December Exam 2020

A. MULTIPLE CHOICE QUESTIONS (30%)

1. **On 1 January 20X1 Sty received $1m from the local government on the condition that they employ at least 100 staff each year for the next 4 years. Due to an economic downturn and reduced consumer demand, on 1 January 20X2, Sty no longer needed to employ any more staff and the conditions of the grant required full repayment.**
   What should be recorded in the financial statements on 1 January 20X2?
   a. Reduce deferred income balance by $750,000
   b. Reduce deferred income by $750,000 and recognise a loss of $250,000
   c. Reduce deferred income by $1,000,000
   d. Reduce deferred income by $1,000,000 and recognise a gain of $250,000

2. **Dempsey's year end is 30 September 20X4. Dempsey commenced the development stage of a new pharmaceutical drug on 1 January 20X4. $40,000 per month was incurred until the project was completed on 30 June 20X4 when the drug went into immediate production. The directors became confident of the project's success on 1 March 20X4. The drug has an estimated life span of five years and time-apportionment is used by Dempsey where applicable.**
   What amount will Dempsey charge to profit or loss for development costs, including any amortisation, for the year ended 30 September 20X4?
   a. $12,000
   b. $98,667
   c. $48,000
   d. $88,000

3. **At 1 April 20X4, Tilly owned a property with a carrying amount of $800,000 which had a remaining estimated life of 16 years. The property had not been revalued. On 1 October 20X4, Tilly decided to sell the property and correctly classified it as being 'held-for-sale'.**
   A property agent reported that the property's fair value less costs to sell at 1 October 20X4 was expected to be $790,500 which had not changed at 31 March 20X5.
   What should be the carrying amount of the property in Tilly's statement of financial position as at 31 March 20X5?
   a. $775,000
   b. $790,500
   c. $765,000
   d. $750,000

4. **Which ONE of these changes would be classified as 'a change in accounting policy' as determined by IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors?**
   a. Increased the allowance for irrecoverable receivables for 20X6 from 5% to 10% of outstanding debts
   b. Changed the method of valuing inventory from FIFO to average cost
   c. Changed the depreciation of plant and equipment from straight line depreciation to reducing balance depreciation
   d. Changed the useful economic life of its motor vehicles from six years to four years

5. **Magna owned cows recorded in the financial statements at $10,500 on 1 January 20X4. At 31 December 20X4 the cows have a fair value of $13,000. If Magna sold the cows, commission of 2% would be payable. What is the correct accounting treatment for the cows at 31 December 20X4 according to IAS 41 Agriculture?**
    a. Hold at cost of $10,500
    b. Revalue to $13,000, taking gain of $2,500 to the statement of profit or loss
    c. Revalue to $13,000, taking gain of $2,500 to the revaluation surplus
    d. Revalue to $12,740, taking gain of $2,240 to the statement of profit or loss

6. **Holmes has the following balances included on its trial balance at 30 June 20X4:**

	$
Taxation	**7,000 Credit**
Deferred taxation	**16,000 Credit**

The balance on Taxation relates to an overprovision from 30 June 20X3. At 30 June 20X4, the directors estimate that the provision necessary for taxation on current year profits is $12,000. The balance on the deferred tax account needs to be increased to $23,000, which includes the impact of the increase in property valuation below. During the year Holmes revalued its property for the first time, resulting in a gain of $10,000. The rate of tax is 30%. What is the charge for taxation that will appear in the statement of profit or loss for the year to 30 June 20X4?
    a. $9,000
    b. $12,000
    c. $23,000
    d. $1,000

7. **Which ONE of the following would require a provision for a liability to be created by BW at its reporting date of 31 October 20X5?**
    a. The government introduced new laws on data protection which come into force on 1 January 20X6. BW's directors have agreed that this will require a large number of staff to be retrained. At 31 October 20X5, the directors were waiting on a report they had commissioned that would identify the actual training requirements.
    b. At the year-end BW is negotiating with its insurance provider about an outstanding insurance claim. On 20 November 20X5, the provider agreed to pay $200,000.
    c. BW makes refunds to customers for any goods returned within 30 days of sale, and has done so for many years.
    d. A customer is suing BW for damages alleged to have been caused by BW's product. BW is contesting the claim and at 31 October 20X5 the directors have been advised by BW's legal advisers that it is very unlikely to lose the case.

