500	2,330

The following information is important:

1) The fair value of the land and buildings of Brandon Ltd. at the date of acquisition showed the following:

	Book Value	Fair Value
	Rwf m	*Rwf m*
Land	8,000	9,000
Building	4,000	5,000

2) Details of the capital and reserves at 1 January 2010 are as follows:

	Tobias Plc	Brandon Ltd.	Emma Ltd.
	Rwf m	*Rwf m*	*Rwfm*
Equity Rwf1,000	20,000	15,000	10,000
Share premium	10,000	5,000	2,000
Retained earnings	28,000	9,000	6,000

3) In the post acquisition period sales by Tobias Ltd to Brandon Ltd. amounted to Rwf2 billion. Tobias Ltd made a profit of Rwf400,000,000 on this sale. Half of these goods were still in Brandon Ltd's inventory at 31 December 2010.

4) On 31 December 2010, Tobias Ltd and Brandon Ltd. paid dividends of Rwf6,000m and Rwf2,400m respectively.

   Neither company has accounted for dividends paid or dividends received.

5) Tobias Ltd's policy is to value the non-controlling interest at fair value at the date of acquisition. At the date of acquisition, the goodwill attributable to the non-controlling interest was Rwf4,500m.

6) All profits and losses are deemed to accrue evenly throughout the year.

REQUIRED:

a) Calculate the goodwill arising on the acquisitions of both companies. **(5 marks)**

b) Prepare a consolidated statement of comprehensive income for the Tobias group for the year ended 31 December 2010. **(15 Marks)**
(1 mark presentation)

c) Calculate the consolidated retained profits that will be carried forward at 31 December 2010. **(2 marks)**

d) Oscar Ltd is a public limited company and prepares its financial statements to the year ending 31 December each year. Oscar Ltd has made a number of transactions denominated in foreign currency in the year to 31 December 2010. The company's functional and presentational currency is the Rwf and during the year ended 31 December the company has also conducted foreign operations through a foreign entity. On 30 September 2010, Oscar Ltd purchased goods from a supplier, based in Manchester for GBP 6 million (£ Sterling). At the year end this trade payable was still outstanding and the goods were still in the inventories held by Oscar Ltd. In addition, on the 30 September 2010, Oscar Ltd also sold goods to a customer based in Portsmouth for GBP4 million and received payment for the goods in GBP on 31 December 2010. The directors of Oscar Ltd would like advice on how to treat these transactions in the financial statements for the year ended 31 December 2010. Exchange rates for £Sterling against the Rwf are as follows:

Exchange rate at:	GBP/Rwf 1,000	*GBP/Rwf*
31-Dec-09	0.9600	*0.000960*
30-Sep-10	0.9000	*0.000900*
31-Dec-10	0.8500	*0.000850*
Average rate	GBP/Rwf 1,000	
2009	0.9200	*0.000920*
2010	0.8800	*0.000880*

REQUIRED:

Prepare notes for a meeting with the directors of Oscar Ltd which:

i. explains the difference between functional and presentational currency and
ii. advises the directors on the accounting treatment for the two transactions referred to above

(7 marks)
(Total 30 Marks)

3. The following multiple choice question contains eight sections, each of which is followed by a choice of answers. Only one of each set of answers is strictly correct.

REQUIRED:

Give your answer to each section on the answer sheet provided. **(Total: 20 marks)**

1) Ella Ltd. has a profit before tax for 2010 of Rwf180,000 after charging Rwf42,000 of depreciation. Ella Ltd's trade receivables have increased by Rwf35,000 during 2010 and its trade payables increased by Rwf25,000.

In accordance with IAS 7 Statement of Cash Flows, what is Ella Ltd's cash generated for 2010?

a) Rwf212,000
b) Rwf222,000
c) Rwf232,000
d) Rwf180,000

2) On 1 July 2007, Michael Ltd. bought a machine for Rwf160,000. The machine was depreciated at 20% per annum on a straight line basis. On 1 July 2009, the machine was revalued to Rwf105,000 with an estimated remaining life of three years. The directors of Michael Ltd. have elected to transfer the additional depreciation from revaluation surplus.

According to IAS 16 Property, Plant and Equipment, the depreciation charge for the year ended 30 June 2010 and the balance on the revaluation surplus are:

	Depreciation charge	*Revaluation surplus*
	Rwf	Rwf
a)	32,000	9,000
b)	32,000	6,000
c)	35,000	9,000
d)	35,000	6,000

3) Scruby Ltd. has a four year construction contract with a district council which commenced in 2007, with the following information:

	Year to 31 December			
	2008	2009	2010	2011
	Rwfm	Rwfm	Rwfm	Rwfm
Total contract sales value	20	22	24	25
Estimated % complete	45%	60%	75%	100%

Under IAS 11 Construction Contracts the income that can be recognised in the financial statements for the year ended 31 December 2010 is:

	Rwf m
(a)	9
(b)	13.2
(c)	4.2
(d)	4.8

4) According to IAS 1 (revised) Presentation of Financial Statements, identify which of the following must be recognised in the statement of comprehensive income (using the two statement approach):

   a) Equity dividends paid
   b) Depreciation
   c) Revaluation gains
   d) Effects of a change in accounting policy

5) CN Ltd owns 80% of the issued share capital of Noel Ltd. For the year ended 31 December 2010, Noel Ltd. reported a net profit after tax of Rwf25 million. During 2010, Noel Ltd. sold goods to CN Ltd for Rwf7.5 million at cost plus 25%. At the year end 75% of these goods are still held by CN Ltd.

The amount of profit attributable to the non-controlling interest in the Consolidated Statement of Comprehensive

Income for the year ended 31 December 2010 is:

	Rwf m
(a)	3.5
(b)	4.78
(c	5
(d)	6

6) Extracts from the Statement of Financial Position of Dingle Ltd. as at 30 June 2010 are as follows:

60,000 ordinary shares
Rwf400,000 5% preference shares
Rwf40,000 4% cumulative preference shares
Rwf100,000 5% loan stock

The profit after tax for the year was Rwf80,000.
The correct basic earnings per share is:

	Rwf
(a)	1.00
(b)	0.97
(c)	0.88
(d)	None of the above

7) An entity that is the parent of a group has the following properties:

i. A property that is leased to a non-group company.
ii. A property that is leased to a subsidiary for its operations.
iii. A property that is used by the parent as its Head Office but is located in an area where a substantial capital appreciation might be expected.
iv. Land that has been purchased by the parent but whose future use has not yet been determined.

The properties that would be classified as investment properties under IAS 40 are:

a) and (iii) only
b) (ii) (iii) and (iv) only
c) (i) (ii) (iii) and (iv)
d) (i) and (iv) only

8) Which of the following must be disclosed on the face of the statement of comprehensive income (classification by function format)?

i. Tax charge
ii. Dividends
iii. Depreciation
iv. Finance charges

a) and (iv)
b) (ii) and (iii)
c) (i) and (iv)
d) None of the above

4. IAS 17 Leases sets out the accounting treatment for leases.

Blakemore Ltd., which uses the straight line method for depreciating assets, entered into a three-year leasing contract for a new machine on 1 January 2010 with Holborn Finance Company. The lease contract includes the following information:

Fair value of leased machine	Rwf25,390,000
Present value of minimum lease payments	Rwf25,380,000
Lease rentals payable six monthly in arrears	Rwf5,000,000
Six monthly implicit rate of interest	5%

The machine has an expected useful life of four years and a residual value of nil.

Blakemore Ltd. is responsible for the insurance and maintenance of the machine.

In addition to the above lease contract, Blakemore Ltd. also entered into a contract on 1 January 2010, to lease a piece of equipment from Angle Ltd. at a cost of Rwf250k per month payable in advance and terminable by either party. The cash price of this type of office equipment is Rwf8m and its estimated useful life is four years.

