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Questions

Module 1

Question 1.1
Which one of the following factors will be reflected in the amount of a short-term employee benefit obligation measured in accordance with IAS 19 Employee Benefits?

A the risk-free interest rate
B salary rates current at reporting date
C salary rates that reflect the future sacrifice
D interest rates on high-quality corporate bonds

Question 1.2
According to IAS 19 Employee Benefits, measurement of the long-term employee benefit obligation should be based on

A vested benefits at future salary rates.
B vested benefits at current salary rates.
C vested and non-vested benefits at future salary rates.
D vested and non-vested benefits at current salary rates.

Question 1.3
Which of the following identifies the assumption(s) underpinning the preparation of general purpose financial statements in accordance with the Conceptual Framework? Select which two options are correct.

A relevance
B going concern
C cash basis of accounting
D accrual basis of accounting

Question 1.4
Sandy Ltd (Sandy) measures its investment in Blue Chip Ltd (Blue Chip) shares at fair value. Blue Chip shares are listed and actively traded on the stock exchange. Which one of the following valuations should Sandy use to measure its investment in shares in Blue Chip in its financial statements at 30 June 20X3?

A the closing price of Blue Chip shares on the stock market at 30 June 20X3
B the average price of Blue Chip shares on the stock market from 1 June 20X3 to 30 June 20X3
C an estimate derived from a model that uses observable industry growth rates and past cash flows
D an estimate derived from a model that uses Sandy’s estimates of Blue Chip’s future profits and required rate of return
Question 1.5
Which one of the following is a criticism of the distinction between operating leases and finance leases in IAS 17 Leases?

A Commitments arising under non-cancellable operating leases must be disclosed.
B The obligations of the lessee are not recognised unless substantially all of the risks and rewards of ownership are transferred.
C It results in a lack of comparability because operating leases, but not finance leases, are recognised in the statement of financial position.
D The principles-based approach provides greater opportunity than a rules-based approach to structure leases so as to avoid recognition of lease assets and liabilities.

Question 1.6
Which one of the following statements is correct in relation to the approach adopted by IAS 17 Leases to classifying leases as either finance or operating leases?

A This approach is dependent on only qualitative criteria.
B This approach copes well with the wide variety of lease arrangements.
C This approach ensures that present obligations are recognised as liabilities.
D This approach can result in leases with similar economic characteristics being treated differently.

Question 1.7
Which of the following factors contribute to a finance lease classification?
Select which two options are correct.

A The lease term is for two years of the leased asset’s economic life of 10 years.
B Legal ownership of the leased asset transfers to the lessee at the end of the lease term.
C The return on the lease only compensates the lessor for insurance, maintenance and operating costs incurred by the lessor.
D The present value of the minimum lease payments equals 95 per cent of the fair value of the leased asset at the start of the lease.

Question 1.8
Self-Starter Sports Ltd (Self-Starter Sports) internally developed several assets. Which one of the following internally generated assets should be recognised in accordance with IAS 38 Intangible Assets? Assume that the expected future economic benefits of the internally generated assets are probable and the cost of the asset can be measured reliably.

A brand name ‘OneStep’ associated with Self-Starter Sports’ starter range
B customer list of customers signed up to Self-Starter Sports’ loyalty program
C computer program to keep track of customers’ orders and automate the generation of invoices
D masthead for a new sporting magazine called Hockey Highlights launched by Self-Starter Sports Ltd
Question 1.9

On 1 June 20X1 Bridget Ltd (Bridget) acquired an item of plant for an agreed consideration of 1000 of its own shares.

The plant was received on 1 June 20X1 and the obligation to transfer shares was to be settled on 1 August 20X1. The fair value of the plant was $10,000 on 1 June 20X1. Bridget's share price was $8 on 1 June 20X1 and $9 on 30 June 20X1.

In accordance with IFRS 2 Share-based Payment Bridget should

A remeasure the equity to $9000 on 30 June 20X1.
B initially recognise the plant and equity at $8000 on 1 June 20X1.
C make no entry in relation to the transaction until 1 August 20X1.
D initially recognise the plant and equity at $10,000 on 1 June 20X1.

Question 1.10

A long-term employee benefit obligation should reflect the amount which, if invested at measurement date, would provide the necessary pre-tax cash flows to pay the accrued obligation when expected to be settled. Where a deep market exists for all relevant financial instruments, IAS 19 requires that this amount is invested in

A risk-free securities.
B government bonds.
C a portfolio of high-quality shares.
D a portfolio of high-quality corporate bonds.

