Applied Skills

Financial Reporting

Mock Exam 1 – Questions

Time allowed: 3 hours

This examination is divided into three sections:

Section A

- 15 objective test (OT) questions, each worth 2 marks
- 30 marks in total

Section B

- Three OT cases, containing a scenario which relates to five OT questions, each worth 2 marks
- 30 marks in total

Section C

- Two constructed response questions, each containing a scenario which relates to one or more requirement(s)
- Each constructed response question is worth 20 marks in total
- 40 marks in total

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Section A

This section of the exam contains **15 objective test (OT) questions.**
Each question is worth **2 marks** and is compulsory.
This exam section is worth **30 marks** in total.

1 On 28 September 20X6, GY Co received an order from a new customer, ZZ Co, for products with a sales value of $750,000. ZZ Co enclosed a deposit with the order of $75,000.

On 30 September 20X6, GY Co had not completed the credit referencing of ZZ Co and had not despatched any goods.

Indicate, by clicking on the relevant boxes, the journal entry to record this transaction in GY Co's financial statements for the year ended 30 September 20X6 according to IFRS® 15 *Revenue from Contracts with Customers*.

Debit	Cash	Revenue	Trade receivables	Contract liability
Credit	Cash	Revenue	Trade receivables	Contract liability
Amount		$75,000	$675,000	$750,000

2 **Which of the following statements regarding historical cost accounting are correct?**

(1) Holding gains on assets are never recognised

(2) Inflation can be ignored when comparing financial performance between different time periods

(3) Market values are reported for non-current assets

○ 1 only
○ 2 only
○ 1 and 2
○ 2 and 3

3 A company has $500,000 issued share capital of $0.50 equity shares. The following events occurred in the financial year ended 31 December 20X6:

(1) On 31 March, paid a final dividend of $0.10 a share that had been proposed on 31 December 20X5.

(2) On 31 July, paid an interim dividend of $0.05 a share.

(3) On 31 December, proposed a final dividend of $0.12 a share.

What amount for dividends should be included in the statement of changes in equity for the year ended 31 December 20X6?

$ [ ] 000

4 **According to IAS® 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, which of the following would require a prior period adjustment in a company's financial statements for the year ended 31 October 20X6?**

○ Inventory as at 31 October 20X4 had been materially overvalued due to double counting of some inventory in a warehouse

○ The straight-line method of depreciation applied to vehicles up to 31 October 20X5 was changed to reducing balance method from 1 November 20X5

○ The non-controlling interest in a subsidiary acquired on 1 June 20X5 has been measured at fair value. Non-controlling interests in all other subsidiaries are measured at their share of identifiable net assets

○ A business segment sells kitchen units to customers. From 1 April 20X6, the segment also offers a kitchen fitting service to customers

5 In the year to 31 May 20X5, Ordov Co recognised an increase of $125,000 in the value of land. In the year to 31 May 20X6, a further increase of $12,000 was recognised. During the year to 31 May 20X7, the land suffered an impairment of $30,000.

Based on the above information, match the changes in amounts of retained profits and total equity over the three years.

Changes in amounts	Statement of financial position
An increase of $137,000	Retained profits
An increase of $107,000	Total equity
A decrease of $30,000	
No change	

6 Dash Co has the following two legal claims outstanding:

(1) A legal action against Dash Co claiming compensation of $700,000, filed in February 20X7. Dash Co has been advised that it is probable that the liability will materialise.

(2) A legal action by Dash Co against another entity, claiming damages of $300,000, started in March 20X7. Dash Co has been advised that it is probable that it will win the case.

In respect of each of these legal actions, match the appropriate accounting treatment to show how they should be reported in Dash Co's financial statements for the year ended 30 April 20X7.

Accounting treatment	
	(1) Legal action against Dash Co:
No disclosure	
Disclose in a note	**(2) Legal action by Dash Co:**
Make a provision	
Recognise an asset	

7 At 31 October 20X6, the non-current assets of Nium Co had a carrying amount of $754,860 and a tax base of $543,875. At 31 October 20X5, the company's provision for deferred tax was $39,853. The tax rate is 20%.

What amount should be reported in Nium Co's statement of profit or loss for the year to 31 October 20X6 for deferred tax?

Select…
$2,344 credit
$2,344 charge
$42,197 credit
$42,197 charge

8 The books of Eastham Co show the following:

	$000
Loss before interest and tax	5,000
Depreciation	23,000
Income from associate	6,000
Tax paid	10,000

What is Eastham Co's net cash inflow from operating activities?