REQUIRED:

Prepare a memorandum for the finance director of Blakemore Ltd. which:

a) with reference to IAS17 Leases:, explains the difference between a finance lease and an operating lease; describes the accounting treatments; and discusses briefly the merits of capitalising a finance lease in the financial statements.

(5 marks)

b) shows the effect of both leases on the Statement of Comprehensive Income and Statement of Financial Position for each of the years 31 December 2010 to 31 December 2012.

(15 marks)
(Total: 20 marks)

5. IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors, lays down criteria for selection of accounting policies and prescribes circumstances in which an entity may change an accounting policy. The standard also deals with accounting treatment of changes in accounting policies, changes in accounting estimates and correction of prior errors.

You are the financial controller of LFW Ltd. The company began trading on 1 January 2007 and are currently involved in the preparation of financial statements for the year ended 31 December 2010. You have recently attended a one day seminar on the application of International Financial Reporting Standards (organised by the Institute of Certified Public Accountants in Ireland (CPA)). On 1 January 2010, the company had 50 million Rwf1 ordinary shares in issue. On 30 June 2010, LFW Ltd. issued 10 million 10% Rwf1 irredeemable preference shares at par. There have been no other changes in share capital in the last five years. The appropriate dividend in respect of these shares was paid on 31 December 2010. A property revaluation at the year end gave a surplus of Rwf250,000.

During the year ended 31 December 2010, LFW Ltd. changed its accounting policy for depreciation in relation to the depreciation of property, plant and equipment. The depreciation charges calculated using the previous accounting policy and shown in the company's financial statements for three years ending 31 December 2009 were as follows:

	Rwfm
Year to 31 December 2007	690
Year to 31 December 2008	810
Year to 31 December 2009	870

Assuming the new accounting policy had been applied in previous years, depreciation charges would have been:

	Rwf m
Year to 31 December 2007	1,170
Year to 31 December 2008	930
Year to 31 December 2009	690

An extract from LFW Ltd's Statement of Comprehensive Income for the year to 31 December 2010 (before making any adjustments to reflect the change in accounting policy for the year 31 December 2009) shows the following:

	2010	2009
	Rwfm	Rwfm
Profit before depreciation	7,530	7,350
Depreciation of property, plant and equipment	570	870
Profit before taxation	6,960	6,480
Taxation	2,088	1,944
Profit after taxation	4,872	4,536
Other Comprehensive Income:		
Gains on property revaluation	250	-

LFW Ltd's retained earnings were reported as Rwf8,829m at 31 December 2008. No dividends have been paid in any year. The company pays tax at 30% on the profit.

REQUIRED:

a) Distinguish between accounting policies, accounting estimates and prior period errors. **(4 marks)**

b) Present the extract from the statement of comprehensive income so as to reflect the change in accounting policy, in accordance with IAS 8. **(4 marks)**

c) Compute LFW Ltd's retained earnings at 31 December 2010 and the restated retained earnings as at 31 December 2008 and 2009 **(6 marks)**

a) Prepare a statement of changes in equity for the year ended 31 December 2010. **(6 marks)**

(Total 20 Marks)

END OF PAPER

SUGGESTED SOLUTIONS

SOLUTION 1

Black Group

Consolidated statement of cash flows for the year ended 31 December 2010

	Rwfbn	Rwfbn
Cash flows from operating activities		
Cash generated from operations	2,117	
Interest paid	(210)	
Income tax paid (w1)	(350)	
Net cash from operating activities		1,557
Cash flows from investing activities		
Purchase of property plant and equipment (w2)	(929.1)	
Acquisition of subsidiary White Ltd net of cash acquired (w7)	(385)	
Dividends received from associates (w6)	60	
Proceeds from sale of property plant and equipment	55	(1,199)
Net cash used in investing activities		

Cash flows from financing activities		
Share issue	100	
Dividends paid to Non controlling interest (w8)	(398)	
Dividends paid (w5)	(200)	(498)
Net cash used in financing activities		
Net increase in cash and cash equivalents		(140)
Cash and cash equivalents at beginning of period		60
Cash and cash equivalents at end of period		(80)

Note: Reconciliation of profit before tax to cash generated from operations

Profit before tax	1,705
Finance cost	210
Depreciation charge	209
Amortisation charge (w3)	(52)
Loss on disposal of property plant and equipment	85
Share of profits from associates	(110)
Decrease in stores (685-600-180)	95
Decrease in trade and other receivables (310-260-85)	35
Decrease in trade and other payables (210-190-80)	(60)
Cash generated from operations	2,117

Goodwill NA acquired (80% * (740-100-.1))	511.92	
Paid (400+100)	500	or W7
Goodwill on acquisition	11.92	

(Total: 22 Marks)

W1

Income Tax

	Rwf bn		Rwf bn
Cash β	350	Bal b/d (260+20)	280
Bal c/d	340	Statement of Comprehensive Income	410
		Acquisition taxation	
690	690		690

W2 PPE

	Rwfbn		Rwfbn
Bal b/d	1,400	Disposals	140
Acquisition of sub (460-100)	360	Statement of Comprehensive Income: depreciation	209
Cash β	1,029	Bal c/f	2,440
2,789	2,789		2,789

W3 Intangibles

Rwfbn	Rwfbn		Rwfbn
Bal b/d	420	IS amortised	12
Acquisition - goodwill	52	Bal c/f	460
	472		472

W4 Share capital and premium

	Rwfbn		Rwfbn
		Bal b/d (400 +100)	500
Bal c/d (450+250)	700	Acquisition of White Ltd	100
		Cash	100
	700		700

W5 Retained earnings

	Rwfbn		Rwfbn
Dividends paid	200	Bal b/d	810
Bal c/d	1,595	IS	985
1,795	1,795		1,795

W6 Investments in Associates

	Rwfbn		Rwfbn
Bal b/d	330	Cash	60
IS	110	Bal c/f	380
	440		440

(21 marks)
Presentation (1 mark)

b) IFRS 3 (revised) Business Combinations deals with such acquisitions. The legal fees of Rwf100m must be expensed and are not part of the cost of the investment. The revised standard requires the acquirer to recognise the acquisition date fair value of contingent consideration as part of the consideration. Fair value being defined as 'amount for which an asset could be exchanged, or a liability settled between knowledgeable, willing parties in an arm's length transaction'. In the case of Activity Ltd the purchase consideration is Rwf40 billion plus the present value of the guaranteed minimum payment of Rwf8 billion /1.052 = Rwf47.26bn, plus the fair value of the contingent consideration of Rwf4 billion, giving a total of Rwf51.26bn. The cost of the investment is Rwf51.26bn and a provision will be created for the deferred consideration of Rwf7.26bn, the discount of Rwf0.74bn should be recorded as a finance cost and will be unwound over the two year period.

The acquirer is required to recognise separately an intangible asset of the acquired company at the acquisition date if it meets the definition of an intangible asset as set out in IAS 38 Intangible Assets. Its fair value must be capable of being measured reliably. The cost of the brand name 'Noddy' will not be recognised in the statement of financial position of Noddy Ltd but there is sufficient information to conclude that the 'brand' can be separately identifiable from goodwill and this included within the statement of financial position of Activity Group. Brand names are specifically mentioned by IAS 38. The 'brand' would appear to be separable, has been sold and the purchase price (Rwf10 billion) would be a reliable measure of cost.