8. **Using the requirements set out in IAS 10 Events after the Reporting Period, which of the following would be classified as an adjusting event after the reporting period in financial statements ended 31 March 20X4 that were approved by the directors on 31 August 20X4?**
   a. A reorganisation of the enterprise, proposed by a director on 31 January 20X4 and agreed by the Board on 10 July 20X4.
   b. A strike by the workforce which started on 1 May 20X4 and stopped all production for 10 weeks before being settled.
   c. The receipt of cash from a claim on an insurance policy for damage caused by a fire in a warehouse on 1 January 20X4. The claim was made in January 20X4 and the amount of the claim had not been recognised at 31 March 20X4 as it was uncertain that any money would be paid. The insurance enterprise settled with a payment of $1.5 million on 1 June 20X4.
   d. The enterprise had made large export sales to the USA during the year. The year-end receivables included $2 million for amounts outstanding that were due to be paid in US dollars between 1 April 20X4 and 1 July 20X4. By the time these amounts were received, the exchange rate had moved in favour of the enterprise.

9. **During the financial year ended 31 March 2019, Marty Plc sold goods at an invoice value of €60,000 to a customer on a 'sale or return' basis. This included a profit margin of 30%. No payment was received. At 31 March 2019, the goods had not yet been sold on by the customer.**
   Under IFRS 15 - Revenue from Contracts with Customers, how much should Marty Plc report as revenue, as trade receivables and as inventory in respect of the above goods?

	Revenue	Trade Receivables	Inventory
a.	€60,000	€60,000	Nil
b.	Nil	Nil	Nil
c.	Nil	Nil	€60,000
d.	Nil	Nil	€42,000

10. **On January 2, 2015, Q. Tong Inc. purchased equipment with a cost of HK$10,440,000, a useful life of 10 years and no salvage value. The Company uses straight-line depreciation. At December 31, 2015 and December 31, 2016, the company determines that impairment indicators are present. The following information is available for impairment testing at each year end:**

	12/31/2015	**12/31/2016**
Fair value less cost to sell	**HK$9,315,000**	**Hk$8,350,000**
Value-in-use	**HK$9,350,000**	**HK$8,315,000**

There is no change in the asset's useful life or salvage value. The 2016 income statement will report
   a. Recovery of Impairment Loss of HK$3,889.
   b. Impairment Loss of HK$10,000.
   c. Recovery of Impairment Loss of HK$38,889.
   d. Impairment Loss of HK$1,000,000.

11. On July 1, year 2, a company decided to adopt IFRS. The company's first IFRS reporting period is as of and for the year ended December 31, year 2. The company will present one year of comparative information. What is the company's date of transition to IFRS?

a. January 1, year 1.
b. January 1, year 2.
c. July 1, year 2.
d. December 31, year 2.

12. On January 1, year 1, an entity acquires for $100,000 a new piece of machinery with an estimated useful life of 10 years. The machine has a drum that must be replaced every five years and costs $20,000 to replace. Continued operation of the machine requires an inspection every four years after purchase; the inspection cost is $8,000. The company uses the straight-line method of depreciation. Under IFRS, what is the depreciation expense for year 1?

a. $10,000
b. $10,800
c. $12,000
d. $13,200

13. Mealiffe Plc is an Irish company whose functional currency is the euro (€). On 31 May 2019, it sold goods to a UK customer at an agreed price of GBP £40,000. At the reporting date 31 July 2019, the balance remained payable. The relevant exchange rates were as follows:

31 May 2019:	**€1 = GBP £0.98**
31 July 2019:	**€1 = GBP £0.93**

Ignoring the time value of money, what is the amount of exchange gain or loss that would appear in the financial statements of Mealiffe Plc for year ended 31 July 2019 based on the above transaction?