$ [ ] 000

9 **Which TWO of the following future cash flows are relevant to the calculation of a machine's value in use?**

☐ $200,000 to be incurred in three years' time which will extend the life of the machine by a further five years

☐ $55,000 annual revenue from products manufactured using the machine

☐ $6,000 of finance costs on a bank loan taken out to purchase the machine

☐ $60,000 maintenance costs to be incurred in 12 months' time

10 On 1 January 20X4, Able Co purchased 75% of the equity share capital of Cain Co for $920,000.

During the year ended 31 December 20X6, Cain Co sold goods to Able Co for $30,000; the goods were sold at a mark-up of 20%. At 31 December 20X6, 80% of the goods were still held as inventory by Able Co.

Retained earnings of the two companies on acquisition and as at 31 December 20X6 are as follows:

	Able Co	*Cain Co*
	$	$
1 January 20X4	374,000	107,000
31 December 20X6	427,000	151,000

What will be the consolidated retained earnings for the Able Group as at 31 December 20X6? Ignore goodwill.

○ $456,000
○ $457,000
○ $460,000
○ $537,250

11 Jethro Co issued $500,000 6% bonds at a discount of 5% on 1 January 20X5. The bond will be repaid five years after issue at a premium of $100,000.

Interest is paid annually in arrears and the effective interest rate of this instrument is 10.5%

What will be the finance expense charged to Jethro Co's profit or loss for the year ended 31 December 20X6?

○ $30,000
○ $49,875
○ $51,962
○ $54,863

12 On 1 January 20X6, Mango Co entered into a lease agreement for an item of equipment. The terms of the contract included an initial deposit of $6,000 and three further annual payments of $10,000: the first in two years' time on 31 December 20X7. The effective rate of interest on the contract is 10%.

Applying the requirements of IFRS 16 *Leases,* at what amount should the right-of-use asset be measured on the commencement date?

- O $22,607
- O $24,868
- O $28,607
- O $30,868

13 **Which TWO of the following should be treated as an investment property in consolidated financial statements in accordance with *IAS 40 Investment Property*?**

- ☐ An office building that is rented under an operating lease to an associate
- ☐ A property that is under construction for a specific customer
- ☐ A plot of land that is currently vacant and the entity has not decided what to do with it
- ☐ A hotel that is owner-occupied by the entity

14 The books of Quest Co include the following figures, extracted from the financial statements for the year ended 31 December 20X6.

Statement of profit or loss

	$
Gross profit	83,250
Interest expense	9,465
Tax expense	6,270
Profit for the year	17,600

Statement of financial position

	$
Equity	127,920
Non-current liabilities	63,200
Current liabilities	57,960

What is Quest Co's return on capital employed at 31 December 20X6?

- O 14.2%
- O 17.4%
- O 26.1%
- O 43.6%

15 Windsor Co has taken out a loan for the sole purpose of constructing a factory building. The asset meets the definition of a qualifying asset in accordance with IAS 23 *Borrowing Costs* and construction has commenced. The entire loan was not required immediately, so Windsor Co invested the surplus amount in short-term investments to earn investment income.

How should Windsor Co account for the borrowing costs and the investment income in accordance with IAS 23?

	Borrowing costs	*Investment income*
O	Capitalise	Set off against the specific borrowing costs
O	Capitalise	Credit to profit or loss immediately
O	Expense to profit or loss immediately	Credit to profit or loss immediately
O	Expense to profit or loss immediately	Set off against the cost of the asset

Section B

This section of the exam contains **three OT cases**.
Each OT case contains a scenario which relates to **five OT questions**.
Each question is worth **2 marks** and is compulsory.
This exam section is worth **30 marks** in total.

The following scenario relates to questions 16–20.

Janner Co is preparing its financial statements for the year ended 31 December 20X6. The following issues are relevant:

(1) Inventory

Janner Co holds inventory that cost $120,000 and will incur a further $5,000 of selling costs. The inventory is expected to be sold for $117,000.

(2) Machinery

Janner Co has calculated the future operating cash flows of an item of machinery, which is not part of a cash-generating unit, to be as follows:

		$000
Year ended:	31 December 20X7	260
	31 December 20X8	320
	31 December 20X9	140

Additional servicing costs in respect of the machine are expected to be $60,000 and will be paid on 31 December 20X7. Janner Co expects to dispose of the machine on 31 December 20X9 for $10,000.