(8 marks)
(Total: 30 Marks)

SOLUTION 2

a)

		Rwfm
Brandon		
Consideration		
Equity 15,000* 70% X 2/3 X Rwf5,000		35,000
7% Loan stock 10,500 * 100 / 500		2,100
Less		
Equity	15,000	
Share premium	5,000	
Retained earnings (9,000 + 4,500*4/12)	10,500	
Fair value adjustment	2,000	
	32,500 * 70%	22,750
Goodwill attributable to parent		14,350
Goodwill attributable to non-controlling interest		4,500
Full goodwill		18,85
Emma		
Equity: 10,000 * 40% = 4,000 * Rwf5,000 / 5	4,000	
Cash 4,000 * Rwf1,000		4,000
		8,000
Less		
Equity	10,000	
Share premium	2,000	
Reserve 6,000 + (2,330 x 4/12)	6,777	
	18,777 * 40%	7,511

Goodwill 489

Appropriate alternative calculation accepted.

(5 marks)

b) Tobias group consolidated statement of comprehensive income for the year ended 31 December 2010

	Rwfm
Revenue W1	60,000
Cost of sales W2	(17,633)
Gross profit	42,367
Operating expenses W3	(19,667)
Operating profit	22,700
Income from associates W4	621
Finance costs	(4,000)
Profit on ordinary activities before taxation	19,321
Taxation	(5,200)
	14,121
Profit for the period	14,121
Other Comprehensive Income	
Revaluation gain	2,000
Total Comprehensive Income	16,121

Attributable to:	
Owners of the parent	13,251
Non controlling interest W5	870
	14,121

Attributable to:	
Owners of the parent	14,651
Non controlling interest W6	1,470
	16,121

W1 Revenue	**Rwf m**
Tobias	42,000
Brandon (30,000*8/12)	20,000
	62,000
Less intra group sales	(2,000)
	60,000

W2 Cost of Sales	**Rwf m**
Tobias	10,000
Brandon 14,000*8/12	9,333
Less:	
Additional depreciation	100
Intra group purchases	(2,000)
URP on inventories	200
	17,633

W3 Operating expenses	**Rwf m**
Tobias	14,000
Brandon (8,500*8/12)	5,667
	19,667

W4 Income from Associates	**Rwf m**
Profit after taxation 2,330 * 8/12 * 40%	621

W5 Non-controlling interests	**Rwf m**
Profit	4,500
8/12	3,000
Less depreciation	(100)
	2,900
2,900*30%	870

(16 marks)

c)

W6	Consolidated retained profit		Rwf m
	Profit for the year		14,121
	Dividends paid to NCI		(480)
	Retained earnings b/f	(28,000 – 6,000)	22,000
	Retained earnings c/f		35,641

(2 marks)

d) Functional currency is the currency that the company (i.e. Oscar Ltd) will operate in that the predominate currency (determined by the economic environment in which it operates) in which it sets prices, pays wages and raises finance. An entity's presentation currency refers to the currency in which the financial statements are presented. The foreign subsidiary of Oscar PLC may present their financial statements in a different presentation currency to the Euro. IAS21 contains rules for translating the financial statements of a foreign subsidiary from its functional currency to a presentation currency.

The inventory and trade payable would initially be recorded at £6m/ 0.0009 = Rwf6.67bn. At the year end, the amount payable is still outstanding and is retranslated at Rwf1,000 = £0.85 i.e. Rwf7.06bn. An exchange loss of (Rwf7.06 - Rwf6.67)bn will be reported in the SCI. The stores inventory would be recorded at Rwf6.67bn unless there is an NRV problem.

The sale of goods would be recorded at £4m/0.00090 = Rwf4.44bn as both a sale and trade receivable. Payment is received on 31 December 2010 in GBP and the actual value of GBP received will be GBP4m/0.00085 = Rwf4.71bn. The gain on exchange of Rwf0.27bn will be reported in profit/loss via SCI.

(7 marks)
(Total: 30 Marks)

SOLUTION 3

MCQ

1. a) 180,000 + 42,000 – 35,000 + 25,000 = 212,000

2. (d)

160,000 * 20%	=	32,000	2007/08
	=	32,000	2008/09
		64,000	
160,000- 64,000	=	96,000 – 105,000 = 9,000	
105,000/3= 35,000			

Additional depreciation 35,000-32,000 = 3,000
Revaluation surplus = 9,000 – 3,000 = 6,000

3. (d)

	2008	2009	2010
20m*45%	9.0		
22m*60%		13.2	
24m * 75%			18.0
Less revenue recognised in previous years	-	(9.0)	(13.2)
	9.0	4.2	4.8
			(d)

4. (b)

5. (b)

	Rwf''000
Noel Ltd	25,000
Less PURP (7,500 x 25/125 x 0.75)	(1,125)
	23,875
NCI share (x 20%)	4,775

6. (b)

(Rwf80,000 – preference dividend Rwf20,000 – cumulative preference dividend Rwf1,600)/60,000 = Rwf0.97 cents

7. (d)

8. (a)

SOLUTION 4

Memorandum

A finance lease is defined in IAS 17 as a lease that transfers substantially all the risks and rewards of ownership of an asset to the lessee.

Such a transfer is normally assumed to have taken place when at the inception of the lease, the present value of the minimum lease payments amount to substantially all (90% or more) of the fair value of the leased asset. Present value is computed using the interest rate implicit in the lease.

An operating lease is any lease other than finance lease i.e. one that fails to meet the above conditions.

Finance lease – should be capitalised and lease obligation reduced over the period of lease. Asset should be depreciated over the shorter of lease term and useful lf of asset.

Operating lease – should be written off as an expense in each accounting period. The merits of capitalisation include:

- the provision of more useful information to users of accounts with respect to assets employed in the running of the business and the related lease obligations.

- reflects the substance of the transaction rather than the legal form i.e. if the asset is effectively "owned" by the lessee then capitalisation of it reflects this.

- makes comparability between companies using similar assets but with different policies on ownership/leasing possible. **(5 marks)**

Period	Capital Sum at Start Rwf '000	Finance Charge (5%) Rwf '000	Capital Sum during Period Rwf '000	Rental Paid Rwf '000	Capital sum end of Period Rwf '000
30/06/2010	25,380	1,269	26,649	5,000	21,649
31/12/2010	21,649	1,082	22,731	5,000	17,731
		2,351			
30/06/2011	17,731	886	18,617	5,000	13,617
31/12/2011	13,617	681	14,298	5,000	9,298
		1,567			
30/06/2012	9,298	465	9,763	5,000	4,763
31/12/2012	4,763	238	5,001	5,000	-
		703			
		4,621			

Depreciation 25,380 ÷ 3 : 8,460 (approx) per annum

SCI (Extracts)

	31/12/10	31/12/11	31/12/12
Lease interest	2,351	1,567	703
Depreciation	8,460	8,460	8,460
Operating lease rental	3,000	3,000	3,000

SFP (Extracts)

Non-current assets			
Cost	25,380	25,380	25,380
Acc Depn	8,460	16,920	25,380
Net Book Value	16,920	8,460	-
Lease obligation	17,731	9,298	4,763
Current liability	8,433	9,298	-
Non-current liability	9,298	-	-

(15 marks)
(Total: 20 marks)

SOLUTION 5

a) Accounting policies are the ‘specific principles, bases, conventions, rules and practices applied by the entity in preparing and presenting the financial statements’. For example, an entity may choose between the revaluation model and cost model for measuring property, plant and equipment. The entity’s choice is one of its accounting policies.

Accounting estimates are judgement applied when measuring items that cannot be measured with precision (e.g. estimates of useful life of non-current asset/allowance for doubtful debts).

A material prior error is a material omission or the misstatement occurring in an entity’s financial statements for a prior period. Material prior period errors should be corrected retrospectively. This generally involves restating the comparative figures for the prior period in which the error occurred.

