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F2 - Advanced Financial Reporting

Cima F2

Version Demo

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Topic Break Down

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QUESTION NO: 1

Which THREE of the following would typically indicate a finance lease?

A. An asset with a useful life of ten years is being leased for ten years.

B. The lessor is responsible for the annual maintenance of the asset.

C. The lessee has the option to buy the asset at the end of the lease for $1.

D. The lease contract for an asset includes an upgrade to the asset every two years.

E. A leased asset has been specifically modified for the lessee's use.

ANSWER: A C E

Explanation:

A finance lease is indicated where the arrangement transfers substantially all of the risks and rewards incidental to ownership to the lessee. Leasing an asset for its entire ten-year useful life means the lessee obtains the economic benefits from using the asset for essentially all of its useful life and bears the associated usage and obsolescence risks. This is a strong indicator that the lease is, in substance, a financing arrangement rather than a short-term right to use an asset.

An option allowing the lessee to buy the asset for $1 at the end of the lease is a bargain purchase option. It makes exercise of the option reasonably certain in commercial terms, so ownership is expected to pass to the lessee. This is a classic indicator of a finance lease.

A leased asset that has been specifically modified for the lessee's use is also indicative of a finance lease because it is sufficiently specialised that the lessor would be unlikely to be able to lease it to another party without major modifications. The lessee therefore effectively takes the residual-value and specialised-use risks. These indicators align with the lease-classification examples in IFRS 16 Leases and the IASB's supporting leases project information.

QUESTION NO: 2

CD granted 1,000 share options to its 100 employees on 1 January 20X8.To be eligible, employees must remain employed for 3 years from the grant date. In the year to 31 December 20X8, 15 staff left and a further 25 were expected to leave over the following two years.

The fair value of each option at 1 January 20X8 was $10 and at 31 December 20X8 was $15.

Which THREE of the following are true in respect of recording these share options in the year ended 31 December 20X8?

A. The credit entry will be to equity.

B. The credit entry will be to non-current liabilities.

C. Fair value at 1 January 20X8 will be used to value the options.

D. Fair value at 31 December 20X8 will be used to value the options.

E. The calculation of the charge for the year will be adjusted for actual leavers only.

F. The calculation of the charge for the year will be adjusted for actual and estimated leavers.

ANSWER: A C F

Explanation:

The credit entry will be to equity, because the arrangement grants the entity's own share options and is therefore treated as an equity-settled share-based payment. Over the employees' three-year service (vesting) period, CD recognises the cost of the employee services received as an expense and recognises a corresponding increase in equity. IFRS 2 requires equity-settled awards to be measured at the grant-date fair value of the equity instruments granted. Accordingly, Fair value at 1

January 20X8 will be used to value the options. Subsequent changes in the option value do not alter the grant-date measurement of an equity-settled employee award.

The calculation of the charge for the year will be adjusted for actual and estimated leavers because continued employment for three years is a non-market vesting condition. CD must revise its estimate of the number of options expected to vest at each reporting date, incorporating both the 15 employees who have actually left and the further 25 expected to leave. At 31 December 20X8, 60 employees are expected to satisfy the service condition, giving an expected award of 60,000 options. The cumulative expense after one of the three vesting years is therefore 60,000 × $10 × 1/3 = $200,000. This approach is consistent with IFRS 2 Share-based Payment and the IAS Plus IFRS 2 summary.

QUESTION NO: 3

Which TWO of the following are true in relation to IAS21 The Effects of Changes in Foreign Exchange Rates when consolidating an overseas subsidiary?

A. A current period exchange gain or loss is shown within the consolidated statement of comprehensive income within other comprehensive income.

B. Goodwill is re-translated at the end of each reporting period and reflected at the period end exchange rate in the consolidated statement of financial position.

C. Assets and liabilities of the subsidiary are translated at each reporting date using the average exchange rate for the period.

D. Goodwill is reflected in the consolidated statement of financial position translated at the exchange rate on the date of acquisition.

E. The statement of profit or loss of the subsidiary is translated for the reporting period using the closing exchange rate.

ANSWER: A B

Explanation:

When an overseas subsidiary has a functional currency different from the group's presentation currency, IAS 21 requires its financial statements to be translated for consolidation. Translation differences arising from converting the foreign operation's financial statements are recognised in other comprehensive income and accumulated in a separate component of equity, commonly described as the foreign currency translation reserve. This treatment applies while control is retained; on disposal of the foreign operation, the cumulative amount is generally reclassified to profit or loss where required by the standard.

Goodwill arising on the acquisition of a foreign operation is treated as an asset of that foreign operation. It is therefore expressed in the foreign operation's functional currency and translated at the closing exchange rate at each reporting date for inclusion in the consolidated statement of financial position. Exchange movements on that goodwill form part of the overall translation difference recognised in other comprehensive income. These requirements ensure that goodwill and the subsidiary's net assets are presented consistently using the reporting-date exchange rate. See IFRS Foundation: IAS 21 and Deloitte IAS Plus: IAS 21 summary.

QUESTION NO: 4

GH began construction of a qualifying asset on 1 January 20X8. The asset was ready for use on 31 December 20X8.

During the year, GH had specific borrowings of $8 million at an annual interest rate of 6%, obtained solely to finance the construction. Temporary investment income of $20,000 was earned on funds not immediately used.

Which THREE of the following statements are correct in accordance with IAS 23 Borrowing Costs?

A. The constructed asset may be a qualifying asset.

B. Interest of $480,000 is the starting point for calculating borrowing costs eligible for capitalisation.

C. The $20,000 temporary investment income is deducted from borrowing costs eligible for capitalisation.

D. All borrowing costs must be recognised as a finance cost because GH borrowed cash rather than acquiring the asset directly.

E. Capitalisation continues indefinitely after the asset is ready for use provided the specific borrowing remains outstanding.

ANSWER: A B C

Explanation:

A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. Construction of such an asset can meet this definition. Borrowing costs directly attributable to its acquisition, construction or production are capitalised as part of the cost of that asset.

