

Mock Exam 2 QUESTIONS

SECTION A – ALL 15 questions are compulsory and MUST be attempted

Each question is worth 2 marks.

1 Identify, by selecting the relevant box in the table below which of the following statements are true or false regarding the duties of the IFRS Interpretations Committee?

- A. To interpret the application of International Financial Reporting Standards
- B. To work directly with national standard setters to bring about convergence with IFRS
- C. To provide guidance on financial reporting issues not specifically addressed in IFRSs
- D. To publish draft interpretations for public comment

2 Which of the following will be treated as a subsidiary of Poulgo Co as at 31 December 20X7?

- (1) The acquisition of 60% of Zakron Co's equity share capital on 1 March 20X7. Zakron Co's activities are significantly different from the rest of the Poulgo group of companies.
- (2) The offer to acquire 70% of Unto Co's equity share capital on 1 November 20X7. The negotiations were finally signed off during January 20X8.
- (3) The acquisition of 45% of Speeth Co's equity share capital on 31 December 20X7. Poulgo Co is able to appoint three of the ten members of Speeth Co's board.

- A 1 only
- B 2 and 3
- C 3 only
- D 1 and 2

3 On 1 January 20X6, Gardenbugs Co received a \$30,000 government grant relating to equipment which cost \$90,000 and had a useful life of six years. The grant was netted off against the cost of the equipment. On 1 January 20X7, when the equipment had a carrying amount of \$50,000, its use was changed so that it was no longer being used in accordance with the grant. This meant that the grant needed to be repaid in full but by 31 December 20X7, this had not yet been done.

Using the drag and drop options in the table below, state the journal entry required to reflect the correct accounting treatment of the government grant and the equipment in the financial statements of Gardenbugs Co for the year ended 31 December 20X7?

Depreciation expense	DEBIT	CREDIT
Liability		

Property, plant and equipment

\$10,000

\$15,000

\$20,000

\$30,000

4 The following two issues relate to Spiko Co's mining activities:

Issue 1: Spiko Co began operating a new mine in January 20X3 under a five-year government licence which required Spiko Co to landscape the area after mining ceased at an estimated cost of \$100,000.

Issue 2: During 20X4, Spiko Co's mining activities caused environmental pollution on an adjoining piece of government land. There is no legislation which requires Spiko Co to rectify this damage, however, Spiko Co does have a published environmental policy which includes assurances that it will do so. The estimated cost of the rectification is \$1,000,000.

In accordance with IAS 37 Provisions, Contingent Liabilities and Contingent Assets, which of the following statements is correct in respect of Spiko Co's financial statements for the year ended 31 December 20X4?

A A provision is required for the cost of both issues 1 and 2

B Both issues 1 and 2 require disclosure only

C A provision is required for the cost of issue 1 but issue 2 requires disclosure only

D Issue 1 requires disclosure only and issue 2 should be ignored

5 Parket Co acquired 60% of Suket Co on 1 January 20X7. The following extract has been taken from the individual statements of profit or loss for the year ended 31 March 20X7:

	Parket Co	Suket Co
	\$'000	\$'000
Cost of sales	710	480

Parket Co consistently made sales of \$20,000 per month to Suket Co throughout the year. At the year end, Suket Co held \$20,000 of this in inventory. Parket Co made a mark-up on cost of 25% on all sales to Suket Co.

Select the correct figure for Parket Co's consolidated cost of sales for the year ended 31 March 20X7?

A. \$954,000

B. \$950,000

C. \$774,000

D. \$766,000

6 Quilo Co has decided to change its depreciation method to better reflect the pattern of use of its equipment.

Which of the following correctly reflects what this change represents and how it should be applied?

- A It is a change of accounting policy and must be applied prospectively
- B It is a change of accounting policy and must be applied retrospectively
- C It is a change of accounting estimate and must be applied retrospectively
- D It is a change of accounting estimate and must be applied prospectively

7 Included within the financial assets of Zinet Co at 31 March 20X9 are the following two recently purchased investments in publicly traded equity shares:

Investment 1 – 10% of the issued share capital of Haruka Co. This shareholding was acquired as a long-term investment as Zinet Co wishes to participate as an active shareholder of Haruka Co.