(4 marks)

b) Statement of Comprehensive Income (Extract)

	2010	**2009**
	Rwfm	**Rwfm**
Profit before depreciation	7,530	7,350
Depreciation of property, plant and equipment	570	690
Profit before taxation	6,960	6,660
Taxation	2,088	1,998
Profit after taxation	4,872	4,662

(4 mark)

c)

	Rwf'm
Balance at 31 December 2008 as previously reported	8,829
Changes in accounting policy relating to depreciation (see below)	(420)
Retained balance at 31 December 2008	8,409
Retained profit for the year to 31 December 2009	4,662
Retained balance at 31 December 2009	13,071
Profit for the year to 31 December 2010	4,872
Balance at 31 December 2010	17,943

Note: the change in accounting policy results in additional depreciation of Rwf480,000 in 2007 and Rwf120m in 2008. The total is Rwf600m tax saved is Rwf180m. Therefore profit after tax for the two years falls by Rwf420m. **(6 marks)**

d) Statement of changes in equity for the year ended 31 December 2010

	Share capital	Revaluation reserve	Retained earnings	Total
	Rwf m	Rwf m	Rwf m	Rwf'000
Balance at 1 January 2009	50,000		8,409	58,409
Total comprehensive income for the year as restated			4,662	4,662
Balance at 31 December 2009	50,000		13,071	63,071
Changes in equity for 2010				
Issue of share capital	10,000			10,000
Revaluation of property		250		250
Dividends paid (10 x 10% x 6/12)			-500	-500
Total comprehensive income for the year			4,872	4,872
Balance at 31 December 2010	60,000	250	17,443	77,693

(6 Marks)
(Total: 20 Marks)

END OF SOLUTIONS

I1.2 FINANCIAL REPORTING

INTERMEDIATE 1

EXAMINATION FORMAT REVISION QUESTIONS & SOLUTIONS

NOTES:

You are required to answer Questions 1, 2 **and** 3. You are also required to answer **either** Question 4 **or** 5.

(If you provide answers to both Questions 4 and 5, you must draw a clearly distinguishable line through the answer not to be marked. Otherwise, only the first answer to hand for Questions 4 or 5 will be marked.)

Note: Students have optional use of the Extended Trial Balance, which if used, must be included in the answer booklet.

PRO-FORMA STATEMENT OF COMPREHENSIVE INCOME BY NATURE, STATEMENT OF COMPREHENSIVE INCOME BY FUNCTION AND STATEMENT OF FINANCIAL POSITION ARE PROVIDED.

TIME ALLOWED:
3.5 hours, plus 10 minutes to read the paper.

INSTRUCTIONS:
During the reading time you may write notes on the examination paper but you may not commence writing in your answer book. **Please read each Question carefully.**

Marks for each question are shown. The pass mark required is 50% in total over the whole paper.

Start your answer to each question on a new page.

You are reminded to pay particular attention to your communication skills and care must be taken regarding the format and literacy of the solutions. The marking system will take into account the content of your answers and the extent to which answers are supported with relevant legislation, case law or examples where appropriate.

List on the cover of each answer booklet, in the space provided, the number of each question(s) attempted.

BLANK

I1.2 FINANCIAL REPORTING

INTERMEDIATE LEVEL 1

1. The following Statements of Comprehensive Income relate to Rednut Ltd (Rednut) and its investee companies, Blutec Ltd (Blutec) and Minton Ltd (Minton).

Statements of Comprehensive Income for year ended 31 December 2011

Rednut Ltd Blutec Ltd Minton Ltd

Statements of Comprehensive Income for year ended 31 December 2011

	Rednut Ltd	Blutec Ltd	Minton Ltd
	Rwf Bn	Rwf Bn	Rwf Bn
Revenue	1,230	680	425
Cost of Sales	(465)	(240)	(189)
Gross profit	765	440	236
Operating expenses	(310)	(230)	(145)
Finance costs	(50)	(30)	(20)
Other income	9		
Investment income	36	-	-
Profit before taxation	450	180	71
Taxation	(75)	(30)	(15)
Profit for the year	375	150	56
Other comprehensive income (net of tax)	63	20	18
Total comprehensive income for the year	438	170	74

The following additional information is provided:

i) Rednut bought a 60% holding in the equity of Blutec on 1 January 2010.On that date the fair value of certain plant & equipment of Blutec was Rwf72 billion in excess of its book value. This plant & equipment had a useful economic life of 4 years from the date of acquisition. The revised values were not incorporated into the books of Blutec.

ii) Goodwill on the acquisition of Blutec was reviewed for impairment on 31 December 2011 and an impairment loss of Rwf7 billion was found to be necessary. No previous impairment losses had been recognised on goodwill. Non-controlling interests in Blutec had been measured at their proportionate share of the fair values of the identifiable net assets of Blutec at the acquisition date, and this figure had been incorporated into the goodwill calculation.

iii) During 2011, Rednut sold goods to Blutec for Rwf15 billion.These goods were sold by Rednut at a mark-up on cost of 25%. One third of the goods remained in the stores of Blutec at 31 December 2011. At 31 December 2010 there were goods to the value of Rwf2 billion in the stores of Blutec which had been supplied by Rednut during 2010 on the same terms.

iv) Blutec declared a dividend of Rwf60 billion during the year. Rednut has recognised its share of this dividend within “investment income”.

v) Since acquisition, Rednut has managed the administration of the entire group. Rednut invoiced Blutec Rwf3 billion for its share of these costs. Rednut recorded this transaction within “other income”, and Blutec within “operating expenses”.

vi) On 1 July 2011, Rednut purchased a 30% holding in Minton. Rednut exercises significant influence over Minton as a result of this acquisition.

vii) On 1 July 2011, immediately following the purchase of shares in Minton, Rednut sold some land to Minton for Rwf20 billion, recording a profit of Rwf6 billion. This profit is included within “other income” in the books of Rednut.

REQUIREMENT:

a) Prepare the Consolidated Statement of Comprehensive Income for the Rednut Group for year ended 31 December 2011, in accordance with IFRS.

(19 marks)
Presentation (1 mark)

b) Write a brief memo to the Board of Directors explaining your treatment of the transactions described at notes (iv) and (v) above.

(4 marks)

(c) Note: The following information should have no impact on your answer to (a) and (b) above.

Assume Rednut’s entire holding in Blutec was sold on 1 January 2012 for an agreed price of Rwf1,700 billion. Expenses of sale were Rwf40 billion. At the date of sale the net assets of Blutec had a carrying value of Rwf1,950 billion in its books. This excludes the fair value adjustment recognised at acquisition and described at note (i) above. Goodwill had a carrying value of Rwf133 billion. The non-controlling interest had a carrying value (based on fair value at acquisition plus share of post-acquisition results) of Rwf365 billion. Show the journal entry to record this transaction from the perspective of the group accounts.

(6 marks)
(Total: 30 MARKS)

2. The following trial balance was extracted from the books of Thirdgear Ltd on 31 December 2011.

		Rwf million	Rwf million
Revenue			460
Cost of sales		195	
Distribution costs		65	
Administration expenses		42	
Investment properties	(i)	300	
Equity investments at cost	(ii)	42	
Interim dividends		66	
Land and buildings at cost	(iii)	400	
Plant and equipment at cost	(iii)	650	
Accumulated depreciation 1 January 2011 – land & buildings	(iii)		120
Accumulated depreciation 1 January 2011 - plant and equipment	(iii)		310
Development expenditure	(iv)	80	
Suspense account	(v)	13	
Trade receivables		70	
Inventory at 31 December 2011		66	
Cash and bank		99	
Trade payables			46
Share premium account			150
Ordinary shares of Rwf100 each	(vii)		500
8% Debenture (issued on 1 February 2011)	(viii)		120
Retained earnings reserve at 1 January 2011			382
		2,088	2,088

The following notes are relevant to your answer:

i. Investment properties are accounted for under the fair value model of IAS 40 - *Investment Property*. The figure included in the trial balance above represents the fair value of these properties at 1 January 2011. The fair value of these properties at 31 December 2011 was Rwf265 million.

ii. The figure for investments represents the cost of equities purchased during the year. As permitted by IFRS 9 - *Financial Instruments: Classification and Measurement,* an election was made at the date of purchase to account for any fair value gains and losses on these equity investments through "other comprehensive income". The fair value of the equity investments at 31 December 2011 was Rwf47.5 million.

iii. Land and buildings are carried under the cost model as permitted by IAS 16 - *Property, Plant & Equipment*. The land cost included in the trial balance figure for land & buildings is Rwf100 million. The buildings were originally deemed to have had a useful economic life of 30 years, of which 12 had passed by 1 January 2011. During the year a decision was taken to change the accounting policy to apply the revaluation model from 31 December 2011. The revalued amounts at that date were certified by a qualified valuer to be Rwf65 million for the land and Rwf200 million for the buildings.