For specific borrowings, the capitalisation rate is based on the actual borrowing costs incurred on those borrowings. GH's gross borrowing costs are $480,000 ($8 million × 6%). IAS 23 requires this amount to be reduced by income earned on the temporary investment of those borrowings. Therefore, $460,000 is eligible for capitalisation, assuming construction expenditure and activities were undertaken throughout the period.

Capitalisation begins only when expenditure on the asset is being incurred, borrowing costs are being incurred and activities necessary to prepare the asset are in progress. It ceases when substantially all activities necessary to prepare the asset for use or sale are complete. See IAS 23 Borrowing Costs.

QUESTION NO: 5

UV entered into a five year non-cancellable operating lease for an asset two years ago. Lease payments are settled annually in arrears.

At the year end, UV no longer requires this leased asset as they have decided to discontinue the product line that it was used for.

At this date UV had made two out of the five lease payments.

Which of the following statements about the unavoidable lease payments is true in accordance with IAS 37 Provisions, Contingent Liabilities and Assets?

A. A provision should be recognised for the unavoidable lease payments with a corresponding charge to profit or loss.

B. A provision should be recognised for the unavoidable lease payments with a corresponding charge to other comprehensive income.

C. The amount of the unavoidable lease payments should be disclosed in the financial statements with no corresponding accounting entry.

D. The amount of the unavoidable lease payments should be ignored in the financial statements.

ANSWER: A

Explanation:

A provision should be recognised for the unavoidable lease payments with a corresponding charge to profit or loss. The non-cancellable lease remains enforceable despite UV no longer using the asset. As discontinuation of the product line means that the leased asset will provide no future economic benefit to UV, the remaining unavoidable payments represent the cost of an onerous contract. IAS 37 defines an onerous contract as one where the unavoidable costs of meeting the contractual obligation exceed the economic benefits expected from it. Here, the unavoidable cost is the remaining lease rentals for the unexpired three-year period, subject to measurement at the best estimate of the expenditure required to settle the obligation and any relevant discounting where the time value of money is material. The provision is recognised when the contract becomes onerous, which is at the reporting date when UV decides the asset is no longer required and cannot avoid the remaining payments. Because the expense arises from the lease becoming onerous in the period, the corresponding debit is recognised in profit or loss. IAS 37's requirements for onerous contracts are summarised by IFRS Foundation's IAS 37 page and explained in Deloitte IAS Plus: IAS 37.

QUESTION NO: 6

Which of the following are limitations of financial statement figures for ratio analysis? Select the ALL that apply.

A. Only provides historic data

B. Only provides financial information

C. Limited information to identify trends over time

D. Provide only summarised information

E. Contains complicated information that needs to be summarised

F. Only provides forecast data

ANSWER: A B C D

Explanation:

Financial statement figures have inherent limitations when they are used as the sole basis for ratio analysis. “Only provides historic data” is correct because published financial statements principally report transactions and conditions from completed reporting periods. Ratios calculated from them therefore describe past performance and financial position, rather than directly establishing future prospects. “Only provides financial information” is also correct: ratios do not capture important qualitative and non-financial factors, such as management capability, customer satisfaction, product quality, market conditions, employee expertise, or competitive position.

“Limited information to identify trends over time” is correct where the statements or ratio calculations cover only a limited number of periods. A meaningful trend assessment needs consistent comparative information over several years, together with awareness of changes in accounting policies, business structure, and economic conditions. “Provide only summarised information” is correct because primary financial statements aggregate many underlying transactions into broad line items. This can conceal significant details, including the composition, timing, risk, and quality of balances and performance. Ratio analysis should consequently be supplemented by notes to the accounts, management commentary, cash-flow information, non-financial measures, and relevant industry benchmarks. The Financial Reporting Council discusses the purpose of financial reporting in its accounting and reporting resources, while the IFRS Foundation provides the Conceptual Framework for Financial Reporting, which explains the information provided by general-purpose financial reports.

QUESTION NO: 7

XY owned 80% of the equity share capital of AB at 1 January 20X5. Â XY disposed of 20% of AB's equity share capital on 31 December 20X5 for $200,000. Â The non controlling interest was measured at $140,000 immediately prior to the disposal. Â

What was the amount of the credit to retained earnings that XY will process in respect of this disposal when it prepares its consolidated financial statements at 31 December 20X5?

A. $60,000

B. $140,000

C. $200,000

D. $80,000

ANSWER: A

Explanation:

$60,000 is the credit to retained earnings. Following the sale, XY still owns 60% of AB and therefore continues to control AB. The disposal is consequently accounted for as an equity transaction with owners in their capacity as owners; AB remains consolidated and no gain or loss is recognised in profit or loss.

Immediately before the disposal, the non-controlling interest represents 20% and is measured at $140,000. After XY sells a further 20% interest, the non-controlling interest becomes 40%. Assuming the same underlying net assets at the disposal date, its carrying amount is therefore $280,000. The increase in non-controlling interest is $140,000 ($280,000 less $140,000).

XY receives consideration of $200,000. The difference between the consideration received and the $140,000 adjustment to non-controlling interests is credited directly to owners' equity, normally retained earnings: $200,000 − $140,000 = $60,000. This treatment follows the requirements for changes in a parent's ownership interest that do not result in loss of control under IFRS 10. See IFRS 10—Consolidated Financial Statements and the IFRS Foundation's IFRS 10 project information.

QUESTION NO: 8

Which of the following examples would be classed as related parties ofJH Ltd due to the power they possess to directly influence the company?

1: JH Ltd's managing director

2: The son of JH Ltd's managing director, who is an intern in the company's office

3: The brother of JH Ltd's managing director, whose business supplies a large amount of production material for the company

4: JH Ltd's subsidiary company, AL Ltd

5: BR PLC, one of JH Ltd's regular customers

A. 1&4

B. 1

C. 1, 2, 3 & 4

D. 2, 3 & 4

E. 1, 2 & 3

F. All of the above

ANSWER: A

Explanation:

"1&4" is correct. IAS 24 identifies key management personnel as related parties. Key management personnel are individuals with authority and responsibility for planning, directing and controlling an entity's activities, directly or indirectly. A managing director normally has this authority and is therefore a related party of JH Ltd. This relationship exists because of the managing director's capacity to participate in directing and controlling the company, rather than because of any individual transaction with it.

