Applied Skills

Financial Reporting

Mock Exam 2 – 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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FR MOCK 2

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 A draft statement of cash flows contains the following calculation of net cash inflow from operating activities:

	$m
Operating profit	13
Depreciation	2
Decrease in inventories	(3)
Decrease in trade and other receivables	5
Decrease in trade payables	4
Net cash inflow from operating activities	21

Which TWO of the following corrections need to be made to the calculation?

☐ Depreciation should be deducted, not added

☐ Decrease in inventories should be added, not deducted

☐ Decrease in receivables should be deducted, not added

☐ Decrease in payables should be deducted, not added

2 Hood Co has a five-year contract to construct a new road for a government agency. The contract meets the requirements of IFRS® 15 *Revenue from Contracts with Customers* for revenue to be recognised over time. Revenue is recognised using an input method, based on costs. The sales price of the contract is $5m and Hood Co estimates the total cost of the contract to be $4m. Hood Co incurred costs of $500,000 in year 1, $1m in each of years 2 and 3 and $750,000 in each of years 4 and 5. These costs do not meet capitalisation criteria.

What amount of profit would Hood Co recognise on the contract in year 4?

○ $187,500
○ $200,000
○ $812,500
○ $1,000,000

3 **Identify, by clicking on the relevant box in the table below, whether each of the following topics is included in or excluded from the IFRS *Conceptual Framework for Financial Reporting*?**

The objective of general purpose financial reporting	INCLUDED	EXCLUDED
Concepts of capital maintenance	INCLUDED	EXCLUDED
Regulatory bodies governing financial statements	INCLUDED	EXCLUDED
Measurement of the elements of financial statements	INCLUDED	EXCLUDED

4 Austen Co has owned 80% of Kipling Co and 30% of Dickens Co for many years. At 31 December 20X6, the trade receivables and trade payables shown in the individual companies' statements of financial position were as follows:

	Austen Co	*Kipling Co*	*Dickens Co*
	$000	$000	$000
Trade receivables	50	30	40
Trade payables	30	15	20
Trade payables comprised			
Amounts owing to			
Austen Co	–	–	–
Kipling Co	2	–	4
Dickens Co	3	–	–
Other suppliers	25	15	16
	30	15	20

The intra-group accounts agreed after taking into account the following:

(1) An invoice for $3,000 posted by Kipling Co on 31 December 20X6 was not received by Austen Co until 2 January 20X7

(2) A cheque for $2,000 posted by Austen Co on 30 December 20X6 was not received by Dickens Co until 4 January 20X7

What amount should be shown as trade receivables in the consolidated statement of financial position of the Austen group?

$ [ ] 000

5 Recognition is the process of capturing for inclusion in the financial statements an item that meets the definition of one of the elements of financial statements.

Identify, by clicking on the relevant boxes in the table below, which of the following elements should be recognised in the financial statements in the manner described.

As a non-current liability: a provision for possible hurricane damage to property located in a high risk hurricane area	RECOGNISED	NOT RECOGNISED
In equity: irredeemable preference shares	RECOGNISED	NOT RECOGNISED
As a trade receivable: $10,000 due from a customer which has been sold (factored) to a finance company with no recourse to the seller	RECOGNISED	NOT RECOGNISED
In revenue: the entire proceeds from the sale of an item of plant which has to be maintained by the seller for three years as part of the sale agreement	RECOGNISED	NOT RECOGNISED

6 The draft accounts of Swan Co for the year ended 31 December 20X6 include the following:

Revenue	$240m
Gross profit	$60m

It was subsequently discovered that the revenue was overstated by $30m and the closing inventory understated by $10m.

What will the gross profit percentage be after the correction of the above errors?

- O 9.5%
- O 14.3%
- O 19.0%
- O 29.2%

7 GY Co made a number of changes during the financial year to 30 September 20X6.

Classify each of the following in accordance with IAS® 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, by clicking on the relevant boxes.