Plant & equipment is being depreciated at 25% per annum reducing balance.

All depreciation is charged to cost of sales.

iv. The development expenditure relates to amounts incurred on various projects undertaken by the company during the year. It is estimated that the composition of this figure is as follows:

Research costs: *Rwf15 million*

Development costs (relating to projects meeting the *IAS 38 - Intangible Assets* criteria for capitalisation): *Rwf37.5 million*

Development costs (relating to projects not meeting the *IAS 38 - Intangible Assets* criteria for capitalisation): *Rwf27.5 million*

v. The suspense account relates to a contingent asset recognised during the year ended 31 December 2011, as it was considered virtually certain to be recovered. However, developments during 2011 led to the conclusion that the likelihood of recovering this amount had fallen somewhat. It is now considered 65% likely to be recovered. The bookkeeper was unsure what to do about this item.

vi. Corporation tax for the year was estimated at Rwf1.3 million.

vii. The directors proposed a final ordinary dividend of Rwf1.2 per share. The proposal was approved prior to the reporting date. No account has been taken of this proposal.

viii. The debentures were issued during the year. Interest is payable annually in arrears. No interest has been provided for or paid as at 31 December 2011.

REQUIREMENT:

a) As far as the above information permits, prepare the following financial statements for Thirdgear Ltd in accordance with current international accounting standards:

(i) The Statement of Comprehensive Income for the year ended 31 December 2011; and

(ii) The Statement of Financial Position as at 31 December 2011.

Notes to the financial statements are not required. (23 marks)
Presentation (2 marks)

b) Discuss briefly the circumstances under which it may be appropriate to change accounting policy in accordance with the guidance given in IAS 8 - *Accounting Policies, Changes in Accounting Estimates and Errors*, and state with reasons whether the changes described in notes (iii) and (v) above should be considered changes in accounting policies.

(5 marks)
(Total: 30 MARKS)

1. **The following multiple choice question contains eight sections, each of which is followed by a choice of answers. Only one of each set of answers is strictly correct. Each question carries equal marks.**

REQUIREMENT:

Record your answer to each section in the answer sheet provided. **(Total: 20 MARKS)**

1) Redstone Ltd. commenced a two-year fixed price contract for Rwf4.0 billion to construct a bridge on 1 January 2011. The following figures are available on 31 December 2011:

Material cost incurred to date:	Rwf2 billion
Other contract costs incurred to date:	Rwf1 billion
Costs remaining to complete (estimated):	Rwf2 billion

The engineer's report confirms the contract is 60% complete at 31 December 2011.
How much profit or loss should Redstone Ltd. recognise in its financial statements for year ended 31 December 2011?

a) Loss of Rwf0.5 billion.
b) Loss of Rwf1 billion.
c) No profit or loss.
d) Loss of Rwf0.6 billion.

2) During 2011, Freedom Ltd constructed a new office building for its own use. Construction was carried out from 1 July to 31 December 2011. Rwf10 billion was borrowed on 1 July 2011 at 10% per annum specifically to finance the construction. Rwf5 billion of this was spent on 1 July, Rwf3 billion on 30 September, and Rwf2 billion on completion on 31 December. Unused funds were deposited at a 5% annual interest rate until needed. How should the interest income and expense be recorded under IAS 23?

a) Rwf500 million may be capitalised as part of the cost of construction.
b) Rwf500m must be capitalised as part of the cost of construction.
c) Rwf412.5m may be capitalised as part of the cost of construction.
d) Rwf412.5m must be capitalised as part of the cost of construction.

3) Under the IASB's revised conceptual framework, issued in 2010, qualitative characteristics of financial information are divided into those considered "fundamental" and "enhancing". The following is a list of some qualitative characteristics the framework identifies:

i) Relevance.
ii) Comparability.
iii) Understandability.
iv) Timeliness.
v) Faithful representation.
vi) Verifiability.

Which of the above are identified by the conceptual framework as "fundamental"?

a) (ii) and (iv).
b) All of the above.
c) (i) and (vi).
d) (i) and (v).

4) Readytags Ltd is a Rwandan company whose functional currency is the Rwf. On 31 July 2011, it sold goods to a Swiss customer for CHF 30,000. At the reporting date 31 January 2012, the amount remained receivable. The relevant exchange rates were as follows:

31 July 2011:	Rwf1 =	CHF 0.0016
31 January 2012:	Rwf1 =	CHF 0.0018

Ignoring the time value of money, the amounts which would appear in the financial statements of Readytags Ltd for year ended 31 January 2012 are:

	Revenue	Receivables
(a)	Rwf18.75m	Rwf18.75m
(b)	Rwf16.67m	Rwf16.67m
(c)	Rwf18.75m	Rwf16.67m
(d)	Rwf16.67m	Rwf18.75m

5) Tullygrow Ltd issued an 8% Rwf15 million bond on 1 March 2011 at a 10% discount to par value. Expenses of issue were Rwf200,000. The bond is due for redemption on 28 February 2021 at par. The effective annual interest rate to maturity can be assumed to be 9.8%.

How much should be charged to finance costs in the Statement of Comprehensive Income for the year ended 29 February 2012?

a. Rwf1,200,000.
b. Rwf1,470,000.
c. Rwf1,064,000.
d. Rwf1,303,400.

6) Rory Ltd. has its reporting date on 31 December each year. It has traditionally reported under old conventions. The Directors wish to present the annual report for year ended 31 December 2011 under IFRS as per the Law N°07/2009 of 27/04/2009 relating to companies.

What is Rory Ltd's "transition date" to IFRS under IFRS 1 - *First Time Adoption of IFRS*?

a. 31 December 2011.
b. 1 January 2011.
c. 31 December 2010.
d. 1 January 2010.

7) Which one of the following would not be considered a biological asset under IAS 41 - *Agriculture*?

a. Land on which a crop of wheat is growing.
b. Timber growing in a forestry plantation.
c. Cattle being fattened in a feedlot.
d. Purebred bovine calves being reared for milk production purposes.

8) On 1 April 2011, Hare Ltd purchased an 80% holding in Brush Ltd for a cash payment of Rwf100 million. On that date the net assets of Brush Ltd had a fair value of Rwf110 million. Consolidated goodwill was calculated at Rwf14 million using the full "fair value" method permitted by IFRS 3 - *Business Combinations*.

What was the fair value of the non-controlling interest at the date of acquisition?

a. Rwf10 billion.
b. Rwf14 billion.
c. Rwf22 billion.
d. Rwf24 billion.

Answer either Question 4 or Question 5

4. IFRS 9 - *Financial Instruments: Classification & Measurement* was issued in November 2009, with an expanded and amended version appearing in October 2010. IFRS 9 simplifies the previous requirements of IAS 39 -

Financial Instruments: Recognition & Measurement for recognising and measuring financial instruments. The IASB intends that IFRS 9 will ultimately replace IAS 39 in its entirety. However, it is being issued in stages in response to users' requests that accounting for financial instruments be improved quickly.

