Mock Exam 1 QUESTIONS

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

Each question is worth 2 marks.

1 Which of the following should be capitalised in the initial carrying amount of an item of plant?

(1) Cost of transporting the plant to the factory
(2) Cost of installing a new power supply required to operate the plant
(3) Cost of a three-year plant maintenance agreement
(4) Cost of a three-week training course for staff to operate the plant

A (1) and (3)
B (1) and (2)
C (2) and (4)
D (3) and (4)

2 When a parent is evaluating the assets of a potential subsidiary, certain intangible assets can be recognised separately from goodwill, even though they have not been recognised in the subsidiary's own statement of financial position.

Which of the following is an example of an intangible asset of the subsidiary which may be recognised separately from goodwill when preparing consolidated financial statements?

A A new research project which the subsidiary has correctly expensed to profit or loss but the directors of the parent have reliably assessed to have a substantial fair value

B A global advertising campaign which was concluded in the previous financial year and from which benefits are expected to flow in the future

C A contingent asset of the subsidiary from which the parent believes a flow of future economic benefits is possible

D A customer list which the directors are unable to value reliably

3 On 1 October 20X4, Flash Co acquired an item of plant under a five-year lease agreement. Under the terms of the agreement, an immediate deposit of $2m is payable on inception of the lease and the present value of future lease payments at that date have been calculated as $25,272,000. Annual rentals of $6 are payable on 30 September each year for five years. The agreement had an implicit rate of interest of 5% per annum.

What is the current liability for the leased plant in Flash Co's statement of financial position as at 30 September 20X5?

$_____?

4 Financial statements represent transactions in words and numbers. To be useful, financial information must represent faithfully these transactions in terms of how they are reported. Identify, by selecting the relevant box in the table below, whether the statement regarding faithful representation is true or false?

Charging the rental payments for an item of plant to the statement of profit or loss where the rental agreement meets the criteria for a lease and no recognition exemptions are available

Including a convertible loan note in equity on the basis that the holders are likely to choose the equity option on conversion

Treating redeemable preference shares as part of equity in the statement of financial position

Derecognising factored trade receivables sold without recourse to the seller

5 On 1 October 20X4, Kalatra Co commenced drilling for oil from an undersea oilfield. Kalatra Co is required to dismantle the drilling equipment at the end of its five-year licence. This has an estimated cost of $30m on 30 September 20X9. Kalatra Co's cost of capital is 8% per annum and $1 in five years' time has a present value of 68 cents.

Identify the provision which Kalatra Co would report in its statement of financial position as at 30 September 20X5 in respect of its oil operations?

A. $32,400,000
B. $22,032,000
C. $20,400,000
D. $1,632,000

6 When a single entity makes purchases or sales in a foreign currency, it will be necessary to translate the transactions into its functional currency before the transactions can be included in its financial records.

In accordance with IAS 21 The Effect of Changes in Foreign Currency Exchange Rates, which of the following foreign currency exchange rates may be used to translate the foreign currency purchases and sales?

(1) The rate which existed on the day that the purchase or sale took place
(2) The rate which existed at the beginning of the accounting period
(3) An average rate for the year, provided there have been no significant fluctuations throughout the year
(4) The rate which existed at the end of the accounting period

A (2) and (4)
B (1) only
C (3) only
D (1) and (3)

7 On 1 October 20X4, Hoy Co had $2.5 million of equity share capital (shares of 50 cents each) in issue.

No new shares were issued during the year ended 30 September 20X5, but on that date there were outstanding share options which had a dilutive effect equivalent to issuing 1.2 million shares for no consideration.

Hoy's profit after tax for the year ended 30 September 20X5 was $1,550,000.

In accordance with IAS 33 Earnings per Share, what is Hoy's diluted earnings per share for the year ended 30 September 20X5?

A $0.25
B $0.41
C $0.31
D $0.42

8 Fork Co owns an 80% investment in Spoon Co which it purchased several years ago.

The goodwill on acquisition was valued at $1,674,000 and there has been no impairment of that goodwill since the date of acquisition.