Up to 30 September 20X5, GY Co measured inventory on a FIFO basis. It now uses a weighted average basis as this is more widely used in GY Co's industry sector	CHANGE IN ACCOUNTING POLICY	CHANGE IN ACCOUNTING ESTIMATE	PRIOR PERIOD ERROR
Depreciation of vehicles was changed from straight line to reducing balance from 1 October 20X5	CHANGE IN ACCOUNTING POLICY	CHANGE IN ACCOUNTING ESTIMATE	PRIOR PERIOD ERROR
On 1 March 20X6, GY Co changed an output method for measuring the progress of the satisfaction of a performance obligation to an input method	CHANGE IN ACCOUNTING POLICY	CHANGE IN ACCOUNTING ESTIMATE	PRIOR PERIOD ERROR
GY Co identified that loan interest relating to a qualifying asset had been expensed to profit or loss in 20X4, rather than capitalised	CHANGE IN ACCOUNTING POLICY	CHANGE IN ACCOUNTING ESTIMATE	PRIOR PERIOD ERROR

8 On 1 January 20X5, Dupont Co issued $6m 6% convertible debt at par. Interest is payable annually in arrears on 31 December each year. The debt is redeemable at a premium of 10%, at the option of the holder, in four years' time, on 31 December 20X8. An equivalent loan without the conversion rights would have an interest rate of 12%.

The present values $1 receivable at the end of each year, based on discount rates of 6%, 10% and 12% are:

		6%	10%	12%
End of year	1	0.943	0.909	0.893
	2	0.890	0.826	0.797
	3	0.840	0.751	0.712
	4	0.792	0.683	0.636
Present value of an annuity factor after four years		3.465	3.169	3.038

What will be the value of the debt in Dupont Co's statement of financial position at 31 December 20X6 (to the nearest $000)?

- O $6,600,000
- O $5,874,000
- O $5,566,000
- O $5,291,000

9 Welbeck Co owns two properties, property 1 and property 2. As economic circumstances have worsened recently, Welbeck Co has carried out an impairment review of its properties. The values calculated during the review as at 31 October 20X6 are as follows:

	Carrying amount	*Fair value less costs of disposal*	*Value in use*
	$000	$000	$000
Property 1	1,650	1,500	1,400
Property 2	2,500	2,300	2,600

Match the carrying amounts of the properties in the statement of financial position of Welbeck Co as at 31 October 20X6, after any impairment loss has been recognised in accordance with IAS 36 *Impairment of Assets.*

	Property 1	**Property 2**
$1,400,000		
$1,500,000		
$2,300,000		
$2,500,000		
$2,600,000		

10 For the year ended 30 April 20X6, Hop Co and its 90% subsidiary Skip Co had the following trading accounts:

	Hop Co	*Skip Co*
	$	$
Revenue	100,000	46,000
Cost of sales	(70,000)	(34,500)
Gross profit	30,000	11,500

Notes:

(1) Goods purchased by Skip Co at a cost of $9,000 were sold to Hop Co at a mark-up of 50%.

(2) Hop Co had sold two-thirds of these goods by the year end.

What will the revenue figure be in the consolidated statement of profit or loss for the year ended 30 April 20X6?

$ ______

11 IAS 16 *Property, Plant and Equipment* deals with the recognition and measurement of tangible non-current assets. One of the issues covered by IAS 16 is the depreciation of those non-current assets.

Which of the following statements best describes the purpose of depreciating non-current assets?

- ○ To set aside funds for the eventual replacement of non-current assets
- ○ To determine the current value of non-current assets
- ○ To measure the fall in value of the non-current asset during the current period
- ○ To allocate the cost of a non-current asset over that asset's useful life

12 HA Co acquired 80% of SB Co's equity shares on 1 September 20X6 for $185,000. The values of SB Co's assets at that date were:

	Carrying amount	*Fair value*
	$000	$000
Property	100	115
Plant and equipment	75	70

On 1 September 20X6, all other assets and liabilities had a fair value approximately equal to their carrying amounts.