Investment 2 – 10% of the issued share capital of Lukas Co. This shareholding was acquired for speculative purposes and Zinet Co expects to sell these shares in the near future.

Neither of these shareholdings gives Zinet Co significant influence over the investee companies.

Wherever possible, the directors of Zinet Co wish to avoid taking any fair value movements to profit or loss, so as to minimise volatility in reported earnings.

How should the fair value movements in these investments be reported in Zinet Co's financial statements for the year ended 31 March 20X9?

- A In profit or loss for both investments
- B In other comprehensive income for both investments
- C In profit or loss for investment 1 and in other comprehensive income for investment 2
- D In other comprehensive income for investment 1 and in profit or loss for investment 2

8 Shiba Co entered into a non-cancellable four-month lease to hire an office on 1 December 20X7. The terms of the lease agreement were as follows:

Lease rental	\$5,000 per month
Cash back incentive received at the start of the lease	\$1,000
Useful life of the property	Eight years

What is the charge in the statement of profit or loss of Shiba Co for the year ended 31 December 20X7 in respect of this lease, assuming IFRS 16 Leases recognition exemptions are applied?

- A \$2,375

- B \$4,000
- C \$4,750
- D \$5,250

9 Trasten Co operates in an emerging market with a fast-growing economy where prices increase frequently.

Which TWO of the following statements are true when using historical cost accounting compared to current value accounting in this type of market?

- A. Capital employed which is calculated using historical costs is understated compared to current value capital employed
- B. Historical cost profits are overstated in comparison to current value profits
- C. Capital employed which is calculated using historical costs is overstated compared to current value capital employed
- D. Historical cost profits are understated in comparison to current value profits

10 Patula Co acquired 80% of Sanka Co on 1 October 20X5. At this date, some of Sanka Co's inventory had a carrying amount of \$600,000 but a fair value of \$800,000. By 31 December 20X5, 70% of this inventory had been sold by Sanka Co.

The individual statements of financial position at 31 December 20X5 for both companies show the following:

	Patula Co \$'000	Sanka Co \$'000
Inventories	3,250	1,940

What will be the total inventories figure in the consolidated statement of financial position of Patula Co as at 31 December 20X5?

\$_____?

11 Top Trades Co has been trading for a number of years and is currently going through a period of expansion.

An extract from the statement of cash flows for the year ended 31 December 20X7 for Top Trades Co is presented as follows:

	\$'000
Net cash from operating activities	995
Net cash used in investing activities	(540)
Net cash used in financing activities	(200)
Net increase in cash and cash equivalents	255
Cash and cash equivalents at the beginning of the period	200
Cash and cash equivalents at the end of the period	455

Which of the following statements is correct according to the extract of Top Trades Co's statement of cash flows?

A The company has good working capital management

B Net cash generated from financing activities has been used to fund the additions to non-current assets

C Net cash generated from operating activities has been used to fund the additions to non-current assets

D Existing non-current assets have been sold to cover the cost of the additions to non-current assets

12 Rooney Co acquired 70% of the equity share capital of Marek Co, its only subsidiary, on 1 January 20X6.

The fair value of the non-controlling interest in Marek Co at acquisition was \$1.1m. At that date the fair values of Marek Co's net assets were equal to their carrying amounts, except for a building which had a fair value of \$1.5m above its carrying amount and 30 years remaining useful life.

During the year to 31 December 20X6, Marek Co sold goods to Rooney Co, giving rise to an unrealised profit in inventory of \$550,000 at the year end. Marek Co's profit after tax for the year ended 31 December 20X6 was \$3.2m.

State the amount to be presented as the non-controlling interest in the consolidated statement of financial position of Rooney Co as at 31 December 20X6?

A. \$1,895,000

B. \$1,495,000

C. \$1,910,000

D. \$1,880,000

13 When a gain on a bargain purchase (negative goodwill) arises, IFRS 3 Business Combinations requires an entity to first of all review the measurement of the assets, liabilities and consideration transferred in respect of the combination.

When a bargain purchase is confirmed, how is it then recognised?