On 30 September 20X4, Fork Co disposed of its entire investment in Spoon Co, details of which are as follows:

	$'000
Sales proceeds of Fork Co's entire investment in Spoon Co	5,580
Cost of Fork Co's entire investment in Spoon Co	3,720

Immediately before the disposal, the consolidated financial statements of Fork Co included the following amounts in respect of Spoon Co:

	$'000
Carrying amount of the net assets (excluding goodwill)	4,464
Carrying amount of the non-controlling interests	900

What is the profit/loss on disposal (before tax) which will be recorded in Fork Co's CONSOLIDATED statement of profit or loss for the year ended 30 September 20X4?

A $1,860,000 profit
B $2,016,000 profit
C $342,000 profit
D $558,000 loss

9 Consolidated financial statements are presented on the basis that the companies within the group are treated as if they are a single economic entity.

Which TWO of the following are requirements of preparing consolidated financial statements?

A. All subsidiaries must adopt the accounting policies of the parent in their individual financial statements

B. Subsidiaries with activities which are substantially different to the activities of other members of the group should not be consolidated

C. All entity financial statements within a group should normally be prepared to the same accounting year end prior to consolidation

D. Unrealised profits within the group must be eliminated from the consolidated financial statements

10 Dashing Group sells goods to its 80% owned subsidiary, Dancer Co, during the financial year, some of which remains in inventory at the year end.

Using the drag and drop options below, select the correct adjustment required in the consolidated statement of financial position to eliminate any unrealised profit in inventory?

A. Debit - Group retained earnings & Credit - Inventory
B. Credit - Group retained earnings & Debit - Inventory
C. Debit - Group retained earnings & Inventory
D. Credit - Group retained earnings & Inventory

11 Caddy Co acquired 240,000 of Ambel Co's 800,000 equity shares for $6 per share on 1 October 20X4.

Ambel Co's profit for the year ended 30 September 20X5 was $400,000 and it paid an equity dividend on 20 September 20X5 of $150,000.

On the assumption that Ambel Co is an associate of Caddy Co, what would be the carrying amount of the investment in Ambel Co in the consolidated statement of financial position of Caddy Co as at 30 September 20X5?

A $1,560,000
B $1,395,000
C $1,515,000
D $1,690,000

12 Quartile Co is in the jewellery retail business which can be assumed to be highly seasonal. For the year ended 30 September 20X5, Quartile Co assessed its operating performance by comparing selected accounting ratios with those of its business sector average as provided by an agency. Assume that the business sector used by the agency is a meaningful representation of Quartile Co's business.

Which TWO of the following circumstances may invalidate the comparison of Quartile Co's ratios with those of the sector average?

A. In the current year, Quartile Co has experienced significant rising costs for its purchases

B. The sector average figures are compiled from companies whose year ends are between 1 July 20X5 and 30 September 20X5

C. Quartile Co does not revalue its properties, but is aware that other entities in this sector do

D. During the year, Quartile Co discovered an error relating to the inventory count at 30 September 20X4. This error was correctly accounted for in the financial statements for the current year ended 30 September 20X5

13 Which of the following criticisms does NOT apply to historical cost financial statements during a period of rising prices?

A They are difficult to verify because transactions could have happened many years ago
B They contain mixed values; some items are at current values and some are at out of date values
C They understate assets and overstate profit
D They overstate gearing in the statement of financial position

14 The following information has been taken or calculated from Fowler's financial statements for the year ended 30 September 20X5:

Cash cycle at 30 September 20X5	70 days
Inventory turnover	six times
Year-end trade payables at 30 September 20X5	$230,000

Credit purchases for the year ended 30 September 20X5	$2 million
Cost of sales for the year ended 30 September 20X5	$1.8 million

What is Fowler's trade receivables collection period as at 30 September 20X5?
A 106 days
B 89 days
C 56 days
D 51 days

15 On 1 October 20X4, Pyramid Co acquired 80% of Square Co's 9 million equity shares. At the date of acquisition, Square Co had an item of plant which had a fair value of $3m in excess of its carrying amount.