Non-controlling interest is measured at fair value at the date of acquisition at $42,000 in accordance with group policy.

SB Co's equity at 1 September 20X6 was:

	$000
$1 equity shares	150
Share premium	15
Retained earnings	(20)

What was the value of goodwill on the acquisition of SB Co?

- ○ $61,000
- ○ $67,000
- ○ $72,000
- ○ $82,000

13 The objective of IAS 23 *Borrowing Costs* is to prescribe the accounting for costs associated with the borrowing of funds.

Which of the following statements in respect of IAS 23 is correct?

- ○ Capitalisation of borrowing costs is not allowed even if the costs are directly attributable to the acquisition, construction or production of a qualifying asset
- ○ Capitalisation of borrowing costs is optional for costs that are directly attributable to the acquisition, construction or production of a qualifying asset
- ○ Capitalisation of borrowing costs is mandatory if the costs are directly attributable to the acquisition, construction or production of a qualifying asset
- ○ Capitalisation of borrowing costs is mandatory at all times

14 **Identify, by clicking on the relevant box in the table below, whether each of the following material matters should be adjusted or not in a company's financial statements for the year ended 30 June 20X6, which are to be authorised for issue in September 20X6.**

The sale in August 20X6 for $520,000 of inventory carried in the statement of financial position at $500,000. The normal selling price for these items was $700,000	ADJUSTED	NOT ADJUSTED
Serious fire damage to a factory with a carrying amount of $3m in July 20X6. The factory resumed production by August 20X6 but its value was reduced to $2m	ADJUSTED	NOT ADJUSTED
The company issued one million equity shares in August 20X6	ADJUSTED	NOT ADJUSTED
The determination in July 20X6 of management's profit sharing bonus for which no provision had been made as at 30 June 20X6	ADJUSTED	NOT ADJUSTED

15 At 30 November 20X6, the carrying amount of the non-current assets of Reynard Co was $3,570,000 and the tax written down value was $2,450,000. The liability balance for deferred tax at 1 December 20X5 was $250,000.

The tax rate is 22%.

For the year ended 30 November 20X6 what should be reported in the profit or loss in respect of deferred tax?

Select… ▾
$3,600 credit
$3,600 debit
$246,400 credit
$246,400 debit

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.

On 1 October 20X6, Pluto Co acquired 80% of Saturn Co's equity shares by means of a share exchange of three new shares in Pluto Co for every four acquired shares in Saturn Co. In addition, Pluto Co agreed to pay a further $8.8m in cash on 1 October 20X7. Pluto Co's cost of capital is 10%.

The market value of Pluto Co's shares at 1 October 20X6 was $3 each share, and the market value of Saturn Co's share on the same date was $1.60 per share.

The fair value of an item of Saturn Co's machinery was $2m in excess of its carrying amount on 1 October 20X6. On that date, the machine had a remaining useful life of four years.

On 1 January 20X7 Pluto Co paid $7.25m to acquire 30% of the share capital of Aries Co, this holding allowed Pluto Co to exert significant influence over Aries Co.

Extracts of the statements of financial position of the three companies as at 31 March 20X7 are:

	Pluto Co	*Saturn Co*	*Aries Co*
	$000	$000	$000
Non-current assets			
Property, plant and equipment	59,300	27,100	30,600
Equity shares of $1 each	50,000	40,000	20,000
Retained earnings/(losses) – at 1 April 20X6	22,200	(1,000)	6,300
– for year ended 31 March 20X7	7,400	9,000	3,200

Earnings accrued evenly throughout the year ended 31 March 20X7.