AL Ltd is also a related party because it is JH Ltd's subsidiary. IAS 24 treats entities within the same group as related parties: a parent, subsidiary and fellow subsidiaries are related to one another. The group relationship reflects control and the potential for decisions, resources and transactions to be affected by that relationship. Consequently, disclosures are required to enable users of the financial statements to understand the effect that such related-party relationships and transactions may have on JH Ltd's financial position and performance.

The relevant definition and disclosure framework is set out in IAS 24, available from the IFRS Foundation's IAS 24 page. A useful technical summary of the standard's related-party definitions is also provided by IAS Plus.

QUESTION NO: 9

LM and JK operate in the same country and prepare their financial statements to 30 June 20X6 in accordance with International Accounting Standards. On 27 June 20X6 both entities raised $1 million cash by issuing debt instruments with identical terms and conditions. Prior to this issue both entities were financed entirely by equity.

At 30 June 20X6 the gearing ratios, calculated as Debt/Equity x 100%, were as follows:

LM: 30%

JK: 65%

Which of the following independent options would explain the difference between LM and JK's year-end gearing?

A. LM revalued its land and buildings upwards in the year; JK has performed no revaluations.

B. LM made a bonus issue from retained earnings in the year; JK issued no shares in the year.

C. LM had 100,000 $1 shares at the year end; JK had 200,000 50c shares in issue at the year end.

D. LM held no investments in other entities; JK revalued its available for sale investments upwards in the year.

ANSWER: A

Explanation:

LM revalued its land and buildings upwards in the year; JK has performed no revaluations. This explains why LM reports substantially lower gearing despite both entities issuing the same $1 million of debt. With debt fixed at $1 million, gearing of 30% implies equity of approximately $3.33 million for LM, whereas gearing of 65% implies equity of approximately $1.54 million for JK. LM therefore needs a larger equity balance at the reporting date.

Under IAS 16, when an entity applies the revaluation model to property, plant and equipment, an upward revaluation is generally recognised in other comprehensive income and accumulated in equity as a revaluation surplus. The land and buildings remain recognised at their revalued carrying amount, while the corresponding revaluation surplus increases total equity. Consequently, the same amount of debt forms a smaller proportion of LM's increased equity base, producing the lower debt-to-equity gearing ratio. This treatment is directly relevant because the stated gearing measure uses total equity as its denominator. IAS 16's requirements for recognising revaluation increases are summarised in the IFRS IAS 16 overview; the recognition of items in other comprehensive income is addressed in IAS 1.

QUESTION NO: 10 - (SIMULATION)

LKÂ acquired 100% of the equityÂ sharesÂ of TU on 1 January 20X4. LK disposed of 60% of TU for Â£2,400,000 on 30 September 20X4.Â The sale proceedsÂ reflectedÂ the fair value of TU's shares on that date.

The remaining 40% shareholding gave LKÂ the ability to exerciseÂ significant influence overÂ the activities ofÂ TU. TUÂ reported profit of $1,800,000 for the year ended 31 December 20X4 and this accrued evenly throughout the year.

Calculate the investment in associateÂ that will be presented inÂ LK's consolidated statement of financial position as at 31 December 20X4.

Give your answer to the nearest whole $'000.

Â $Â Â Â 000

ANSWER: See the explanation for the answer

Explanation:

Investment in associate at 31 December 20X4: $1,780,000 (i.e. **$1,780** in whole $'000).

The 60% disposal proceeds of $2,400,000 represent fair value. Therefore, the fair value of the retained 40% interest on 30 September is: `$2,400,000 × 40% ÷ 60% = $1,600,000`.
TU's profit for the three months after it became an associate (1 October–31 December) is: `$1,800,000 × 3/12 = $450,000`.
LK recognises its 40% share of this post-disposal profit: `$450,000 × 40% = $180,000`.
Carrying amount: `$1,600,000 + $180,000 = $1,780,000`.

QUESTION NO: 11

Which THREE of the following actions should improve the cash position of an entity?

A. Substituting a bonus issue for the final dividend.

B. Selling non current assets and leasing them back under operating leases.

C. Implementing an efficient inventory ordering system.

D. Revaluing all non-current assets.

E. Revising the depreciation policy of non-current assets.

F. Offering extended credit terms to existing customers.

ANSWER: A B C

Explanation:

Substituting a bonus issue for the final dividend preserves cash that would otherwise be paid to shareholders. A bonus issue capitalises reserves by issuing additional shares, rather than creating a cash distribution, so it allows the entity to retain funds for operations, investment or debt servicing. Selling non-current assets and leasing them back under operating leases can improve liquidity immediately because the sale generates cash proceeds while the entity may continue to use the assets through the lease arrangement. The future lease payments must be managed, but the transaction can release capital previously tied up in assets. Implementing an efficient inventory ordering system improves working-capital management by reducing avoidable inventory holdings, storage costs and the amount of cash committed to stock. Cash is then released for other business needs, provided inventory availability remains sufficient to support sales and production. These actions respectively reduce a discretionary cash outflow, convert an illiquid asset into cash, and reduce cash tied up in operating working capital. Cash-flow reporting distinguishes cash movements from non-cash accounting entries; see IFRS Foundation: IAS 7 Statement of Cash Flows. For further discussion of inventory and working-capital efficiency, see ACCA: Working capital management.

QUESTION NO: 12

Which of the following examples of contracts will use cost of sales as the balancing figure when calculating profit or loss?

Select ALL that apply.

A. Contract A has a total value of£50m, costs to date of£42m and expected costs to completion of£15m. The project's % stage of completion is 74% using the cost method.

B. Contract A has a total value of£55m, costs to date of£33m and expected costs to completion of£18m.

C. Contract A has a total value of£75m, costs to date of£61m and expected costs to completion of£20m. The contracts % stage of completion was calculated by dividing its value to date of£45m by£75m.