At the date of acquisition it had a useful life of five years. Pyramid Co's policy is to value non-controlling interests at fair value at the date of acquisition. For this purpose, Square Co's shares had a value of $3.50 each at that date. In the year ended 30 September 20X5, Square Co reported a profit of $8m.

At what amount should the non-controlling interests in Square Co be valued in the consolidated statement of financial position of the Pyramid group as at 30 September 20X5?

A $26,680,000
B $7,900,000
C $7,780,000
D $12,220,000

(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.

Telepath Co has a year end of 30 September and owns an item of plant which it uses to produce and package pharmaceuticals. The plant cost $750,000 on 1 October 20X0, and at that date, had an estimated useful life of five years. A review of the plant on 1 April 20X3 concluded that the plant would last for a further three and a half years and that its fair value was $560,000.

Telepath Co adopts the policy of revaluing its non-current assets to their fair value but does not make an annual transfer from the revaluation surplus to retained earnings to represent the additional depreciation charged due to the revaluation.

On 30 September 20X3, Telepath Co was informed by a major customer that it would no longer be placing orders with Telepath Co. As a result, Telepath revised its estimates that net cash inflows earned from the plant for the next three years would be:

Year ended 30 September:	$
20X4	220,000
20X5	180,000
20X6	200,000

Telepath Co's cost of capital is 10% which results in the following discount factors:
Value of $1 at 30 September:

20X4	0.91
20X5	0.83
20X6	0.75

Telepath Co also owns Rilda Co, a 100% subsidiary, which is treated as a cash-generating unit. On 30 September 20X3, there was an impairment to Rilda's assets of $3,500,000.

The carrying amount of the assets of Rilda Co immediately before the impairment were:

	$
Goodwill	2,000,000
Factory building	4,000,000
Plant	3,500,000
Receivables and cash (at recoverable amount)	2,500,000
	12,000,000

16 In accordance with IAS 36 Impairment of Assets, which of the following explains the impairment of an asset and how to calculate its recoverable amount?

A An asset is impaired when the carrying amount exceeds its recoverable amount and the recoverable amount is the higher of its fair value less costs of disposal and its value in use

B An asset is impaired when the recoverable amount exceeds its carrying amount and the recoverable amount is the lower of its fair value less costs of disposal and its value in use

C An asset is impaired when the recoverable amount exceeds its carrying amount and the recoverable amount is the higher of its fair value less costs of disposal and its value in use

D An asset is impaired when the carrying amount exceeds its recoverable amount and the recoverable amount is the lower of its fair value less costs of disposal and its value in use

17 Prior to considering any impairment, what is the carrying amount of Telepath Co's plant and the balance on the revaluation surplus at 30 September 20X3?

	Plant carrying amount	Revaluation surplus
	$000	$000
A	480	nil
B	300	185
C	480	185
D	300	nil

18 What is the value in use of Telepath Co's plant as at 30 September 20X3?

A $600,000
B $450,000
C $499,600
D $nil

19 Which of the following are TRUE in accordance with IAS 36 Impairment of Assets?

(1) A cash-generating unit is the smallest identifiable group of assets for which individual cash flows can be identified and measured

(2) When considering the impairment of a cash-generating unit, the calculation of the carrying amount and the recoverable amount does not need to be based on exactly the same group of net assets

(3) When it is not possible to calculate the recoverable amount of a single asset, then that of its cash-generating unit should be measured instead

A (1) only
B (2) and (3)
C (3) only
D (1) and (3)

20 What is the carrying amount of Rilda Co's plant at 30 September 20X3 after the impairment loss has been correctly allocated to its assets?

A. $2,479,000
B. $2,800,000
C. $2,211,000
D. $3,500,000

The following scenario relates to questions 21–25.