16 **What is the cost of investment in Saturn Co to be included in Pluto Co's statement of financial position?**

- ○ $98m
- ○ $80.8m
- ○ $80m
- ○ $46.4m

17 **What is the value of investment in associate at 31 March 20X7?**

$ [ ] 000

18 **What is the carrying amount of property, plant and equipment in Pluto Co's consolidated statement of financial position as at 31 March 20X7?**

- ○ $87,900,000
- ○ $88,150,000
- ○ $97,330,000
- ○ $118,750,000

19 In addition to the current 30% shareholding in Aries Co, Pluto Co has an option to acquire a further 30% equity shareholding in Aries Co that will be exercisable in 20X8.

Which of the following statements regarding how the options will affect the assessment of control is correct?

- ○ The options are relevant to an assessment of control only when they are exercised
- ○ Pluto Co will achieve control over Aries Co when the options become exercisable in 20X8 even if they are not exercised
- ○ Share options are never taken into account when assessing control by a parent over a subsidiary
- ○ An investor cannot have power over an investee if it does not hold a majority of equity shares

20 Pluto Co is considering acquiring other subsidiary and estimates that transaction costs of $3m would be incurred in this acquisition. These costs consist of $1m share issue costs and $2m relating to due diligence work.

Which of the following is the correct treatment of the transaction costs?

- ○ Expense $3m to profit or loss
- ○ Add $3m to the cost of investment
- ○ Expense $2m to profit or loss and debit $1m direct to equity
- ○ Debit $3m to share premium

The following scenario relates to questions 21–25.

On 1 January 20X6, Darton Co acquired a machine under the following terms:

	$000
Manufacturer's base price	935
Transport costs	10
Site preparation	5
Staff training in use of machine (incurred in January and February)	20
Purchase of a three-year service contract	12
Estimated residual value	50
Useful life	10 years

On 20 December 20X6, Darton Co purchased a crane hoist, from a foreign supplier, for Kr220,000 when the exchange rate was $1 = Kr2.25. At the 31 December, Darton Co had still not paid for the crane hoist and the exchange rate on that date was now $1 = Kr2.30.

Darton Co held a property that originally cost $20m and had a carrying amount of $8m at 1 July 20X6. On 1 July 20X6, it vacated the property and rented it to another entity. The property now meets the definition of investment property and its fair value at 1 July 20X6 was $9m.

21 **What is the total expense charged to profit or loss for the year ended 31 December 20X6 in respect of the machine acquired on 1 January 20X6?**

- ○ $122,000
- ○ $114,000
- ○ $94,000
- ○ $90,000

22 **At what cost should the crane hoist be recognised in the statement of financial position at 31 December 20X6 (to the nearest $000)?**

$ [ ] 000

23 **How will the transfer from owner-occupied property to investment property be measured at 1 July 20X6?**

- ○ At $8m
- ○ At $9m with gain of $1m included in profit or loss
- ○ At $8m with deferred income of $1m recognised over its remaining life
- ○ At $9m with gain of $1m recognised in other comprehensive income

24 Darton Co has an asset that requires a major overhaul every four years, the estimated cost of the overhaul is $10m.

Use the tokens to complete the following description in accordance with IAS 16 *Property, Plant and Equipment*.

To account for the overhaul cost, Darton Co should [ ] [ ] when [ ].

TOKENS		
capitalise	the present value of $10m	the asset is put into use
recognise a provision of	$10m	the cost is incurred

25 Darton Co is about to take out a loan to finance the construction of a new office building that will be occupied by administration staff; the building meets the definition of a qualifying asset.

In accordance with IAS 23 *Borrowing Costs* when must Darton Co cease capitalisation of any borrowing costs in respect of the office building?

- ○ When the office is substantially complete and ready for occupation
- ○ When the office starts to generate economic benefits
- ○ When the borrowing has been repaid
- ○ If construction of the office is suspended due to industrial action by the workforce

The following scenario relates to questions 26–30.

The following information relates to transactions of ZeBe Co.

On 1 July 20X6, ZeBe Co classified a factory as held for sale in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations.* At 1 January 20X6, the carrying amount of the factory was $26,200 and annual depreciation was $4,000. At 1 July 20X6, the fair value of the factory was $24,100 and costs to sell the asset were $3,100.