A. €2,195 loss
B. €2,195 gain
C. €3,011 loss
D. €3,011 gain.

14. Troy Plc has calculated its closing inventory for year ended 31 July 2018 at €56,900. Included in this figure is a batch of 30 items of raw material carried at the cost price €1,000 each. These items have declined in value, and could be sold for a maximum of €23,500 at 31 July 2018. However, Troy Plc plans to incorporate these items into finished goods and it expects these to generate a profit of €6,800. What is the correct figure for closing inventory at 31 July 2018 according to IAS 2 - Inventory?

A. €26,900
B. €50,400
C. €56,900
D. €63,700.

15. **IAS 23 - *Borrowing Costs* sets out the conditions under which such costs should be capitalised or expensed.**

On 1 August 2018, Malcock Plc commenced construction of a factory building for its own use. On the same date it issued a 5% debenture for €40 million. The entire proceeds of the bond were used immediately to pay for the land and to purchase building materials for the project. Construction work commenced on 1 October 2018 and continued throughout the year, except for a half-month break at Christmas 2018 and a further half-month break in July 2019.

Which of the following amounts should be capitalised as borrowing costs under IAS 23?

A. €2,000,000
B. €1,833,333
C. €1,666,667
D. €1,500,000.

16. **Which of the following would be recognized as an investment property under IAS 40 Investment property in the consolidated financial statements of Build Co?**
    a. A property intended for sale in the ordinary course of business
    b. A property being constructed for a customer
    c. A property held by Build Co as a right-of-use asset and leased out under a six month lease
    d. A property owned by Build Co and leased out to a subsidiary

17. **Benedict Corporation reports the following information:**

Net income	**$500,000**
Dividends on ordinary shares	**140,000**
Dividends on preference shares	**60,000**
Weighted average ordinary shares outstanding	**125,000**

Benedict should report earnings per share of

a. $2.40.
b. $2.88.
c. $3.52.
d. $4.00

18. **Which of the following is not one of the major types of pronouncements issued by the International Accounting Standards Board (IASB)?**
    a. International financial reporting standard.
    b. Memorandum of understanding.
    c. Framework for financial reporting.
    d. International financial reporting interpretations.

19. **Each of the following events occurred after the reporting date of 31 March 2015, but before the financial statements were authorized for issue.**

    Which would be treated as a NON-adjusting event under IAS 10 Events After the Reporting Period?
    a. A public announcement in April 2015 of a formal plan to discontinue an operation which had been approved by the board in February 2015
    b. The settlement of an insurance claim for a loss sustained in December 2014

c. Evidence that $20,000 of goods which were listed as part of the inventory in the statement of financial position as at 31 March 2015 had been stolen
d. A sale of goods in April 2015 which had been held in inventory at 31 March 2015. The sale was made at a price below its carrying amount at 31 March 2015

20. An operating segment is a reportable segment if:

a. its operating profit is 10% or more of the combined operating profit of profitable segments.
b. its operating loss is 10% or more of the combined operating losses of segments that incurred an operating loss.
c. the absolute amount of its operating profit or loss is 10% or more of the company's combined operating profit or loss.
d. none of these answer choices are correct.

B. Exercises

Exercise # 1 (10%)

Biogenics is a publicly listed pharmaceutical company. During the year to 31 December 20X9 the following transactions took place:

a) $6m was spent on developing a new obesity drug which received clinical approval on 1 July 20X9 and is proving commercially successful. The directors expect the project to be in profit within 12 months of the approval date. The patent was registered on 1 July 20X9. It cost $1,500,000 and remains in force for three years.
b) A research project was set up on 1 October 20X9 which is expected to result in a new cancer drug. $200,000 was spent on computer equipment and $400,000 on staff salaries. The equipment has an expected life of four years.
c) On 1 September 20X9 Biogenics acquired an up-to-date list of GPs at a cost of $500,000 and has been visiting them to explain the new obesity drug. The list is expected to generate sales throughout the life-cycle of the drug.