D. Contract A has a total value of£60m, costs to date of£42m and expected costs to completion of£15m. The project's % stage of completion is 80% using the value method.

E. Contract A has a total value of£85m, costs to date of£69m and expected costs to completion of£22m. The contracts % stage of completion was calculated by dividing its costs incurred to date of£69m by £75m.

ANSWER: C D

Explanation:

"Contract A has a total value of£75m, costs to date of£61m and expected costs to completion of£20m. The contracts % stage of completion was calculated by dividing its value to date of£45m by£75m." uses the value method: work certified or valued to date is £45m, giving 60% completion. Total forecast costs are £81m, so the contract has an expected £6m loss. Where progress is measured by value, revenue is determined first from the value of work completed; the expected contract loss is then recognised in full. Cost of sales is the balancing amount needed to report that revenue and loss in profit or loss.

“Contract A has a total value of£60m, costs to date of£42m and expected costs to completion of£15m. The project's % stage of completion is 80% using the value method.” also uses the value method. Revenue recognised is £48m (80% × £60m). The forecast contract profit is £3m (£60m less total forecast costs of £57m), of which £2.4m is attributable to 80% completion. Cost of sales is therefore derived as the balancing figure between recognised revenue and recognised profit. This is consistent with the principle that a measure of progress depicts the transfer of control of goods or services, while expected losses require appropriate recognition. See IFRS 15 and IAS 37.

QUESTION NO: 13

MNO has calculated its return on capital employed ratio for 20X4 and 20X5 as 41% and 56% respectively.

Taking each statement in isolation, which would explain the movement in the ratio between the 2 years?

A. In 20X5 the average interest rate on borrowing decreased compared to 20X4.

B. In 20X4 an onerous contract was provided for and this provision did not change in 20X5.

C. In 20X5 the increase in value of MNO's head office was reflected in the financial statements.

D. In 20X4 an unused building was sold at a price in excess of its carrying value.

ANSWER: B

Explanation:

In 20X4 an onerous contract was provided for and this provision did not change in 20X5.

Return on capital employed commonly measures operating profit before finance costs and tax as a percentage of capital employed. Recognition of an onerous-contract provision in 20X4 creates an operating expense in that year, reducing the operating profit used in the numerator. IAS 37 requires a provision to be recognised when the unavoidable costs of meeting contractual obligations exceed the economic benefits expected from the contract. Therefore, the 20X4 ratio would be depressed by the one-off provision charge. If the provision remained unchanged in 20X5, there would be no further expense from creating or revising that provision in 20X5. Operating profit would consequently be higher than in 20X4, all else being equal, which explains the increase from 41% to 56%.

The provision is also a liability, but the key year-on-year driver described is the recognition of the expense in 20X4 and its absence in 20X5. This produces a higher return generated from the capital employed in the later year. IAS 37’s requirements for onerous contracts are set out in the IFRS IAS 37 overview; the standard’s recognition principle is also summarised in IAS 37.

QUESTION NO: 14

You are a Financial Controller at BCD and are in the process of preparing the year-end financial statements. A member of your finance team has come to see you about her provisions balance at year-end.

She says that the Managing Director has asked her to increase the provisions balance by $1 million overall. She thinks this is because BCD has had a very good year in terms of profit, and the Managing Director wants to put some profit aside to protect against any future reductions in profit. $1 million is material to BCD.

YouÂ believe that the provisions balance wasÂ fairly stated without the additional $1 million.

Which TWO of the following would be appropriate actions in this scenario?

A. Discuss the matter with the Finance Director as he is your immediate line manager.

B. Speak to the Managing Director to explain that the level of provisions is governed by financial reporting standards.

C. Tell the member of your finance team to ignore the Managing Director and to leave the provisions balance as it was.

D. Contact the external auditors of BCD and tell them that the Managing Director wants to change the provisions balance.

E. Speak to the shareholders at the upcoming annual general meeting about this issue.

F. Discuss the matter with the Finance Director as your immediate line manager, and explain to the Managing Director that provisions are governed by financial reporting standards.

ANSWER: F

Explanation:

Discussing the matter with the Finance Director as the immediate line manager and speaking to the Managing Director to explain that the level of provisions is governed by financial reporting standards are the appropriate actions. The proposed $1 million increase is material and must not be recorded merely to defer reported profit or create a reserve for possible future lower earnings. Financial statements must represent the entity's financial position faithfully, using estimates that are supportable under the applicable reporting requirements.

IAS 37 requires a provision to be recognised only where there is a present obligation arising from a past event, a probable outflow of economic benefits, and a reliable estimate. Its measurement must be the best estimate of the expenditure needed to settle that obligation. Therefore, the Financial Controller should communicate the technical accounting requirement to the Managing Director while using the established reporting line to involve the Finance Director. This provides an appropriately documented, proportionate escalation route and supports the professional duties of integrity, objectivity and professional behaviour. Further guidance is available in IAS 37—Provisions, Contingent Liabilities and Contingent Assets and CIMA's Code of Ethics.

QUESTION NO: 15

Which TWO of the following statements about bonds and their issue are true?

A. Credit rating agencies assign risk categories to bond issues.

B. Bonds are a form of loan capital, traded on stock exchanges.

C. Bonds are a risk-free form of investing because they will always be repaid.

D. All bonds have the same terms and conditions when issued.

E. A bond issue is never underwritten because the return is fixed and guaranteed.

ANSWER: A B

Explanation:

Credit rating agencies assign risk categories to bond issues because a credit rating is an independent assessment of the issuer's relative ability and willingness to meet the contractual interest and principal payments on its debt. Ratings therefore provide investors with a standardised indication of credit risk and are an important consideration in the pricing and marketability of a bond issue. The Financial Conduct Authority explains the role of credit-rating agencies and the regulatory framework governing ratings activity: FCA: Credit rating agencies.