REQUIREMENT:

a) Discuss the methods of accounting for financial instruments "amortised cost" and "fair value" required by IFRS 9.

Your answer should incorporate the accounting implications of each method and describe the types of financial instrument to which each method is applied.

(8 marks)

b) Justdec Ltd controls the following financial assets at its reporting date of 31 December 2011:

i. An investment in the equity shares of another Limited companypurchased during March 2011 for Rwf3.6 billion. The fair value of this investment at 31 December 2012 was Rwf3.8 billion. An election was made at the date of purchase to recognise any fair value gains and losses through other comprehensive income.

ii. An investment in a bond issued by another Ltd on 1 January 2011. This bond cost Rwf10 billion (equal to its par value) and entitles Justdec Ltd to 8% interest per annum on the anniversary of the bond's issue. The principal is to be returned on 31 December 2015. It is the intention of Justdec Ltd to retain the bond in order to collect the contracted cash flows on the due dates.

iii. An investment in a bond (par value Rwf10 billion) issued by another company purchased in the secondary market at a discounted price of Rwf7.6 billion. The discount was due to the deteriorating financial health of the issuing company. The bond carries a 7% interest rate on its par value, and will mature in 2018. It is the intention of Justdec Ltd to sell this bond in the future as soon as its price recovers. The fair value of the bond on 31 December 2011 is Rwf7.2 billion.

REQUIREMENT:

Explain, showing relevant journal entries, how the above financial assets should be accounted for at 31 December 2011 in accordance with the requirements of IFRS 9.

(12 marks)
(Total: 20 MARKS)

OR

5. IAS 18 - *Revenue* describes the principles of recognising income from business transactions. It seeks to provide guidance regarding the implementation of the conceptual framework's definition of "income". In particular, it considers when the entity should recognise revenue from the supply of goods and the rendering of services to other entities.

REQUIREMENT:

a) Discuss the guidance provided by IAS 18 for recognising revenue from the supply of goods to a third party.

(5 marks)

b) Grunge Ltd is an electrical goods supply company. It has entered into the following transactions during the year ended 31 Dec. 2011.

i. Grunge Ltd sells home theatre systems, together with a promise to install the systems free of charge. At 31 Dec. 2011, it had 15 systems sold awaiting installation. The price paid by the customer was Rwf400,000 per unit, and the customers have taken the units home. Grunge Ltd pays an outside contractor a fee of Rwf30,000 to install each system, and it is expected that this will happen in early January 2012. It is unsure how to account for these 15 systems.

(5 marks)

ii. Grunge Ltd supplies retailers in areas not serviced by its own retail outlets. For certain goods, it supplies these retailers on a 'sale or return' basis. On 31 December 2011, Grunge had supplied the retailers with Rwf20 million worth of goods on which it earns 20% margin. The company is unsure as to how to account for these goods.

(5 marks)

iii. Grunge Ltd publishes a trade magazine for sale to interested parties. It takes 12-month subscriptions in advance. Each magazine is sold for Rwf3,000 (Rwf36,000 per 12-month subscription). On 31 December 2011, Grunge Ltd had taken payment of Rwf33,000,000 for magazines yet to be supplied and is unsure how to account for this cash.

(5 marks)

REQUIREMENT:

For each of the above transactions, identify the correct accounting treatment in accordance with IAS 18. Discuss if this treatment is consistent with the principles of the conceptual framework and provide appropriate journal entries for each transaction.

(Total: 20 MARKS)

END OF PAPER

SOLUTION 1:

Marking scheme:

a) Statement

Basic consolidation plan (100% R + 100% B)	4
Depreciation on FVA (calculation and inclusion in expenses)	1
Goodwill impairment (inclusion in expenses)	1
Intra-group revenue and purchases (exclusion)	1
Unrealised profit (calculation and elimination)	2
Intragroup dividend (exclusion)	1
Administration cost (exclusion)	1
Recognition of share of PFY and OCI of associate (time apportion, 30%)	4
Elimination of share of profit on sale of land to associate	1
Calculation and attribution of results to NCI and owners of parent	3
Presentation	1
Subtotal	**20**

b) Journal entry

Calculation of net assets including FVA	2
Other figures in journal (4 X 1 mark)	4
Subtotal	**6**

c) Memo

Each transaction explained X 2 marks each	4
Subtotal	**4**
Overall total	**30**

SUGGESTED SOLUTION

(a) Rednut Ltd: Consolidated statement of comprehensive income for year ended 31 December 2011

	(100% Rednut + 100% Blutec)	**Rwf Bn**
Revenue	(1,230 + 680 – 15(iii))	1,895.0
Cost of Sales	(465 + 240 + 18(i) -15(iii) + 0.6(iii))	(708.6)
Gross Profit		1,186.4
Operating expenses	(310 + 230 + 7(ii) – 3(v))	(544.0)
Finance costs	(50 + 30)	(80.0)
Other income	(9 – 3(v))	6.0
Investment income	(36 – 36(iv))	-
Share of profit for year of associate	(8.4(vi) – 1.8(vii))	6.6
Profit before taxation		575.0
Taxation	(75 + 30)	(105.0)
Profit for the year		470.0
Other comprehensive income (net of tax)	(63 + 20)	83.0
Share of other comprehensive income of associate	(2.7(vi))	2.7
Total comprehensive income for the year		555.7
Profit for the year attributable to:		
Owners of the parent	(balancing figure 470 – 52.8)	417.2
Non-controlling interest	(viii)	52.8
		470.0
Total comprehensive income attributable to:		
Owners of the parent	(balancing figure 555.7 – 60.8)	494.9
Non-controlling interest	(viii)	60.8
		555.7

Group structure:
Rednut Ltd – Parent
Blutec Ltd – subsidiary for entire year therefore include 100% of results
Minton – 30% associate, include for 6 months as mid-year acquisition

Working (i)
Additional depreciation from fair value adjustment 72bn / 4 years = Rwf18bn
Current year's amount only included as cost of sales expense this year.
NCI is affected as it is Blutec's asset that is being adjusted.

Working (ii)
Impairment loss on consolidated goodwill Rwf7bn included as operating expense in year of recognition.

Working (iii)
Eliminate intra-group sales and purchases (Rwf15bn) in full from group revenue and group cost of sales.
Closing unrealised profit provision required = 15bn * 25/125 * 1/3 = Rwf1bn
Opening unrealised profit provision = 2bn * 25/125 = Rwf0.4bn

Increase required = 1bn – 0.4bn = 0.6bn [Dr Cost of sales, Cr Inventory in SOFP]
NCI is not affected as the parent as the internal selling company recorded the gain.

Working (iv)
Eliminate intragroup dividend from investment income 60m * 60% = Rwf36bn

Working (v)
Eliminate intragroup income and expenses Rwf3bn from other income and operating expenses.