Janner Co's cost of capital is 8% and the present value of $1 receivable at the end of each year, based on a discount rate of 8% are:

End of year 1	0.93
End of year 2	0.86
End of year 3	0.79

(3) Cash-generating unit

At 31 December 20X6, Janner Co has a cash-generating unit that consist of the following assets:

	$000
Goodwill	50
Land	120
Factory building	260
Plant	150
Inventory	80
	660

The recoverable amount of all the assets in this cash-generating unit was measured at $560,000.

16 **In accordance with IAS 36 *Impairment of Assets,* which of the following defines the recoverable amount of an asset?**

Select… ▾
Fair value less costs of disposal
Higher of net realisable value and cost
Lower of carrying amount and value in use
Higher of value in use and fair value less costs of disposal

17 **What is the carrying amount of inventory in Janner Co's statement of financial position as at 31 December 20X6?**

$ [ ] 000

18 **What is the amount of impairment loss to be allocated to Janner Co's factory buildings in the cash generating unit as at 31 December 20X6?**

- ○ $19,697
- ○ $24,528
- ○ $39,394
- ○ $49,057

19 **Which TWO of the following are classified as external indicators of an impairment of an asset in accordance with IAS 36 *Impairment of Assets*?**

- ☐ Decrease in market rates of interest
- ☐ Output from the asset is significantly below budget
- ☐ Competitor enters market place taking 30% of entity's market share
- ☐ New legislation passed leading to higher input costs

20 **What is the value in use of the machine as at 31 December 20X6?**

- ○ $635,500
- ○ $579,700
- ○ $571,800
- ○ $563,900

The following scenario relates to questions 21–25.

RoPo Co is preparing its financial statements for the year ended 31 December 20X6. During the year, RoPo Co entered into the following contracts with customers:

(i) On 1 October 20X6, RoPo Co agreed a 12-month contract to supply mobile phone services to a customer. A handset was supplied free of charge at the start of the contract. The customer will pay a monthly fee of $60. The stand-alone selling prices of the handset and other services were $300 and $600 respectively.

(ii) On 1 July 20X6, RoPo Co sold goods for $7,497. The contract allows the customer two years' interest free credit. RoPo Co's annual cost of capital is 5%.

(iii) In December 20X6, RoPo Co sold goods for $1,000 with an offer of a full refund if the customer is not fully satisfied and returns them within six months of the sale. Historically 5% of goods have been returned within the refund period.

21 What is the amount of revenue which RoPo Co should recognise in profit or loss for the year ended 31 December 20X6 relating to the mobile phone contract?

$ ______

22 Identify, by clicking on the relevant box in the table below, whether each of the following would indicate that, when entering into a contract, RoPo Co is acting as an agent in accordance with IFRS 15 *Revenue from Contracts with Customers*?

It does not bear any inventory risk	INDICATES	DOES NOT INDICATE
It has discretion in setting the price	INDICATES	DOES NOT INDICATE
It receives consideration in the form of commission	INDICATES	DOES NOT INDICATE
It has primary responsibility for fulfilling the contract	INDICATES	DOES NOT INDICATE

23 What is the total credit to profit or loss for the year ended 31 December 20X6 in respect of the goods sold with interest free credit?

- ○ $6,800
- ○ $6,970
- ○ $7,140
- ○ $7,497

24 Indicate, by clicking on the relevant boxes, which of the following statements would indicate that a performance obligation is satisfied at a point in time or over a period of time.

RoPo Co's performance does not create an asset with an alternative use to RoPo Co	AT A POINT IN TIME	OVER A PERIOD OF TIME
The significant risks and rewards of ownership of the asset have transferred to the customer	AT A POINT IN TIME	OVER A PERIOD OF TIME

25 What is the amount of revenue that RoPo Co should recognise in profit or loss for the year ended 31 December 20X6 in respect of the goods sold under the refund policy?

- ○ $1,000
- ○ $950
- ○ $500
- ○ $0

The following scenario relates to questions 26–30.

The following is an extract from the trial balance of Denton Co as at 31 December 20X6:

	$000	$000
Finance cost	1,000	
Equity shares of $0.50 each (note (iii))		40,000
5% convertible loan carrying amount at 1 January 20X6 (note (i))		18,937
Equity component of convertible loan note		1,540
Under/over provision current tax	200	
Deferred tax 1 January 20X6 (note (ii))		6,070

The following notes are relevant:

(i) The 5% convertible loan was issued on 1 January 20X5 at its nominal value of $20m. The loan note can be converted into equity shares on 31 December 20X7 and has an effective interest rate of 8% per year. Annual interest was paid on 31 December 20X6.