At a board meeting in June 20X3, Neutron Co's directors made the decision to close down one of its factories by 30 September 20X3 and market both the building and the plant for sale. The decision had been made public, was communicated to all affected parties and was fully implemented by 30 September 20X3.

The directors of Neutron Co have provided the following information relating to the closure: Of the factory's 250 employees, 50 will be retrained and deployed to other subsidiaries within the Neutron group during the year ended 30 September 20X4 at a cost of $125,000.

The remainder accepted redundancy at an average cost of $5,000 each.

The factory's plant had a carrying amount of $2.2 million, but is only expected to sell for $500,000, incurring $50,000 of selling costs. The factory itself is expected to sell for a profit of $1.2 million.

The company also rented a number of machines in the factory under short-term leases which have an average of three months to run after 30 September 20X3. The present value of these future lease payments at 30 September 20X3 was $1 million, however, the lessor has stated that they will accept $850,000 if paid on 30 October 20X3 as a full settlement.

Penalty payments, due to the non-completion of supply contracts, are estimated to be $200,000, 50% of which is expected to be recovered from Neutron Co's insurers.

21 Identify, by selecting the relevant box in the table below, whether the following statements are required or not required if an operation is to be classified as a discontinued operation in accordance with IFRS 5 Non-current Assets Held for Sale and Discontinued Operations?

A. The operation represents a separate major line of business or geographical area

B. The operation is a subsidiary

C. The operation has been sold or is held for sale

D. The operation is considered not to be capable of making a future profit following a period of losses

22 IFRS 5 Non-current Assets Held for Sale and Discontinued Operations prescribes the recognition criteria for non-current assets held for sale. For an asset or a disposal group to be classified as held for sale, the sale must be highly probable.

Which of the following must apply for the sale to be considered highly probable?

(1) A buyer must have been located
(2) The asset must be marketed at a reasonable price
(3) Management must be committed to a plan to sell the asset
(4) The sale must be expected to take place within the next six months

A (2) and (3)
B (3) and (4)
C (1) and (4)
D (1) and (2)

23 What is the employee cost associated with the closure and sale of Neutron Co's factory which should be charged to profit or loss for the year ended 30 September 20X3?

A $125,000
B $1,250,000
C $1,125,000
D $1,000,000

24 What is the profit or loss on discontinued operations relating to property, plant and equipment for the year ended 30 September 20X3?

A $1.75 million loss
B $1.75 million profit
C $550,000 loss
D $550,000 profit

25 In respect of the leases and penalty payments, what provision is required in the statement of financial position of Neutron Co as at 30 September 20X3?

A $950,000
B $1,200,000
C $1,050,000
D $1,100,000

The following scenario relates to questions 26–30.

Speculate Co is preparing its financial statements for the year ended 30 September 20X3. The following issues are relevant:

(i) Financial assets

Shareholding A – a long-term investment in 10,000 of the equity shares of another company. These shares were acquired on 1 October 20X2 at a cost of $3.50 each.

Transaction costs of 1% of the purchase price were incurred. On 30 September 20X3 the fair value of these shares is $4.50 each.

Shareholding B – a short-term speculative investment in 2,000 of the equity shares of another company.

These shares were acquired on 1 December 20X2 at a cost of $2.50 each. Transaction costs of 1% of the purchase price were incurred. On 30 September 20X3 the fair value of these shares is $3.00 each.

Where possible, Speculate Co makes an irrevocable election for the fair value movements on financial assets to be reported in other comprehensive income.

(ii) Taxation

The existing debit balance on the current tax account of $2.4m represents the over/under provision of the tax liability for the year ended 30 September 20X2. A provision of $28m is required for income tax for the year ended 30 September 20X3. The existing credit balance on the deferred tax account is $2.5m and the provision required at 30 September 20X3 is $4.4m.

(iii) Revenue

On 1 October 20X2, Speculate Co sold one of its products for $10 million. As part of the sale agreement, Speculate Co is committed to the ongoing servicing of the product until 30 September 20X5 (ie three years after the sale). The sale value of this service has been included in the selling price of $10 million. The estimated cost to Speculate Co of the servicing is $600,000 per annum and Speculate Co's gross profit margin on this type of servicing is 25%. Ignore discounting.