Inventory of ZeBe Co was counted on 4 January 20X7 and amounted to $27,400. Between 1 January and 4 January 20X7 the following transactions occurred:

Goods were purchased with a value of $6,300

Goods were sold for $3,565; ZeBe Co applies a mark-up of 15% to all goods sold.

On 1 January 20X5, ZeBe Co entered into a lease contract for an asset; the initial amount recognised for the lease liability was $54,195. The agreement requires ZeBe Co to make four annual payments in arrears of $16,000. The interest rate implicit in the lease is 7%.

26 What is the carrying amount of the held for sale factory at 1 July 20X6 after applying IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*?

$ [ ]

27 What is the value of Inventory included in ZeBe Co's statement of financial position at 31 December 20X6?

- ○ $24,130
- ○ $24,200
- ○ $24,665
- ○ $30,600

28 What is the total lease liability in ZeBe Co's statement of financial position at 31 December 20X6?

- ○ $41,989
- ○ $30,048
- ○ $28,928
- ○ $26,610

29 ZeBe Co is about to lease an asset for a period of four months.

Identify, by clicking on the relevant boxes, whether or not the following accounting treatments are allowed in accordance with IFRS 16 *Leases*.

Capitalise the right-of-use asset	ALLOWED	NOT ALLOWED
Recognise lease payments in profit or loss on a systematic basis	ALLOWED	NOT ALLOWED
Recognise lease rentals in profit or loss when the lease contract is signed	ALLOWED	NOT ALLOWED

30 In accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, which TWO of the following criteria must be met for a factory to be classified as held for sale?

- ☐ Management decide to abandon the factory
- ☐ The sale of the factory is expected to take place in 18 months' time
- ☐ The factory has been advertised for sale in a national trade journal
- ☐ Only minor changes are expected on the current disposal plans

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 three requirements.

Heywood Bottles Co manufactures bottles for many different drinks companies.

The financial statements for the year ended 31 March 20X7 (and the comparative figures) are shown below:

Statements of financial position as at 31 March

	20X7		*20X6*	
	$m	$m	$m	$m
Non-current assets				
Land and buildings		5		5
Plant and equipment (note (1))		58		38
		63		43
Current assets				
Inventory	18		12	
Receivables	94		25	
Deferred expenditure	6		–	
Bank	–		8	
		118		45
Total assets		181		88
Equity and liabilities				
Equity shares of $1 each		25		25
Other components of equity	10		11	
Retained earnings	(12)		8	
		(2)		19
		23		44
Non-current liabilities (note (2))		32		19
Current liabilities				
Trade payables	80		15	
Others	12		10	
Bank	34		–	
		126		25
Total equity and liabilities		181		88

The following notes are relevant:

(1) Plant and equipment is made up as follows:

At 31 March	*20X7*	*20X6*
	$m	$m
Owned plant	18	10
Right-of-use plant	40	28

(2) Non-current liabilities are leasing obligations.

Statements of profit or loss for the years ended 31 March

	20X7		20X6	
	$m	$m	$m	$m
Revenue		300		120
Manufacturing costs	261		83	
Depreciation	9		7	
Cost of sales		(270)		(90)
Gross profit		30		30
Other expenses	28		10	
Interest	10	(38)	2	(12)
Profit/(loss) before tax		(8)		18
Income tax expense		(4)		(6)
Profit/(loss) after tax		(12)		12

The directors were disappointed in the profit for the year to 31 March 20X6 and held a board meeting in April 20X6 to discuss future strategy. The managing director was insistent that the way to improve results was to increase sales and market share. As a result, the following actions were implemented:

(i) An aggressive marketing campaign through trade journals that cost $12m. Due to expected long-term benefits $6m of this has been included as a current asset in the statement of financial position at 31 March 20X7;

(ii) A "price promise" to undercut any other supplier's price was announced in the advertising campaign;

(iii) A major contract with Koola Drinks was signed that accounted for a substantial proportion of the company's output. This contract was obtained through very competitive tendering.