(ii) A provision for current tax for the year ended 31 December 20X6 of $1,480,000 is required. At 31 December 20X6, Denton Co had taxable temporary differences of $32m and deductible temporary differences of $6m. The temporary differences are all within the same tax regime and Denton Co's effective tax rate is 30%.

(iii) Denton Co made a rights issue on 1 October 20X6. The terms of the rights issue were 1 new share at a price of $1.20 for every 4 shares held. Denton Co's market price per share immediately before the rights issue was $1.60.

26 **What amount should be included in Denton Co's statement of financial position as at 31 December 20X6 in respect of the convertible loan note?**

Select…
$20,452,000
$19,884,000
$19,452,000
$18,884,000

27 **What is the income tax expense to be included in Denton Co's statement of profit or loss for the year ended 31 December 20X6?**

- ○ $3,010,000
- ○ $3,410,000
- ○ $9,080,000
- ○ $9,480,000

28 **In accordance with IAS 33 *Earnings per Share*, what is the theoretical ex rights price per share immediately after the rights issue takes place (to two decimal places)?**

$ ______

29 Denton Co's directors have decided to revalue land which they do not intend to sell in the foreseeable future. The land has not previously been revalued or impaired.

What are the deferred tax consequences of the revaluation, in accordance with IAS 12 *Income Taxes*?

- ○ As there is no intention to sell the land, there is no deferred tax liability
- ○ The deferred tax liability should be discounted and expensed to profit or loss
- ○ Charge other comprehensive income with the deferred tax liability
- ○ Charge profit and loss with the deferred tax liability

30 **When calculating diluted earnings per share in accordance with IAS 33 *Earnings per Share,* which TWO of the following instruments may be included in the calculation of the number of shares?**

- ☐ Convertible preference shares
- ☐ Irredeemable loan note
- ☐ Authorised equity shares that have not been issued
- ☐ Share options granted to directors

Section C

This section of the exam contains **two constructed response questions**.

Each question contains a scenario which relates to one or more requirement(s).

Each question is worth **20 marks** and is compulsory.

This exam section is worth **40 marks** in total.

31 This scenario relates to two requirements.

Bigwood Co, a public company, is a high street retailer of clothes and food. The managing director is very disappointed with the current year's results. The company expanded its operations and commissioned a famous designer to restyle its clothes. This has led to increased sales in both retail lines, yet overall profits are down.

Details of the financial statements for the year ended 30 September 20X6 (and the comparative figures) are shown below:

Statements of profit or loss for the year ended 30 September

	20X6		*20X5*	
	$000	$000	$000	$000
Revenue – clothes	16,000		15,600	
– food	7,000	23,000	4,000	19,600
Cost of sales – clothes	14,500		12,700	
– food	4,750	(19,250)	3,000	(15,700)
Gross profit		3,750		3,900
Other operating expenses		(2,750)		(1,900)
Operating profit		1,000		2,000
Interest expense		(300)		(80)
Profit before tax		700		1,920
Income tax expense		(250)		(520)
Profit for period		450		1,400

Statement of changes in equity (extract)

	20X6	*20X5*
	$000	$000
Retained profit b/f	1,900	1,100
Profit for the period	450	1,400
Dividends paid	(600)	(600)
Retained profit c/f	1,750	1,900

Statements of financial position as at 30 September

	20X6		*20X5*	
	$000	$000	$000	$000
Property, plant and equipment				
Cost		17,000		9,500
Accumulated depreciation		(5,000)		(3,000)
		12,000		6,500
Current assets				
Inventory – clothes	2,700		1,360	
– food	200		140	
Trade receivables	100		50	
Bank	–		450	
		3,000		2,000
Total assets		15,000		8,500
Equity and liabilities				
Equity shares of $1 each		5,000		3,000
Share premium		1,000		–
Retained earnings		1,750		1,900
		7,750		4,900
Non-current liabilities				
Long-term loans		3,000		1,000
Current liabilities				
Bank overdraft	930		–	
Trade payables	3,100		2,150	
Current tax payable	220		450	
		4,250		2,600
		15,000		8,500

Note: the directors have signalled their intention to maintain annual dividends at $600,000 for the foreseeable future.

The following information is relevant:

(i) The increase in property, plant and equipment was due to the acquisition of five new stores and the refurbishment of some existing stores during the year. The carrying amount of fixtures scrapped at the refurbished stores was $1.2m; they had originally cost $3m. Bigwood Co received no scrap proceeds from the fixtures, but did incur costs of $50,000 to remove and dispose of them. The losses on the refurbishment have been charged to operating expenses.