26 Which of the following meet the definition of a financial asset in accordance with IFRS 9 Financial Instruments?

(1) An equity instrument of another entity
(2) A contract to exchange financial instruments with another entity under conditions which are potentially favourable
(3) A contract to exchange financial instruments with another entity under conditions which are potentially unfavourable
(4) Cash

A (1) and (2) only
B (1), (2) and (4)
C (1), (3) and (4)
D (4) only

27 Using the pull down list below, select the correct amount will be included in other comprehensive income for the year ended 30 September 20X3, in respect of the financial assets of Speculate Co.

A. Nil
B. $9,650
C. $10,000
D. $10,650

28 What is the total amount which will be charged to the statement of profit or loss for the year ended 30 September 20X3 in respect of taxation?

A $28,000,000
B $30,400,000
C $32,300,000
D $29,900,000

29 What is the amount of deferred income which Speculate Co should recognise in its statement of financial position as at 30 September 20X3 relating to the contract for the supply and servicing of products?

A $1.2 million
B $1.6 million
C $600,000
D $1.5 million

30 Which TWO of the following are TRUE in respect of the income which Speculate Co has deferred at 30 September 20X3?

A. The deferred income will be split evenly between the current and non-current liabilities in Speculate Co's statement of financial position as at 30 September 20X3

B. The costs associated with the deferred income of Speculate Co should be recognised in the statement of profit or loss at the same time as the revenue is recognised

C. The deferred income can only be recognised as revenue by Speculate Co when there is a signed written contract of service with its customer

D. When recognising the revenue associated with the service contract of Speculate Co, the stage of its completion is irrelevant

(30 marks)

Section C – Both questions are compulsory and MUST be attempted

31 After preparing a draft statement of profit or loss for the year ended 30 September 20X5 and adding the current year's draft profit (before any adjustments required by notes (i) to (iii) below) to retained earnings, the summarised trial balance of Kandy Co as at 30 September 20X5 is:

	$'000	$'000
Equity shares of $1 each		20,000
Retained earnings as at 30 September 20X5		15,500
Proceeds of 6% loan note (note (i))		30,000
Investment properties at fair value (note (ii))	20,000	
Land ($5 million) and buildings – at cost (note (ii))	35,000	
Plant and equipment – at cost (note (ii))	58,500	
Accumulated depreciation at 1 October 20X4: buildings		20,000
plant and equipment		34,500
Current assets	68,700	
Current liabilities		43,400
Deferred tax (notes (ii) and (iii))		2,500
Interest paid (note (i))	1,800	
Current tax (note (iii))		1,100
Suspense account (note (ii))		17,000
	184,000	184,000

The following notes are relevant:

(i) The loan note was issued on 1 October 20X4 and incurred issue costs of $1 million which were charged to profit or loss. Interest of $1.8 million ($30 million at 6%) was paid on 30 September 20X5. The loan is redeemable on 30 September 20X9 at a substantial premium which gives an effective interest rate of 9% per annum. No other repayments are due until 30 September 20X9.

(ii) Non-current assets:

On 1 October 20X4, Kandy owned two investment properties. The first property had a carrying amount of $15 million and was sold on 1 December 20X4 for $17 million. The disposal proceeds have been credited to a suspense account in the trial balance above. On 31 December 20X4, the second property became owner occupied and so was transferred to land and buildings at its fair value of $6 million. Its remaining useful life on 31 December 20X4 was considered to be 20 years.

Ignore any deferred tax implications of this fair value.

The price of property has increased significantly in recent years and so the directors decided to revalue the land and buildings. The directors accepted the report of an independent surveyor who, on 1 October 20X4, valued the land at $8 million and the buildings at $39 million on that date. This revaluation specifically excludes the transferred investment property described above. The remaining life of these buildings at 1 October 20X4 was 15 years. Kandy does not make an annual transfer to retained profits to reflect the realisation of the revaluation gain; however, the revaluation will give rise to a deferred tax liability. The income tax rate applicable to Kandy is 20%.