(iv) The credit period for customers was extended from two months to three months.

The board's preliminary review of the accounts to 31 March 20X7 concluded that performance had deteriorated rather than improved. There was particular concern over the prospect of renewing the bank overdraft facility because the maximum agreed level of $30m had been exceeded.

Requirements:

(a) Calculate appropriate ratios and comment on the profitability, liquidity and solvency of Heywood Bottles Co for the year ending 31 March 20X7. Your analysis should consider the impact of the actions taken by the board during the year.

Note: Six marks are available for ratio calculations. (14 marks)

(b) Explain what further information you might require to make your analysis more meaningful. (3 marks)

(c) Due to the poor performance during the year, one of the directors suggested that the long-term lease contracts should be converted into 12-month leases that could be renewed each year. He stated that this would improve both return on capital employed and gearing ratios.

Briefly comment on the director's suggestion of converting the long-term leases into short-term leases. (3 marks)

(20 marks)

32 This scenario relates to three requirements.

The following list of account balances relates to Vincible Co at 31 December 20X6:

	$000	$000
Sales revenue		473,300
Purchases	310,500	
Operating expenses	48,400	
Loan note interest	5,000	
Dividends paid	15,500	
Building at cost (note (ii))	200,000	
Plant and equipment at cost (note (ii))	124,800	
Deferred development expenditure (note (iii))	75,000	
Depreciation at 1 January 20X6 – building		56,000
– plant and equipment		48,800
Amortisation at 1 January 20X6 – development expenditure		15,000
Trade receivables	77,200	
Inventory – 1 January 20X6	27,500	
Bank	16,100	
Trade payables		81,200
Equity shares of $0.25 each		100,000
10% loan notes – issued 20X4		100,000
Deferred tax at 1 January 20X6 (note (iv))		12,400
Retained earnings at 1 January 20X6		13,300
	900,000	900,000

The following notes are relevant:

(i) The cost of the inventory at 31 December 20X6 was $37.7m.

(ii) Non-current assets:

On 1 January 20X6, Vincible Co's building was valued at $270m by an independent surveyor. The useful life of the building was 25 years when Vincible Co acquired it, with depreciation charged at $8m a year. The directors wish to incorporate the revalued amount in Vincible Co's financial statements. The revaluation reserve will be realised over the remaining life of the building.

Plant is depreciated at 20% per year on the reducing balance basis.

All depreciation is charged to cost of sales.

(iii) The deferred development expenditure relates to a new product. The project was successfully completed on 1 January 20X5 and sales of the new product commenced on that date. The development costs are being depreciated on a straight-line basis over the expected product life of five years. On 1 January 20X6, a review of the sales figures for the new product showed that they were disappointing. In view of this Vincible Co has estimated that the present value of the expected net future cash flows from sales of the new product is $30m, however Vincible Co has been approached by a rival company with an offer of $40m for the rights to the product. At this stage, Vincible Co intends to continue to market and sell the product.

(iv) The directors have estimated the required provision for income tax for the year to 31 December 20X6 is $15m. The deferred tax provision at 31 December 20X6 is to be adjusted to reflect the tax base of the company's assets being $70m less than their carrying amounts. $28.8m of this $70m is attributable to the revaluation of the leasehold. Vincible Co's rate of income tax is 25%.

Requirements:

(a) **Prepare the statement of profit or loss and other comprehensive income of Vincible Co for the year ended 31 December 20X6.** (8 marks)

(b) **Prepare the statement of changes in equity of Vincible Co for the year to 31 December 20X6.** (3 marks)

(c) **Prepare the statement of financial position of Vincible Co as at 31 December 20X6.** (9 marks)

Note: The notes to the financial statements are not required.

(20 marks)

End of Questions