(ii) The share price of Bigwood Co averaged $6.00 during the year to 30 September 20X5, but was only $3.00 on 30 September 20X6.

(iii) The following ratios have been calculated:

	20X6	*20X5*
Return on capital employed	9.3%	33.9%
Net assets turnover	2.1 times	3.3 times
Gross profit margin		
– clothes	9.4%	18.6%
– food	32.1%	25%
Net profit (after tax) margin	2.0%	7.1%
Current ratio	0.71:1	0.77:1
Inventory holding period		
– clothes	68 days	39 days
– food	15 days	17 days
Accounts payable period	59 days	50 days
Gearing	28%	17%
Interest cover	3.3 times	25 times

Requirements:

(a) **Prepare, using the indirect method, a statement of cash flows for Bigwood Co for the year ended 30 September 20X6.** (10 marks)

(b) **Write a report analysing the financial and operational performance and financial position of Bigwood Co for the two years ended 30 September 20X6.** (10 marks)

Note: Your report should use the above ratios and the information in your statement of cash flows. It should include a comparison of the performance of the clothes and food lines.

(20 marks)

32 This scenario relates to three requirements.

Gold Co acquired 60% of Silver Co's equity shares on 1 October 20X4 at a cost of $5,020,000. Silver Co's retained earnings on this date were $6,740,000.

On 1 February 20X6, Gold Co acquired 30% of Bronze Co's shares through a 1-for-1 share exchange and a cash payment of $83,400. At the date of acquisition, Gold Co's shares were valued at $3 and Silver Co's shares were valued at $2.40. Gold Co exerts significant influence over the operating and financing decisions of Bronze Co.

The statements of profit or loss of the three companies for the year ended 30 September 20X6 are as follows:

	Gold	*Silver*	*Bronze*
	$000	$000	$000
Sales revenue	3,016	2,636	864
Cost of sales	(2,413)	(2,108)	(690)
Gross profit	603	528	174
Operating expenses	(212)	(168)	(48)
Dividend received	120	10	–
Profit before tax	511	370	126
Income tax expense	(135)	(90)	(30)
Profit for the period	376	280	96

The share capital and reserves of the three companies as at 30 September 20X5 were:

	Gold	*Silver*	*Bronze*
	$000	$000	$000
Equity share capital	1,000	400	400
Share premium	3,600	900	150
Retained earnings	7,960	7,190	656
Total equity	12,560	8,490	1,206

The nominal value of shares in Gold Co and Bronze Co is $1 each and the nominal value of Silver Co's shares is $0.50. Neither Silver Co nor Bronze Co has issued any new shares since their respective acquisitions by Gold Co.

The following information is relevant:

(i) During the year, the following intra-group transactions took place:

Gold Co sold goods to Silver Co for $120,000, one third of the goods remain in inventory at the year-end.

Silver Co, whose main line of business is the sale of computers, sold goods to Gold Co on 1 October 20X5 for $220,000. Gold Co uses the computers as non-current assets and depreciates them over their useful life of four years; depreciation is an operating expense.

All companies sell their goods at a mark-up of 25% on cost.

(ii) The fair value of Silver Co's plant and equipment was $60,000 in excess of its carrying amount at the date of acquisition. These assets had four years remaining life on that date and depreciation is included in cost of sales.

(iii) Profits accrue evenly throughout the year.

(iv) Silver Co paid a dividend of $150,000 on 1 July 20X6.

(v) Non-controlling interest is valued at fair value on the date of acquisition. For this purpose, Silver Co's shares had a value of $10.40 each at that date.

(vi) Goodwill is tested for impairment each year. Goodwill on the acquisition of Silver Co fell by $68,000 during the year ended 30 September 20X5; with a further fall in value of $60,000 in the year ended 30 September 20X6. The recoverable amount of the investment in Bronze Co is greater than the year-end carrying amount of the investment in the consolidated statement of financial position.

Requirements:

(a) Calculate the goodwill on acquisition of Silver Co and identify the charge in respect of goodwill, to the statement of profit or loss for the current period. (4 marks)

(b) Calculate the carrying amount of the investment in Bronze Co that will be included in the consolidated statement of financial position as at 30 September 20X6. (3 marks)

(c) Prepare the consolidated statement of profit or loss of Gold Co for the year to 30 September 20X6. (13 marks)

(20 marks)

End of Questions