Bonds are a form of loan capital, traded on stock exchanges, because the purchaser of a bond lends funds to the issuing entity in return for contractual cash flows, usually periodic interest and repayment of principal at maturity. After issue, bonds are transferable debt securities and can be bought and sold by investors in secondary markets, including recognised exchanges. This liquidity distinguishes a marketable bond from a private, non-transferable loan. The U.S. Securities and Exchange Commission's investor guidance describes bonds as debt securities and explains the issuer's obligation to repay borrowed money with interest: SEC Investor.gov: Bonds.

QUESTION NO: 16

FG's statement of profit or loss account for year ended 31 December 20X1 is:

	$000
Revenue	2,500
Cost of sales	(1,200)
Gross profit	1,300
Distribution costs	(700)
Administrative expenses	(250)
Income from associate undertaking	600
Finance costs	(400)
Profit before tax	550
Tax	(100)
Profit for the year	450

What is the operating profit margin for FG for the year ended 31 December 20X1?

Give your answer to the nearest whole %.

? %

A. 14

ANSWER: A

Explanation:

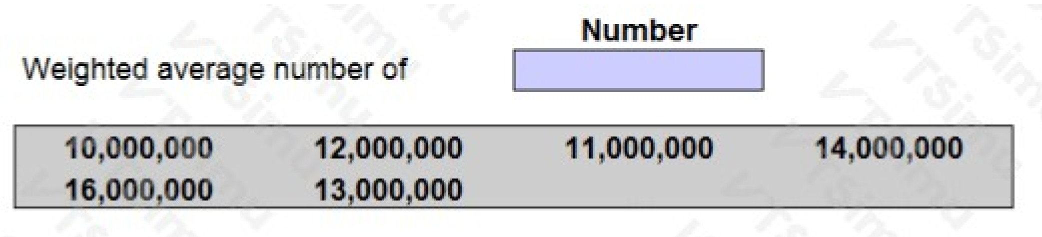
14 is the operating profit margin, rounded to the nearest whole percentage. Operating profit margin measures the proportion of revenue remaining after operating expenses have been deducted, before financing costs and tax. It is calculated as operating profit divided by revenue, multiplied by 100. Using FG's operating-profit and revenue amounts shown in the statement of profit or loss produces a result of approximately 14%, so the required whole-number answer is 14.

This ratio focuses on performance from the entity's trading and operating activities. It therefore uses the operating-profit subtotal reported in the statement rather than profit for the year, because profit for the year may also reflect finance costs, tax expense, and other non-operating items. Presenting revenue and expenses in a statement of profit or loss is governed by IAS 1's financial-statement presentation requirements; ratio analysis then uses those reported figures to assess operating profitability. See the IFRS overview of IAS 1 and CIMA's Professional Qualification information.

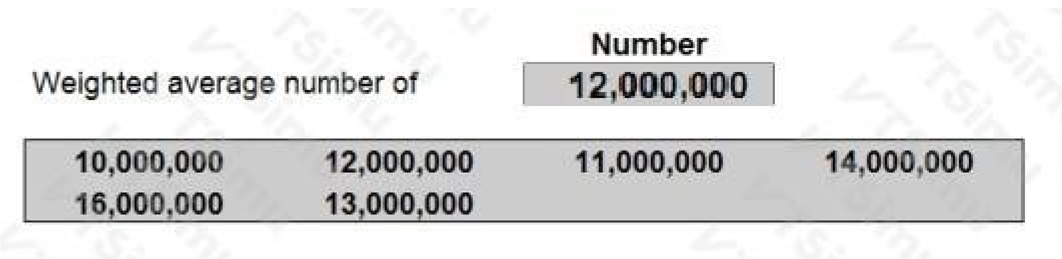
QUESTION NO: 17 - (DRAG DROP)

On 1 January 20X8 XY, a listed entity, had 10,000,000 ordinary shares in issue each with a par value of 50 cents. On 1 July 20X8 XY raised $6,000,000 by issuing ordinary shares at a price of £1.50 each which was the full market price.

Place the correct figure into the box below to show the number that XY will use as its weighted average number of ordinary shares in the calculation of earnings per share for the year to 31 December 20X8.



ANSWER:



Explanation:

The weighted average number of ordinary shares is 12,000,000. Basic earnings per share uses the weighted average number of ordinary shares outstanding during the reporting period, rather than simply the number of shares in issue at the reporting date. This reflects the length of time for which each group of shares was entitled to participate in the period's earnings.

There were 10,000,000 ordinary shares in issue on 1 January, and these remained outstanding for the whole twelve-month year. They therefore contribute 10,000,000 weighted shares. The cash raised on 1 July was $6,000,000, and the issue price was $1.50 per ordinary share. The number of new shares issued is consequently 4,000,000, calculated as $6,000,000 divided by $1.50.

Because the new shares were issued on 1 July, they were outstanding for six months of the year ended 31 December. Their weighted contribution is therefore 4,000,000 multiplied by 6/12, which is 2,000,000 shares. Combining the full-year weighting for the original shares with the six-month weighting for the newly issued shares produces 12,000,000 weighted average ordinary shares.

This is a market-price cash issue, so the shares are included only from their issue date. No retrospective adjustment is needed because there is no bonus element requiring earlier comparative share numbers to be restated. This treatment follows the principle in IAS 33 Earnings per Share that ordinary shares are generally weighted according to the time they are outstanding. Further technical support is available in the PwC weighted-average shares guidance.

QUESTION NO: 18

GH is a listed entity which holds equity shares in one subsidiary and one associate.

Information extracted from the most recent financial statements is as follows:

What is the interest cover for the year?

A. 9.6 times

B. 10.7 times

C. 11.7 times

D. 8.5 times

E. Cannot be determined from the information provided.

ANSWER: E

Explanation:

Cannot be determined from the information provided is correct because the financial data referred to in the question are absent. Interest cover is normally calculated by dividing profit before interest and tax (often EBIT, or operating profit before finance costs and tax) by the finance-cost or interest expense for the period. The result is expressed as a number of times and indicates the extent to which current-period earnings are available to meet interest obligations. To calculate a numerical interest-cover ratio for GH, the question must provide, or enable calculation of, both the relevant pre-interest-and-tax profit measure and the interest or finance cost. Details that GH owns a subsidiary and an associate do not themselves supply either input. They may affect the preparation of group financial statements, including the inclusion of subsidiary results and the equity-accounted share of associate profit, but they do not establish an interest-cover figure. The omitted "Information extracted from the most recent financial statements" is therefore essential evidence; without it, selecting a stated number of times would be unsupported. The IAS 7 definition of financing activities provides useful context for finance-related cash flows, while IFRS 9 addresses recognition and measurement of financial liabilities and related interest expense: IAS 7 and IFRS 9.