Required:

Prepare extracts (with proper explanation) from the statement of financial position of Biogenics at 31 December 20X9 relating to the above items and summarize the costs to be included in the statement of profit or loss for that year.

Exercise # 2 (15%)

Epsilon is a listed entity. You are the financial controller of the entity and its consolidated financial statements for the year ended 30 September 20X8 are being prepared. Your assistant, who has prepared the first draft of the statements, is unsure about the correct treatment of a transaction and has asked for your advice. Details of the transaction are given below:

On 31 August 20X8 the directors decided to close a business segment which did not fit into its future strategy. The closure commenced on 5 October 20X8 and was due to be completed on 31 December 20X8. On 6 September 20X8 letters were sent to relevant employees offering voluntary redundancy or redeployment in other sectors of the business. On 13 September 20X8 negotiations commenced with relevant parties with a view to terminating existing contracts of the business segment and arranging sales of its assets. Latest estimates of the financial implications of the closure are as follows:

a) Redundancy costs will total $30,000,000 , excluding the payment referred to in (b) below.
b) The pension plan (a defined benefit plan) will make a lump sum payment totaling $8,000,000 to the employees who accept voluntary redundancy for termination of their rights under the plan . Epsilon will pay this amount into the plan on 31 January 20X9. The actuaries have advised that the accumulated pension rights that this payment will extinguish have a present value of $7m and this sum is unlikely to alter significantly before 31 January 20X9.
c) The cost of redeploying and retraining staff who do not accept redundancy will total $6,000,000.
d) Plant having a net carrying amount of $11,000,000 at 30 September 20X8 will be sold for $2,000,000.
e) The operating losses of the business segment for October, November and December 20X8 are estimated at $10,000,000.

Your assistant is unsure of the extent to which the above transaction create liabilities that should be recognized as a closure provision in the financial statements. He is also unsure as to whether or not the results of the business segment that is being closed need to be shown separately.

Required:

Explain how the decision to close the business segment should be reported in the financial statements of Epsilon for the year ended 30 September 20X8.

<u>Exercise # 3 (15%)</u>

A. Lessee enters into a 10-year lease for 2,000 square metres of office space. At the beginning of Year 6, Lessee and Lessor agree to amend the original lease for the remaining five years to include an additional 3,000 square meters of office space in the same building. The additional space is made available for use by Lessee at the end of the second quarter of Year 6. The increase in total consideration for the lease is commensurate with the current market rate for the new 3,000 square meters of office space, adjusted for the discount that Lessee receives reflecting that Lessor does not incur costs that it would otherwise have incurred if leasing the same space to a new tenant (for example, marketing costs).
B. Lessee enters into a 10-year lease for 5,000 square meters of office space. The annual lease payments are CU50,000 payable at the end of each year. The interest rate implicit in the lease cannot be readily determined. Lessee’s incremental borrowing rate at the commencement date is 6 per cent per annum. At the beginning of Year 6, Lessee and Lessor agree to amend the original lease to reduce the space to only 2,500 square meters of the original space starting from the end of the first quarter of Year 6. The annual fixed lease payments (from Year 6 to Year 10) are CU30,000. Lessee’s incremental borrowing rate at the beginning of Year 6 is 5 per cent per annum.

Required: For each of the above situations, indicate (with proper quantification where possible) how shall the lessee treat the lease modifications in accordance with International Financial Reporting Standards.