A It is credited directly to retained earnings

B It is credited to profit or loss

C It is debited to profit or loss

D It is deducted from positive goodwill

14 On 1 October 20X5, Anita Co purchased 75,000 of Binita Co's 100,000 equity shares when Binita Co's retained earnings amounted to \$90,000.

On 30 September 20X7, extracts from the statements of financial position of the two companies were: Anita Co Binita Co

	\$'000	\$'000
Equity shares of \$1 each	125	100
Retained earnings	300	150
Total	425	250

What is the total equity which should appear in Anita Co's consolidated statement of financial position as at 30 September 20X7?

\$____?

15 On 1 October 20X1, Bash Co borrowed \$6m for a term of one year, exclusively to finance the construction of a new piece of production equipment. The interest rate on the loan is 6% and is payable on maturity of the loan. The construction commenced on 1 November 20X1 but no construction took place between 1 December 20X1 and 31 January 20X2 due to employees taking industrial action. The asset was available for use on 30 September 20X2 having a construction cost of \$6m.

Select the correct figure for the carrying amount of the production equipment in Bash Co's statement of financial position as at 30 September 20X2?

- A. \$5,016,000
- B. \$6,270,000
- C. \$6,330,000
- D. \$6,360,000

(30 marks)

Section B – ALL 15 questions are compulsory and MUST be attempted

Each question is worth 2 marks.

The following scenario relates to questions 16–20.

Aphrodite Co has a year end of 31 December and operates a factory which makes computer chips for mobile phones. It purchased a machine on 1 July 20X3 for \$80,000 which had a useful life of ten years and is depreciated on the straight line basis, time apportioned in the years of acquisition and disposal. The machine was revalued to \$81,000 on 1 July 20X4. There was no change to its useful life at that date.

A fire at the factory on 1 October 20X6 damaged the machine leaving it with a lower operating capacity. The accountant considers that Aphrodite Co will need to recognise an impairment loss in relation to this damage. The accountant has ascertained the following information at 1 October 20X6:

- (1) The carrying amount of the machine is \$60,750.
- (2) An equivalent new machine would cost \$90,000.
- (3) The machine could be sold in its current condition for a gross amount of \$45,000. Dismantling costs would amount to \$2,000.
- (4) In its current condition, the machine could operate for three more years which gives it a value in use figure of \$38,685.

16 In accordance with IAS 16 Property, Plant and Equipment, what is the depreciation charged to Aphrodite Co's profit or loss in respect of the machine for the year ended 31 December 20X4?

- A \$9,000
- B \$8,000
- C \$8,263
- D \$8,500

17 IAS 36 Impairment of Assets contains a number of examples of internal and external events which may indicate the impairment of an asset.

In accordance with IAS 36, which of the following would definitely NOT be an indicator of the potential impairment of an asset (or group of assets)?

- A An unexpected fall in the market value of one or more assets
- B Adverse changes in the economic performance of one or more assets
- C A significant change in the technological environment in which an asset is employed making its software effectively obsolete
- D The carrying amount of an entity's net assets being below the entity's market capitalisation

18 Select the total impairment loss associated with Aphrodite Co's machine at 1 October 20X6?

- A. \$nil
- B. \$17,750
- C. \$22,065
- D. \$15,750

19 The accountant has decided that it is too difficult to reliably attribute cash flows to this one machine and that it would be more accurate to calculate the impairment on the basis of the factory as a cash generating unit.

In accordance with IAS 36, which of the following is TRUE regarding cash generating units?

- A A cash generating unit to which goodwill has been allocated should be tested for impairment every five years
- B A cash generating unit must be a subsidiary of the parent
- C There is no need to consistently identify cash generating units based on the same types of asset from period to period
- D A cash generating unit is the smallest identifiable group of assets for which independent cash flows can be identified

20 On 1 July 20X7, it is discovered that the damage to the machine is worse than originally thought. The machine is now considered to be worthless and the recoverable amount of the factory as a cash generating unit is estimated to be \$950,000.

At 1 July 20X7, the cash generating unit comprises the following assets:

	\$'000
Building	500
Plant and equipment (including the damaged machine at a carrying amount of \$35,000)	335
Goodwill	85
Net current assets (at recoverable amount)	250
	1,170

In accordance with IAS 36, what will be the carrying amount of Aphrodite Co's plant and equipment when the impairment loss has been allocated to the cash generating unit?