QUESTION NO: 19

XY has in issue a 6% convertible bond which is redeemable at par or convertible into equity shares in one year's time. The conversion terms are 20 equity shares for each $100 of convertible bond. The conversion value in one year's time is expected to be $105 per $100 nominal of the bond based on the current share price of $5.25.

Which of the following statements about the bond is correct?

A. The yield to maturity of the convertible bond is a constant 6%.

B. The bond will be converted into equity shares in one year's time if the share price does not change.

C. XY's post tax cost of debt for the convertible bond will be higher than the yield to maturity.

D. If the bond is redeemed rather than converted that means that the investor will receive $105 for each $100 of nominal value.

ANSWER: B

Explanation:

The bond will be converted into equity shares in one year's time if the share price does not change. At the conversion date, each $100 nominal holding gives the investor a choice between repayment at par, worth $100, and 20 ordinary shares. With a share price of $5.25, the shares received on conversion have a market value of $105 (20 × $5.25). Conversion therefore gives the holder $5 more value per $100 nominal than cash redemption. A rational investor will elect the alternative with the greater value, so the stated unchanged share price results in conversion. This comparison is made at the date the choice becomes exercisable and is based on the conversion value, which is the number of shares receivable multiplied by the market price per share. The 6% coupon is a separate contractual return for the year; it does not alter the fact that, when choosing the terminal form of settlement, the investor compares $105 of shares with $100 cash. Convertible debt is consequently analysed by identifying both the redemption amount and the value obtainable through the conversion terms. This is consistent with the CIMA Financial Reporting syllabus coverage of the classification and analysis of financial instruments; see the CIMA Professional Qualification Syllabus. General guidance on compound financial instruments is also available in IAS 32 Financial Instruments: Presentation.

QUESTION NO: 20

Which THREE of the following statements are true in relation to provisions under IAS 37 Provisions, Contingent Liabilities and Contingent Assets?

A. A provision requires a present obligation resulting from a past event.

B. A provision may be recognised for future operating losses expected from a planned reduction in sales.

C. A provision is measured using the best estimate of the expenditure required to settle the obligation.

D. A provision is recognised where an outflow of resources is possible but not probable.

E. A provision is discounted where the time value of money is material.

F. The unwinding of a discount on a provision is recognised in other comprehensive income.

ANSWER: A C E

Explanation:

A provision is recognised only when an entity has a present legal or constructive obligation arising from a past event, an outflow of resources embodying economic benefits is probable, and a reliable estimate can be made of the obligation. A provision is not a general reserve that management may use to smooth reported profits or provide for possible future operating losses.

Provisions are measured at the best estimate of the expenditure required to settle the present obligation at the reporting date. Where the effect of the time value of money is material, the provision is measured at present value. The subsequent unwinding of the discount is recognised as a finance cost. See IAS 37 Provisions, Contingent Liabilities and Contingent Assets.

QUESTION NO: 21

On 1 January 20X6, AB purchased a machine for $900,000. The machine has an estimated useful life of ten years with no residual value and is depreciated on a straight-line basis.

At 31 December 20X8, following a significant fall in demand, AB estimates that the machine will generate future cash inflows with a value in use of $480,000. The fair value less costs of disposal of the machine is $510,000.

What impairment loss should AB recognise in profit or loss for the year ended 31 December 20X8?

A. $120,000

B. $150,000

C. $390,000

D. $420,000

ANSWER: A

Explanation:

The impairment loss is **$120,000**. Before considering impairment, the carrying amount at 31 December 20X8 is $630,000. This is calculated as cost of $900,000 less three years' depreciation of $270,000 ($900,000 ÷ 10 years × 3).

IAS 36 requires an asset to be written down when its carrying amount exceeds its recoverable amount. Recoverable amount is the higher of fair value less costs of disposal and value in use. In this case, fair value less costs of disposal of $510,000 exceeds value in use of $480,000, so the recoverable amount is $510,000.

The impairment loss is therefore $120,000 ($630,000 − $510,000). This is recognised immediately in profit or loss because the machine has not been carried at a revalued amount. See IAS 36 Impairment of Assets.

QUESTION NO: 22

LM has made the following share purchases during the year:

• Purchased 55% of the equity share capital of OP.

• Purchased 45% of the equity share capital of QR. LM have the power to appoint the majority of board members on the QR board.

• Purchased 30% of the equity share capital of ST. LM is represented by one director on the main board of ST which has five members in total. The other 70% of ST's equity share capital is owned by a single company, UV.

The Managing Director has told you that OP has performed well, but both QR and ST have not performed as expected. He is therefore pleased that OP will be included as a subsidiary and that QR and ST will only be included as investments in the group financial statements.

In accordance with the ethical principle of professional competence and due care how should the investments in OP, QR and ST be treated in the group financial statements?

A. OP and QR should be consolidated and ST should be equity accounted.

B. OP should be consolidated and QR and ST should be equity accounted.

C. OP should be consolidated, QR should be equity accounted and ST should be valued at cost.

D. OP and QR should be equity accounted and ST should be valued at cost.

ANSWER: A

Explanation:

OP and QR should be consolidated and ST should be equity accounted. OP is a subsidiary because LM’s 55% holding gives it a majority of voting rights and, consequently, power over OP. QR is also a subsidiary despite LM holding only 45% of its shares. The decisive factor under IFRS 10 is control, rather than a fixed percentage shareholding. LM’s contractual or other right to appoint a majority of QR’s board members gives it the practical power to direct QR’s relevant activities. Both OP and QR must therefore be included in the group financial statements through full consolidation.