Plant and equipment is depreciated at 12.5% per annum using the reducing balance method.

No depreciation has yet been charged on any non-current asset for the year ended 30 September 20X5.

(iii) A provision of $2.4 million is required for income tax on the profit for the year to 30 September 20X5.
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), Kandy has further taxable temporary differences of $10 million as at 30 September 20X5.

Required

(a) Prepare a schedule of adjustments required to the retained earnings of Kandy Co as at 30 September 20X5 as a result of the information in notes (i) to (iii) above.

(b) Prepare the statement of financial position of Kandy Co as at 30 September 20X5.

Note. The notes to the statement of financial position are not required.

(c) Prepare the extracts from Kandy Co's statement of cash flows for operating and investing activities for the year ended 30 September 20X5 which relate to property, plant and equipment.

The following mark allocation is provided as guidance for this question:
(a) 8 marks
(b) 9 marks
(c) 3 marks

(20 marks)

32 The summarised consolidated financial statements for the year ended 30 September 20X5 (and the comparative figures) for the Tangier group are shown below.

Consolidated statements of profit or loss for the year ended 30 September:

	20X5	20X4
	$m	$m
Revenue	2,700	1,820
Cost of sales	(1,890)	(1,092)
Gross profit	810	728
Administrative expense	(345)	(200)
Distribution costs	(230)	(130)
Finance costs	(40)	(5)
Profit before taxation	195	393
Income tax expense	(60)	(113)
Profit for the year	135	280

Consolidated statements of financial position as at 30 September:

	20X5	20X5	20X4	20X4
	$m	$m	$m	$m
Non-current assets				
Property, plant and equipment		680		310
Intangible asset: manufacturing licences		300		100
Goodwill		230		200
		1,210		610
Current assets				
Inventory	200		110	
Trade receivables	195		75	
Bank	nil	395	120	305
Total assets		1,605		915
Equity and liabilities				
Equity shares of $1 each		330		250
Other components of equity		100		nil
Retained earnings		375		295
		805		545
Non-current liabilities				
5% secured loan notes	100		100	
10% secured loan notes	300	400	nil	100
Current liabilities				
Bank overdraft	110		nil	
Trade payables	210		160	

Current tax payable	80	400	110	270
Total equity and liabilities		1,605		915

At 1 October 20X4, the Tangier group consisted of the parent, Tangier Co, and two wholly owned subsidiaries which had been owned for many years. On 1 January 20X5, Tangier Co purchased a third 100% owned investment in a subsidiary called Raremetal Co. The consideration paid for Raremetal Co was a combination of cash and shares. The cash payment was partly funded by the issue of 10% loan notes. On 1 January 20X5, Tangier Co also won a tender for a new contract to supply aircraft engines which Tangier Co manufactures under a recently acquired long-term licence. Raremetal Co was purchased with a view to securing the supply of specialised materials used in the manufacture of these engines. The bidding process had been very competitive and Tangier Co had to increase its manufacturing capacity to fulfil the contract.

Required

(a) Comment on how the new contract and the purchase of Raremetal Co may have affected the comparability of the consolidated financial statements of Tangier Co for the years ended 30 September 20X4 and 20X5.

(b) Calculate appropriate ratios and comment on Tangier Co's profitability and gearing. Your analysis should identify instances where the new contract and the purchase of Raremetal Co have limited the usefulness of the ratios and your analysis.

Note. Your ratios should be based on the consolidated financial statements provided and you should not attempt to adjust for the effects of the new contract or the consolidation. Working capital and liquidity ratios are not required.

(c) Explain what further information you might require to make your analysis more meaningful.

The following mark allocation is provided as guidance for this question:
(a) 5 marks
(b) 12 marks (up to 5 marks for the ratio calculations)
(c) 3 marks

(20 marks)