Working (vi)
Share of associate's profit for year (time apportioned due to mid-year acquisition) 56m * 6/12 * 30% = Rwf8.4bn
Share of associate's OCI 18bn * 6/12 * 30% = Rwf2.7bn

Working (vii)
Eliminate 30% of Rednut's gain on disposal of land to associate 6 * 30% = Rwf1.8bn (reduce share of results of associate)

Working (viii)

<u>non-controlling interest</u>	Profit Rwf bn	TCI Rwf bn
Blutec per SOCI	150.0	170.0
Less adjustment for depreciation on FVA (i)	(18.0)	(18.0)
Adjusted figures	132.0	152.0
NCI percentage	40%	40%
NCI amount	52.8	60.8

<u>(b) Journal entry for disposal</u>	Rwf bn	Rwf bn
Dr Cash (1,700 – 40)	1,660.0	
Cr net assets derecognised (1,950 + (72 – 18 – 18))		1,986.0
Cr Goodwill derecognised		133.0
Dr Non-controlling interest derecognised	365.0	
Cr Profit or loss (gain on disposal – balancing figure)	94.0	

(c) Memorandum:

To: Directors of Rednut Ltd
From: Accountant
Re: Explanation of treatment of certain transactions
Date: 1st May 2012

Both these transactions are examples of intra-group revenue or expenses.
In the case of the dividend, Blutec is transferring profits to Rednut by way of a dividend. This is reflected as a reduction in Blutec's retained earnings, and an increase to Rednut's. However the profit of Blutec is already being consolidated into group reserves, hence to recognise the dividend as group income is double counting the same profits.
In the case of the intra-group management charge, from the individual entity's perspective the expense and gain is valid. However when we consolidate we are viewing the group as a single entity. Clearly a transfer from one part of the (group) entity to another is neither a gain nor an expense to that entity. Hence we do not recognise this item as a group gain or a group expense.

SOLUTION 2:

Marking scheme:

a) Statement of comprehensive income

Transfer of figures from trial balance to appropriate headings	4
Depreciation on PPE (calculation and inclusion in expenses)	1
Finance cost (calculation and inclusion in expenses)	1
Loss on investment property (calculation and inclusion in P/L)	1
Revaluation loss on land & buildings (calculation and inclusion in P/L)	2
Development costs (w/o to P/L)	1
Contingent asset (w/o to P/L)	0.5
Tax (recognition in P/L)	0.5
Gain on investments (calculation and recognition in OCI)	1
Presentation	1
Subtotal	**13**

b) Statement of financial position

Transfer of figures from trial balance to appropriate headings	4
Depreciation & revaluation of PPE (calculation)	2
Finance cost (calculation and inclusion in liabilities)	1
Loss on investment property (calculation and inclusion in NCA)	0.5
Development costs (balance to NCA)	1
Dividends (calculation and reduction to retained earnings & liabilities)	1.5
Tax (recognition as liability)	0.5
Gain on equity investments (calculation and recognition in NCA)	0.5
Presentation	1
Subtotal	**12**

c) Memo

Discussion of when to change accounting policy	2
Each transaction explained X 1.5 marks each	3
Subtotal	5
Overall total	**30**

SUGGESTED SOLUTION

(a) Thirdgear Ltd: Statement of comprehensive income for year ended 31 December 2011

		Rwf million
Revenue		460.0
Cost of Sales	(195 + 10(iii) + 85 (iii))	(290.0)
Gross profit		170.0
Distribution costs		(65.0)
Administration expenses		(42.0)
Finance costs	(viii)	(8.8)
Loss on revaluation of investment property	(i)	(35.0)
Loss on revaluation of land & buildings	(iii)	(5.0)
Research & development	(iv)	(42.5)
Contingent asset written off	(v)	(13.0)
Profit before tax		(41.3)
Tax	(vi)	(1.3)
Profit for the year		(42.6)
Other comprehensive income:		
Gain on revaluation of investments	(ii)	5.5
Total comprehensive income for the year		(37.1)

Thirdgear Ltd Statement of financial position as at 31 December 2011

		Rwf million
Non-current assets:		
Investment property	(300 - 35(i))	265.0
Equity investments	(42 + 5.5 (ii))	47.5
Land & buildings,	(400 – 120 -10 – 5)	265.0
Plant & equipment	(650 – 310 – 85)	255.0
Development expenditure	(80 – 42.5 (iv))	37.5
		870.0
Current assets:		
Inventory of stocks etc.		66.0
Trade receivables		70.0
Cash & bank		99.0
		235.0
Total assets:		1,105.0
Equity:		
Equity share capital		500.0
Share premium		150.0
Retained earnings	(382 – 66 – 60(vii) -37.1)	218.9
868.9		868.9
Non-current liabilities:		
8% debenture		120.0

Current liabilities:		
Trade payables		46.0
Corporation tax due	(vi)	1.3
Final dividend due	(vii)	60.0
Interest accrued	(viii)	8.8
		116.1
Total equity & liabilities		1,105.0

Working (i)
All movements on investment properties held under the fair value model of IAS 40 are taken to profit or loss.

Working (ii)
Equity investments are normally accounted for at fair value (with gains and losses taken) through profit or loss. However under IFRS 9, an irrevocable election can be made at acquisition of equity investments only. Under this election gains and losses are taken to other comprehensive income, and not recycled to profit or loss on disposal.

Working (iii)
Land & buildings:
As the revaluation takes place at the very end of the year, depreciation must be charged for the year based on the old values. The revised net book value is then used to calculate revaluation gain or loss.

Land **Buildings**		
Cost	100	300
Accumulated depreciation to 1/1/2011		(120)
Depreciation for 2011 (300 * 1/30) to COS (10)		
NBV 31/12/2011 before revaluation	100	170
Revaluation gain (loss) (balancing figure)	(35)	30
Revised NBV per question note (iii)	65	200

Net loss on land & buildings is taken to profit or loss as there is no previous revaluation surplus on the same asset.

Plant & equipment:
depreciation (650 – 310) * 25% = 85
Charge to COS, reduce P&E net book value

Working (iv)
Only development costs meeting the IAS 38 criteria for capitalization are capitalised. All other development costs, and all research costs are written off to profit or loss. Here, Rwf42.5m (27.5 + 15) is taken to P/L, and Rwf37.5 to intangible assets.

Working (v)
A contingent asset needs to be virtually certain to be received in order to recognise it in the books according to IAS 37. As this is only 65% likely to be recovered, it is not virtually certain. Therefore the amount previously recognised is taken to profit or loss as an expense.

Working (vi)
Corporation tax due is charged to P/L and recognised as a liability. There is no existing balance to be updated.

Working (vii)
Final ordinary dividend of Rwf12 is declared on each share of the issued share capital of 5 million shares (5m * Rwf100 = Rwf500m), giving a total amount of Rwf60m. The declaration was made prior to the reporting date, so it is a liability at the reporting date. This is a final dividend so it is in addition to the interim dividend already paid. The amount is deducted from retained earnings and recognised as a liability.

Working (viii)
The debentures were issued on 1 February. Therefore 11 months interest should be accrued.Rwf120m * 8% * 11/12 = Rwf8.8m. This is charged to P/L and recognised as a liability.

(b) Change of accounting policy
Under IAS 8 it is appropriate to change accounting policy in two situations.
(1) If a new standard or interpretation requires a change form an existing policy, and
(2) If a different policy would produce financial statements that are more relevant than the existing policy. In other words, the proposed policy would result in financial statements that reflect the financial position and performance of the entity more fairly.
The change of policy implemented as a result of note (iii) is generally accepted to result in more relevant financial statements, provided reliable measures of fair values are available. While normally a change of accounting policy requires retrospective application, IAS 16 specifically exempts an entity from the requirement to apply retrospectively a decision to implement a policy of revaluation for the first time.
The change required as a result of note (v) is not a change of accounting policy. What happened here is that circumstances changed. This resulted in a different accounting treatment for this item becoming necessary under the existing accounting policy. This is a change of estimate, and it applied prospectively from the date of the change.

SOLUTION 3:
Marking scheme: 2.5 marks per correct answer – Total 20 marks

Suggested solution (plus tutorial notes)

1. Answer (b)

Under IAS 11 a contract loss must be recognised in full as soon as it is foreseeable. Here, Redstone anticipates a loss of Rwf1 billion on the contract as a whole, therefore it must be recognised in full immediately.

2. Answer (d)

IAS 23 requires capitalisation of interest specifically incurred for the construction of a new piece of PPE. If funds borrowed are temporarily invested pending application to the asset, then any investment income earned is deducted from the amount to be capitalised.