LM’s 30% interest in ST gives rise to significant influence, which is presumed when an investor holds 20% or more of voting power. Its representation by one director on ST’s five-member main board is further evidence that LM participates in financial and operating policy decisions. Although UV’s 70% interest means LM does not control ST, it does not remove LM’s significant influence. ST is therefore an associate and is accounted for using the equity method in the consolidated financial statements. The performance of any investee cannot determine its classification; applying the relevant control and significant-influence criteria reflects professional competence and due care. See IFRS 10 and IAS 28.

QUESTION NO: 23

An entity has declared a dividend of $0.12 a share. The cum dividend market price of one equity share is $1.40.

Assuming a dividend growth rate of 7% a year, what is the entity's cost of equity?

A. 17.0%

B. 8.6%

C. 16.2%

D. 9.4%

ANSWER: A

Explanation:

17.0% is correct using the dividend-growth model (also called the Gordon growth model). The model calculates the cost of equity as the expected dividend for the coming year divided by the current ex-dividend share price, plus the constant annual dividend-growth rate: $ke = D1/P0 + g$.

The stated market price is cum dividend, meaning that a purchaser at that price is entitled to receive the dividend that has just been declared. The price relevant to the valuation model must therefore be converted to an ex-dividend price: $1.40 −

$0.12 = $1.28. The declared dividend is the current dividend, so it must be grown by 7% to obtain the next year's expected dividend: $0.12 × 1.07 = $0.1284.

Accordingly, the cost of equity is ($0.1284 ÷ $1.28) + 0.07 = 0.1703125, or 17.03125%. Rounded appropriately, this is 17.0%. This treatment is consistent with the constant-growth dividend valuation approach, which uses the next expected dividend and requires consistency between the dividend entitlement and the share price used. See ACCA's cost of equity guidance and OpenStax's explanation of constant-growth equity valuation.

QUESTION NO: 24 - (SIMULATION)

CD has 200,000 equity shares with a current market value of $2.50 each. The annual dividend of $0.50 a share is about to be paid.

CD also has redeemable debt with a nominal value of $100,000. This is currently trading at $90 for each $100 of nominal value.

The cost of equity is 20% and the post tax cost of debt is 6%.

What is CD ' s weighted average cost of capital?

Give your answer in % to one decimal place.

? %

ANSWER: See the explanation for the answer

Explanation:

CD's WACC = 17.4%

As the $0.50 dividend is about to be paid, deduct it from the current share price to obtain the ex-dividend equity value:
Equity market value = 200,000 × ($2.50 − $0.50) = $400,000
Debt market value = $100,000 × 90% = $90,000
Total market value = $490,000

Therefore:

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WACC = (($400,000 × 20%) + ($90,000 × 6%)) / $490,000
     = 17.4286%
     = 17.4%
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QUESTION NO: 25

LM granted 100 share options to each of its 400 employees on 1 January 20X7. The options will only vest if employees remain with LM for 3 years from the grant date. The fair value of each share option was $5 on 1 January 20X7.

20 employees left in the year to 31 December 20X7 and at that date it was estimated that a further 35 would leave over the following two years.

Which of the following journal entries did LM process to account for the share options in the year to 31 December 20X7, in accordance with IFRS2 Share-based Payments?

A. Dr Profit or loss $57,500 ; Cr Other reserves within equity $57,500

B. Dr Profit or loss $57,500 ; Cr Liabilities $57,500

C. Dr Profit or loss $172,500 ; Cr Other reserves within equity $172,500

D. Dr Profit or loss $172,500 ; Cr Liabilities $172,500

ANSWER: A

Explanation:

Dr Profit or loss $57,500 ; Cr Other reserves within equity $57,500 is correct. This is an equity-settled share-based payment: employees receive options over LM's own shares, so the credit is recognised in equity rather than as a liability. IFRS 2 requires the grant-date fair value of equity instruments granted to employees to be recognised as an employee expense over the vesting period, with the amount adjusted for the best available estimate of awards expected to vest where vesting depends on a service condition.

LM granted 40,000 options in total (400 employees × 100 options). By 31 December 20X7, 20 employees had left and management expects a further 35 employees to leave before the three-year service condition is completed. Therefore, 345 employees are expected to remain and vest, giving 34,500 expected vested options (345 × 100). At the grant-date fair value of $5 per option, the cumulative remuneration cost expected over the full vesting period is $172,500. As one of the three service years has elapsed, LM recognises one-third of that amount in the first year: $57,500. This debit records the employee services received; the corresponding credit is an equity reserve. See IFRS 2—Share-based Payment and IAS Plus: IFRS 2 summary.

QUESTION NO: 26

Mr D, a CIMA qualified accountant, is working on the preparation of a long term profit forecast required by the local stock market prior to a new share issue of equity shares. At the most recent board meeting the directors requested that the forecast be inflated. In Mr D's view this would grossly overestimate the forecast profit. The board intends to publish the revised inflated forecast.

Which THREE of the following are the ethical options available to Mr D in this situation?

A. Consider resignation of his post as accountant.

B. Adjust the figures in line with the board's request as this is a forecast and not the financial statements.

C. Discuss the situation with his line manager.

D. Consider reporting the situation to the appropriate authorities.

E. Delegate the work to a subordinate.

F. Submit the original forecast without the board's approval.

ANSWER: A C D

Explanation:

"Consider resignation of his post as accountant," "Discuss the situation with his line manager," and "Consider reporting the situation to the appropriate authorities" are appropriate ethical actions. An intentionally inflated profit forecast for a share issue could mislead existing and prospective investors and may expose the organisation and individuals involved to regulatory consequences. Mr D must uphold the fundamental principles of integrity, objectivity, professional competence and due care, and professional behaviour; he should not allow pressure from directors to associate him with information that he believes is materially misleading.

The appropriate response is to raise the issue through internal governance channels, beginning with his line manager where appropriate and escalating to those charged with governance if the matter remains unresolved. He should document the facts, communications, and professional judgements made. If the board persists in publishing information that may be materially misleading, resignation may be necessary to avoid continued association with it. Depending on applicable law, regulation, and the public-interest implications, reporting the matter to an external authority may also be considered, particularly where internal escalation has not resolved the issue. CIMA's ethical framework requires members to respond to threats to compliance with the fundamental principles and to take action when unethical conduct is suspected. See CIMA Code of Ethics and FCA guidance on market abuse.