- A \$262,500
- B \$300,000
- C \$237,288
- D \$280,838

The following scenario relates to questions 21–25.

On 1 January 20X5, Blocks Co entered into new lease agreements as follows:

Agreement one

This relates to the lease of a new piece of machinery. Under the terms of the agreement, Blocks Co must pay a deposit of \$20,000 on inception of the lease on 1 January 20X5 followed by five equal annual instalments of \$55,000, starting on 31 December 20X5. The present value of the future lease payments on 1 January 20X5 is \$200,000. . The implicit rate of interest is 11.65%.

Agreement two

This nine-month lease relates to a van. The fair value of the van is \$120,000 and it has an estimated useful life of five years. The agreement requires Blocks Co to make no payment in month one and \$4,800 per month in months 2–9. Blocks Co wishes to take advantage of any recognition exemptions available under IFRS 16.

Agreement three

This sale and leaseback relates to a cutting machine purchased by Blocks Co on 1 January 20X4 for \$300,000. The carrying amount of the machine as at 31 December 20X4 was \$250,000. On 1 January 20X5, it was sold to Cogs Co for \$370,000 (being its fair value) and Blocks Co will lease the machine back for five years, the remainder of its useful life, at \$80,000 per annum. The present value of the annual payments is \$350,000 and the transaction satisfies the IFRS 15 criteria to be recognised as a sale.

21 According to IFRS 16 Leases, which of the following is characteristic of a lease?

- A Ownership of the asset is passed to the lessee by the end of the lease term
- B The lessor is responsible for the general maintenance and repair of the asset
- C The lessee obtains control over the use of the asset
- D The lease term is for a major part of the useful life of the asset

22 For agreement one, what is the finance cost charged to profit or loss for the year ended 31 December 20X6?

- A \$23,300
- B \$12,451
- C \$19,607
- D \$16,891

23 The following calculations have been prepared for agreement one:

Year	Interest	Annual payment	Balance
	\$	\$	\$
31 December 20X7	15,484	(55,000)	93,391
31 December 20X8	10,880	(55,000)	49,271
31 December 20X9	5,729	(55,000)	0

How will the lease obligation be shown in the statement of financial position as at 31 December 20X7?

- A \$44,120 as a non-current liability and \$49,271 as a current liability
- B \$49,271 as a non-current liability and \$44,120 as a current liability
- C \$93,391 as a non-current liability
- D \$93,391 as a current liability

24 For agreement two, what would be charged to profit or loss for the quarter ended 31 March 20X5?

\$__?

25 For agreement three, what profit should be recognised for the year ended 31 December 20X5 as a result of the sale and leaseback?

- A. \$6,486
- B. \$120,000
- C. \$113,514
- D. \$107,028

The following scenario relates to questions 26–30.

Mighty IT Co provides hardware, software and IT services to small business customers.

Mighty IT Co has developed an accounting software package. The company offers a supply and installation service for \$1,000 and a separate two-year technical support service for \$500. Alternatively, it also offers a combined goods and services contract which includes both of these elements for \$1,200. Payment for the combined contract is due one month after the date of installation.

In December 20X5, Mighty IT Co revalued its corporate headquarters. Prior to the revaluation, the carrying amount of the building was \$2m and it was revalued to \$2.5m.

Mighty IT Co also revalued a sales office on the same date. The office had been purchased for \$500,000 earlier in the year, but subsequent discovery of defects reduced its value to \$400,000. No depreciation had been charged on the sales office and any impairment loss is allowable for tax purposes.

Mighty IT Co's income tax rate is 30%.

26 In accordance with IFRS 15 Revenue from Contracts with Customers, when should Mighty IT Co recognise revenue from the combined goods and services contract?

A Supply and install: on installation
Technical support: over two years

B Supply and install: when payment is made
Technical support: over two years

C Supply and install: on installation
Technical support: on installation

D Supply and install: when payment is made
Technical support: when payment is made

27 For each combined contract sold, what is the amount of revenue which Mighty IT Co should recognise in respect of the supply and installation service in accordance with IFRS 15?