Interest cost incurred: Rwf10 billion * 10% * 6/12 = 500,000,000
Interest earned: Rwf5 million * 5% * 3/12 PLUS Rwf2 billion * 5% * 3/12 = 87,500,000
Net cost incurred: 500m – 87.5m = 412.5m

3. Answer (d)

4. Answer (c)

Under IAS 21 the monetary item (here, the amount receivable) is restated at the reporting date. The sales revenue is translated at the rate ruling on the transaction date.

5. Answer (d)

This is a financial liability and should be accounted for under the amortised cost method. The finance cost is based on the carrying value times the effective rate. For year 1, the initial carrying amount is Rwf15m less 10% discount, less issue costs, or Rwf13.3 million. Finance cost is therefore 9.8% of Rwf13.3 million = Rwf1,303,400.

6. Answer (d) Under IFRS 1 the transition date is the opening date of the comparative period presented.

7. Answer (a) Biological assets are those that increase in value as time passes due to natural growth. Land is not a biological asset, it merely supports the produce that grows on it.

8. Answer (d)

Rwf bn	
Cost of investment	100
+FV of NCI (bal fig)	24
-FV of net assets at acquisition	(110)
=Goodwill	14

SOLUTION 4:
Marking scheme:

a) Explanation:

Fair value method	4
Amortised cost method	4
Subtotal	**8**

b) Accounting treatment:

Discussion (3 X 2 marks)	6
Journal entry (3 X 2 marks)	6
Subtotal	**12**
Total	**20**

SUGGESTED SOLUTION
(a) Fair Value:
This means that at each reporting date, the fair value of the asset or liability is assessed. Any differences between carrying value and fair value are normally taken to profit or loss, hence the title "fair value through profit or loss".
The only exception to this is in the case of an investment in another entity's equity instruments when a clear declaration is made at the time of purchase that the entity wishes all fair value gains and losses to be recognised within other comprehensive income. This declaration must be in writing and is irrevocable. Any gains or losses so recognised through OCI may not be recycled to P/L on disposal. Any gain or loss on disposal is taken to profit or loss, and is calculated as the proceeds less carrying amount at the date of disposal.

Amortised cost:
The amortised cost method should be applied to financial assets when the cash flows to be derived from the assets consist solely of interest and principal payments, and the entity intends to hold the asset to its maturity. The amortised cost method is applied to most liabilities unless there is significant uncertainty surrounding the amount or timing of cash flows due.
The method involves allocating the finance cost or income over the life of the asset or liability on a constant percentage of the outstanding amount each period. It is similar to the actuarial method used to account for finance leases under IAS 17. Any such amounts recognised are taken to profit or loss.

(b)
(i) The investment is revalued to fair value at the reporting date. A gain of Rwf200m results. This is recognised in other comprehensive income, as the entity made an election to do so at the date of purchase.

31 Jan 2012	Dr Financial assets		Rwf200m
Cr Other comprehensive income / reserves		Rwf200m	

(fair value gain on investment in shares of another entity)

(ii) As the cash flows due to Justdec under the terms of the bond consist solely of interest and principal, the amortised cost method should be applied. Interest earned during the year ended 31 December 2011 is Rwf800m (8% of Rwf10bn). As this is not payable until the anniversary of the bond's issue (1 January 2012), an accrual must be made for this amount. The fair value of the bond at 31 December 2011 is therefore irrelevant.

31 Dec. 2011	Dr Interest receivable (current asset)		Rwf800m
Cr Profit or loss		Rwf800m	

(interest accrued to Justdec Ltd on bond investment)

(iii) In this case, the cash flows deriving from the bond are not solely interest and principal. The entity hopes to profit from improving financial health of the issuing company, and therefore increased market value. Hence, amortised cost is not appropriate. Justdec Ltd must use the fair value method to account for this bond. As it is not an investment in another entity's equity instruments, an election to take gains and losses to OCI cannot be made. Therefore the loss of Rwf400m must be recognised in profit or loss.

31 Jan 2012	Dr profit or loss		Rwf400m
Cr Financial investmetns		Rwf400m	

(reduction in fair value of bond investment)

SOLUTION 5:

Marking scheme:

a) Revenue from sale of goods:	
conditions which must be satisfied and discussion of same	5
b) Calculations 3 scenarios at 5 marks each	15
Total	**20**

SUGGESTED SOLUTION

(a) IAS 18 requires that revenue from the sale of goods shall be recognised when all the following conditions have been met:

i) the entity has transferred to the buyer the significant risks and rewards of ownership of the goods;
ii) the entity retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold;
iii) the amount of revenue can be measured reliably;
iv) it is probable that the economic benefits associated with the transaction will flow to the entity; and
v) the costs incurred or to be incurred in respect of the transaction can be measured reliably.

The practical effect of this guidance is that revenue is recognised in most cases when custody of the goods has been transferred to the new owner. From this point, the risks associated with owning goods are the responsibility of the new owner. Also, the new owner is entitled to benefit from the goods from that point.

(b) IAS 18 has come in for some criticism for being very vague and lacking in robust application guidance. It is possible for very different accounting treatments for similar transactions to be in compliance with IAS 18. Also, it is possible to identify points where IAS 18 seems to conflict with the framework's guidance. It is one of the key standards identified by the US / IASB convergence project for updating and improvement.

In particular, there is a lack of guidance surrounding transactions with multiple deliverables. For example under IAS 18, revenue from the sale of goods with a warranty attaching is recognised in full. Other standard setters have recommended deferring a portion of the revenue until the warranty has expired.

Another issue of criticism has been the treatment of deferred income. Under IAS 18 cash received in advance of revenue recognition is carried as a liability pending recognition as revenue. However this does not always meet the framework's definition of a liability. For example there may be no obligation to return the money (if a non-refundable deposit) or the obligation to provide goods / services may cost less that the amount of revenue deferred.

(c)

(i) Revenue from goods may be recognised when the entity has transferred the risks and rewards associated with the goods to the new owner. Grunge has supplied the goods are it has been paid to do, However it has not yet provided the installation service. Therefore it has not completed the contract. The revenue should be split, and the portion relating to the goods recognised, and the portion relating to the installation deferred. A reasonable split would be Rwf370 for the goods and Rwf30 for the installation service. Hence:

Dr Cash (400k * 15)	6,000,000
Cr Revenue (370k * 15)	5,550,000
Cr deferred revenue (liability) (30k * 15)	450,000

This treatment seems to comply with the framework. In particular, the revenue does result from an increase to equity, and the liability recognised does represent an obligation to transfer economic benefits, at the expected cost of Rwf30,000 per unit.

(ii) Where goods are supplied on a sale or return basis, the significant risks and rewards have not been transferred to the new owner. Therefore revenue should not be recognised on these goods. The items should be included in closing inventory by Grunge at cost price. Hence:

Dr Inventory (20,000,000 – (20% * 20,000,000))	16,000,000
Cr Cost of sales	16,000,000

This treatment also complies with the framework. Firstly, revenue is not recognised, which is appropriate as Grunge Ltd retains significant risks relating to the goods. The recognition of inventory is also consistent with the framework's definition of an asset, as a resource controlled by the entity, as a result of past events, from which future economic benefits are expected to accrue to the entity.

(iii) Revenue for the supply of goods may only be recognised when the risks and rewards of the goods have been passed on to the new owner. This has not yet happened in respect of the undelivered magazines. Hence the revenue should be deferred until the magazines are delivered..

Dr Cash	33,000,000
Cr Deferred revenue (liability)	33,000,000

This is less compliant with the framework, as the liability does not represent the expected cost of satisfying the obligation (to supply the remaining magazines). The liability recognised under IAS 18 is the fair value of the magazines to be supplied. However, the framework's guidance on measurement is still quite weak, and needs to be developed further.

END OF SOLUTIONS