QUESTION NO: 27

Which of the following would cause a deferred tax balance to be included in the statement of financial position for an entity?

A. Expenses in the statement of profit or loss which are not allowable for tax creating a permanent difference.

B. The acquisition of land for which there is no tax depreciation.

C. The acquisition of plant and equipment a year ago where the tax depreciation rate is different to the accounting depreciation rate.

D. Impairment of goodwill that arose on the acquisition of a subsidiary entity.

ANSWER: C

Explanation:

The acquisition of plant and equipment a year ago where the tax depreciation rate is different to the accounting depreciation rate gives rise to a temporary difference. Accounting depreciation determines the asset's carrying amount in the statement of financial position, whereas tax depreciation (capital allowances) determines its tax base. When the two rates differ, the carrying amount and tax base will normally diverge during the asset's useful life, even though their total deductions may ultimately reconcile over time.

IAS 12 requires an entity to recognise deferred tax for temporary differences: differences between the carrying amount of an asset or liability and its tax base that will affect taxable profit when the asset is recovered or the liability settled. For plant and equipment, faster tax depreciation commonly produces a taxable temporary difference and therefore a deferred tax liability. Conversely, where accounting depreciation reduces the carrying amount faster than tax depreciation, a deductible temporary difference may produce a deferred tax asset, provided that sufficient future taxable profits are probable. The deferred-tax amount is measured using enacted or substantively enacted tax rates expected to apply when the difference reverses. This reflects the future tax consequence already created by using different accounting and tax depreciation patterns. See IFRS Foundation: IAS 12 Income Taxes and IAS 12 standard text.

QUESTION NO: 28

JK has calculated its inventory holding period:

31 March 20X8	31 March 20X7
60 days	32 days

Which THREE of the following would have contributed to the above movement in inventory holding period?

A. JK's main supplier offered a significant one-off discount for purchases made in March 20X8.

B. In January 20X8 a major competitor entered the market in which JK operates.

C. A substantial contract is due to be dispatched early in April 20X8.

D. JK is enforcing stringent inventory control techniques following management instructions.

E. JK suffered industrial action by its production staff in the period December 20X7 to February 20X8.

F. It has been difficult to obtain one of JK's main components due to import issues with its overseas supplier.

ANSWER: A B C

Explanation:

Inventory holding period measures the average time that inventory is held before sale or use in production, commonly calculated as closing (or average) inventory divided by cost of sales, multiplied by the number of days in the period. The movement shown is consistent with a higher inventory balance relative to the cost of sales figure. JK's main supplier offered a significant one-off discount for purchases made in March 20X8 would encourage a bulk purchase before the reporting date, increasing closing inventory. In January 20X8 a major competitor entered the market in which JK operates could reduce JK's sales volumes or slow the rate at which goods are sold, leaving more inventory on hand at the year end. A substantial contract is due to be dispatched early in April 20X8 would lead JK to produce or purchase goods ahead of dispatch, so inventory intended for that contract remains in closing inventory at the reporting date. Each circumstance can therefore increase the calculated days for which inventory is held. Inventory should be measured under the principles in IAS 2, including at the lower of cost and net realisable value; the holding-period ratio is then a useful indicator for management's working-capital analysis. See IFRS: IAS 2 Inventories and ACCA: Ratio analysis.

QUESTION NO: 29

Which THREE of the following statements are correct when applying the acquisition method in accordance with IFRS 3 Business Combinations?

A. Identifiable assets acquired and liabilities assumed are generally measured at acquisition-date fair value.

B. Legal and professional costs directly associated with an acquisition are included in goodwill.

C. Contingent consideration is included in the consideration transferred at its acquisition-date fair value.

D. Goodwill is amortised over its estimated useful life.

E. Acquisition-related costs are recognised as an expense when incurred.

F. The acquirer recognises the acquiree's income and expenses from the beginning of the reporting period, regardless of the acquisition date.

ANSWER: A C E

Explanation:

Identifiable assets acquired and liabilities assumed in a business combination are generally measured at their acquisition-date fair values. This ensures that the consolidated financial statements reflect the assets and obligations obtained by the acquirer at the date control is achieved.

Acquisition-related costs, such as legal, valuation and professional fees, are expensed as incurred rather than included in the consideration transferred. In addition, contingent consideration is recognised at its acquisition-date fair value as part of the consideration transferred. Subsequent changes in the fair value of contingent consideration are normally recognised in profit or loss where the contingent consideration is classified as a financial liability. See IFRS 3 Business Combinations.

QUESTION NO: 30

ST has a contract to construct a specialised asset for a customer. Halfway through construction, the customer requests additional features that were not included in the original contract.

The additional features are distinct from the original promised goods and services. The price increase reflects the stand-alone selling price of the additional features.

Which THREE of the following statements are correct in accordance with IFRS 15 Revenue from Contracts with Customers?

A. The modification is accounted for as a separate contract.

B. Revenue recognised for performance completed before the modification is not adjusted.

C. The additional features are accounted for prospectively.

D. The modification must be accounted for using a cumulative catch-up adjustment.

E. The original contract is restated from inception to include the additional features.

ANSWER: A B C

Explanation:

The additional features are distinct because the customer can benefit from them on their own or together with resources that are readily available, and they are separately identifiable from the other promises in the contract. The price adjustment also reflects their stand-alone selling price. IFRS 15 therefore treats the contract modification as a separate contract.

ST accounts for the original contract without adjusting the revenue already recognised for performance completed before the modification. The additional features are accounted for prospectively under the separate contract. This outcome differs from a modification involving additional distinct goods or services priced below their stand-alone selling price, which is treated as termination of the existing contract and creation of a new contract. Where the remaining goods or services are not distinct, the modification is generally accounted for as part of the existing contract using a cumulative catch-up adjustment.

See IFRS 15 Revenue from Contracts with Customers.