\$_____?

28 Mighty IT Co sells a combined contract on 1 January 20X6, the first day of its financial year. Mighty IT Co financial statements are prepared in accordance with IFRS 15,

Select what is the total amount for deferred income which will be reported in Mighty IT Co's statement of financial position as at 31 December 20X6?

A. \$400

- B. \$250
- C. \$313
- D. \$200

29 In accordance with IAS 12 Income Taxes, what is the impact of the property revaluations on the income tax expense of Mighty IT Co for the year ended 31 December 20X5?

- A Income tax expense increases by \$180,000
- B Income tax expense increases by \$120,000
- C Income tax expense decreases by \$30,000
- D No impact on income tax expense

30 In January 20X6, the accountant at Mighty IT Co produced the company's draft financial statements for the year ended 31 December 20X5. He then realised that he had omitted to consider deferred tax on development costs. In 20X5, development costs of \$200,000 had been incurred and capitalised.

Development costs are deductible in full for tax purposes in the year they are incurred. The development is still in process at 31 December 20X5.

What adjustment is required to the income tax expense in Mighty IT Co's statement of profit or loss for the year ended 31 December 20X5 to account for deferred tax on the development costs?

- A Increase of \$200,000
- B Increase of \$60,000
- C Decrease of \$60,000
- D Decrease of \$200,000

(30 marks)

Section C – BOTH questions are compulsory and MUST be attempted

31 After preparing a draft statement of profit or loss (before interest and tax) for the year ended 31 March 20X6 (before any adjustments which may be required by notes (i) to (iv) below), the summarised trial balance of Triage Co as at 31 March 20X6 is:

	\$'000	\$'000
Equity shares of \$1 each		50,000
Retained earnings as at 1 April 20X5		3,500
Draft profit before interest and tax for year ended 31 March 20X6		30,000
6% convertible loan notes (note (i))		40,000
Leased property (original life 25 years) – at cost (note (ii))	75,000	
Plant and equipment – at cost (note (ii))	72,100	
Accumulated amortisation/depreciation at 1 April 20X5: leased property		15,000
plant and equipment		28,100
Trade receivables (note (iii))	28,000	
Other current assets	9,300	
Current liabilities		17,700
Deferred tax (note (iv))		3,200
Interest payment (note (i))	2,400	
Current tax (note (iv))	700	0
	187,500	187,500

The following notes are relevant:

(i) Triage Co issued 400,000 \$100 6% convertible loan notes on 1 April 20X5. Interest is payable annually in arrears on 31 March each year. The loans can be converted to equity shares on the basis of 20 shares for each \$100 loan note on 31 March 20X8 or redeemed at par for cash on the same date. An equivalent loan without the conversion rights would have required an interest rate of 8%.

The present value of \$1 receivable at the end of each year, based on discount rates of 6% and 8%, are:

		6%	8%
End of year:	1	0.94	0.93
	2	0.89	0.86
	3	0.84	0.79

(ii) Non-current assets:

The directors decided to revalue the leased property at \$66.3m on 1 October 20X5. Triage Co does not make an annual transfer from the revaluation surplus to retained earnings to reflect the realisation of the revaluation gain; however, the revaluation will give rise to a deferred tax liability at the company's tax rate of 20%.

The leased property is depreciated on a straight line basis and plant and equipment at 15% per annum using the reducing balance method.

No depreciation has yet been charged on any non-current assets for the year ended 31 March 20X6.

(iii) In September 20X5, the directors of Triage Co discovered a fraud. In total, \$700,000 which had been included as receivables in the above trial balance had been stolen by an employee. \$450,000 of this related to the year ended 31 March 20X5, the rest to the current year. The directors are hopeful that 50% of the losses can be recovered from the company's insurers.

(iv) A provision of \$2.7m is required for current income tax on the profit of the year to 31 March 20X6.

The balance on current tax in the trial balance is the under/over provision of tax for the previous year.

In addition to the temporary differences relating to the information in note (ii), at 31 March 20X6, the carrying amounts of Triage Co's net assets are \$12m more than their tax base.