The relevant discount factors are:

- The present value of an annuity of CU1 for 10 years at a rate of 6% is 7.3601

- The present value of an annuity of CU1 for 8 years at a rate of 7% is 5.9713
- The present value of an annuity of CU1 for 5 years at a rate of 5% is 4.3295

Exercise # 4 (30%)

The summarised statements of financial position of Alpha and Beta companies as at 31 March 2012 are:

		Alpha	Beta
Assets		$000	$000
Non-current assets			
Property, plant and equipment		23,100	28,500
Investments		41,000	nil
		64,100	28,500
Current assets			
Inventory (note II, note III)		13,900	10,400
Trade receivables (note III)		11,400	5,500
Cash and Cash Equivalent (note III)		9,400	600
Total assets		**98,800**	**45,000**
EQUITY AND LIABILITIES			
Equity			
Equity shares of $1 each		25,000	10,000
Share premium		17,600	nil
Retained earnings	– at 1 April 2011	16,200	18,000
	– for year ended 31 March 2012	14,000	8,000
		72,800	36,000
Non-current liabilities			
Deferred Tax (note I)		14,000	3,000
10% loan notes (note IV)		2,500	1,000
Current liabilities			
Trade Payables (note III)		9,500	5,000
Total equity and liabilities		**98,800**	**45,000**

I. **Alpha's investment in Beta**

On 1 April 2011, Alpha acquired 80% of Beta's equity shares by means of an immediate share exchange of one share in Alpha for every two shares in Beta, and a cash payment of 88 cents per acquired share, deferred until 1 April 2012. Alpha has recorded the share exchange, but not the cash consideration. Alpha's cost of capital is 10% per annum and the market price of Alpha's shares at the date of acquisition was $6.

At the date of acquisition, Alpha conducted a fair value exercise on Beta's net assets which were equal to their carrying amounts with the following exceptions:

- An item of plant had a fair value of $3 million above its carrying amount. At the date of acquisition it had a remaining life of five years.
- Inventory had a fair value of $5 million below its cost. On 31 March 2012, 20% of these goods remained in the inventories of Beta Co.

In the consolidated financial statements, the fair value adjustment will be regarded as a temporary difference for the purposes of computing deferred tax. The rate of deferred tax to apply to temporary differences is 20%. Alpha's policy is to value the non-controlling interest at fair value at the date of acquisition. For this purpose a share price for Beta of $3.50 each is representative of the fair value of the shares held by the non-controlling interest.

II. Intra-group sale of inventories

Beta sells goods to Alpha at cost plus 50%. Below is a summary of the recorded activities for the year ended 31 March 2012 and balances as at 31 March 2012:

	Alpha	*Beta*
	$000	$000
Sales to Alpha		16,000
Of the above purchase Alpha had sold	14,500	

III. Intra-group Trade receivables and payables

	Alpha	*Beta*
	$000	$000
Included in Alpha's payables	1,700	
Included in Beta's receivables		4,400

On 26 March 2012, Beta sold and dispatched goods to Alpha for $1.5 million, which Alpha did not record until they were received on 2 April 2012. Alpha's inventory was counted on 31 March 2012 and does not include any goods purchased from Beta.

On 27 March 2012, Alpha remitted to Beta a cash payment of $1.2 million which was not received by Beta until 4 April 2012. This payment accounted for the remaining difference on the current accounts.

IV. Long-term borrowings

On 31 March 2012, Beta accepted a $1 million 10% loan note from Alpha.

V. Alpha's other investments

On 1 October 2011, Alpha also acquired 25% of the equity shares of Gamma paying $10 million in cash. This enabled Alpha to exercise significant influence over Gamma but not to control Gamma. Gamma made a profit of $1.2 million for the year ended 31 March 2012.

VI. Impairment review

Impairment tests were carried out on 31 March 2012 which concluded that consolidated goodwill was impaired by $2.5 million, and, due to disappointing earnings, the value of the investment in Gamma was impaired by $1.5 million.

Required:

Prepare the consolidated statement of financial position for Alpha as at 31 March 2012.

Good Work!!