Required

(a) Prepare a schedule of adjustments required to the draft profit before interest and tax (in the above trial balance) to give the profit or loss of Triage Co for the year ended 31 March 20X6 as a result of the information in notes (i) to (iv) above.

(b) Prepare the statement of financial position of Triage Co as at 31 March 20X6.

(c) The issue of convertible loan notes can potentially dilute the basic earnings per share (EPS).

Calculate the diluted earnings per share for Triage Co for the year ended 31 March 20X6 (there is no need to calculate the basic EPS).

Note. A statement of changes in equity and the notes to the statement of financial position are not required.

The following mark allocation is provided as guidance for this question:

- (a) 5 marks
- (b) 12 marks
- (c) 3 marks

(20 marks)

32 Gregory Co is a listed company and, until 1 October 20X5, it had no subsidiaries. On that date, it acquired 75% of Tamsin Co's equity shares by means of a share exchange of two new shares in Gregory Co for every five acquired shares in Tamsin Co. These shares were recorded at the market price on the day of the acquisition and were the only shares issued by Gregory Co during the year ended 31 March 20X6.

The summarised financial statements of Gregory Co as a single entity at 31 March 20X5 and as a group at 31 March 20X6 are:

	Gregory group	Gregory Co single entity
STATEMENTS OF PROFIT OR LOSS FOR THE YEAR ENDED		
	31 March 20X6 \$'000	31 March 20X5 \$'000
Revenue	46,500	28,000
Cost of sales	(37,200)	(20,800)
Gross profit	9,300	7,200
Operating expenses	(1,800)	(1,200)
Profit before tax (operating profit)	7,500	6,000
Income tax expense	(1,500)	(1,000)
Profit for the year	6,000	5,000
Profit for year attributable to:		
Equity holders of the parent	5,700	
Non-controlling interest	300	
	6,000	

STATEMENTS OF FINANCIAL POSITION AS AT 31 March 20X6 31 March 20X5

	\$'000	\$'000
Assets		
Non-current assets		
Property, plant and equipment	54,600	41,500
Goodwill	3,000	nil
	57,600	41,500
Current assets	44,000	36,000
Total assets	101,600	77,500
Equity and liabilities		
Equity		
Equity shares of \$1 each	46,000	40,000
Other component of equity (share premium)	6,000	nil
Retained earnings	18,700	13,000
Equity attributable to owners of the parent	70,700	53,000
Non-controlling interest	3,600	nil

	74,300	53,000
Current liabilities	27,300	24,500
Total equity and liabilities	101,600	77,500

Other information:

(i) Each month since the acquisition, Gregory Co's sales to Tamsin Co were consistently \$2m. Gregory Co had chosen to only make a gross profit margin of 10% on these sales as Tamsin Co is part of the group.

(ii) The values of property, plant and equipment held by both companies have been rising for several years.

(iii) On reviewing the above financial statements, Gregory Co's chief executive officer (CEO) made the following observations:

(1) I see the profit for the year has increased by \$1m which is up 20% on last year, but I thought it would be more as Tamsin Co was supposed to be a very profitable company.

(2) I have calculated the earnings per share (EPS) for 20X6 at 13 cents ($6,000/46,000 \times 100$) and for 20X5 at 12.5 cents ($5,000/40,000 \times 100$) and, although the profit has increased 20%, our EPS has barely changed.

(3) I am worried that the low price at which we are selling goods to Tamsin Co is undermining our group's overall profitability.

(4) I note that our share price is now \$2.30, how does this compare with our share price immediately before we bought Tamsin Co?

Required

(a) Reply to the four observations of the CEO.
(8 marks)

(b) Using the above financial statements, calculate the following ratios for Gregory Co for the years ended 31 March 20X6 and 20X5 and comment on the comparative performance:

- (i) Return on capital employed (ROCE)
- (ii) Net asset turnover
- (iii) Gross profit margin
- (iv) Operating profit margin

Note. Four marks are available for the ratio calculations.
(12 marks)

Note. Your answers to (a) and (b) should reflect the impact of the consolidation of Tamsin Co during the year ended 31 March 20X6.

(20 marks)