Question 1.11

Hook Ltd (Hook) purchases an investment property on 1 July 20X0 for $100,000. At 30 June 20X1, Hook determines the fair value of the investment property to be $150,000. At 30 June 20X2, the fair value of the investment property had fallen to $80,000. Hook's accounting policy is to carry investment properties at fair value.

Which one of the following journal entries is processed by Hook on 30 June 20X1?

A No entry is required
B Dr. Investment property $50,000
   Cr. Rental revenue $50,000
C Dr. Investment property $50,000
   Cr. Asset revaluation reserve $50,000
D Dr. Investment property $50,000
   Cr. Gain on revaluation (profit or loss) $50,000
**Question 1.12**

Hook Ltd (Hook) purchases an investment property on 1 July 20X0 for $100 000. At 30 June 20X1, Hook determines the fair value of the investment property to be $150 000. At 30 June 20X2, the fair value of the investment property had fallen to $80 000. Hook Ltd’s accounting policy is to carry investment properties at fair value.

Which one of the following journal entries is processed by Hook Ltd on 30 June 20X2?

A. Dr. Asset revaluation reserve $70 000  
   Cr. Investment property $70 000

B. Dr. Asset revaluation reserve $50 000  
   Dr. Loss on revaluation (profit or loss) $20 000  
   Cr. Investment property $70 000

C. Dr. Loss on revaluation (profit or loss) $50 000  
   Cr. Investment property $50 000

D. Dr. Loss on revaluation (profit or loss) $70 000  
   Cr. Investment property $70 000

**(FR ID 1.12)**

**Question 1.13**

Cayenne Ltd (Cayenne) purchases a property on 1 July 20X0 for $100 000. It sells the property on 1 January 20X3 to Snow Ltd (Snow) in exchange for 10 000 shares in Snow. On that date, Snow’s share price is $11 and the fair value of the property is $108 000.

Which one of the following statements is correct?

A. Snow initially recognises the property at $100 000.

B. Snow initially recognises the property at $108 000.

C. Snow initially recognises the property at $110 000.

D. Snow recognises a decrease in equity of $110 000.

**(FR ID 1.13)**

**Question 1.14**

Which one of the following is a criticism of IAS 40 *Investment Property*?

A. Fair value of investment properties cannot be reliably measured due to their specific nature.

B. Since entities can choose between fair value or cost, the comparability between entities is reduced.

C. Requiring fair value movements to be recognised in profit or loss results in less reliable information for users.

D. Classifying investment properties separately from property, plant and equipment on the statement of financial position does not faithfully represent the operations of the business.

**(FR ID 1.14)**
Question 1.15
Hayden Ltd (Hayden) purchases plant on 1 July 20X5 in exchange for cash consideration equal to the value of 10,000 shares in Hayden, determined and payable on 14 July 20X5. Hayden’s share price was $15 on 1 July 20X5 and $20 on 14 July 20X5. The fair value of the plant was $160,000 on both 1 July 20X5 and 14 July 20X5.

Which one of the following statements is correct?

A  Hayden initially recognises the plant at $150,000.
B  Hayden initially recognises the plant at $160,000.
C  Hayden recognises an increase in equity of $200,000.
D  Hayden remeasures the plant to $200,000 on 14 July 20X5.

(FR ID 1.15)

Question 1.16
On 30/6/20X0 Beta Ltd (Beta) leased equipment from Capital Finance Group. The lease had the following terms.

- The term of the lease is five years.
- The useful life of the equipment is eight years.
- The fair value of the equipment is $675,000 at the commencement of the lease.
- Lease rentals are $120,000 per annum, payable at the beginning of each year.
- The residual value is $110,000 but is not guaranteed.
- The present value of the minimum lease payments is equal to 50 per cent of the fair value of the asset at commencement of the lease.
- If Beta returns the leased equipment before the expiry of the lease, it will be liable to pay an amount equal to 80 per cent of the present value of remaining lease rentals, discounted at a non-risk adjusted rate.

Which one of the following statements is correct?

A  According to IAS 17 Leases, Beta should recognise an asset and liability at the inception of the lease.
B  According to the Conceptual Framework, Beta should recognise an asset and liability at the inception of the lease.
C  According to the Conceptual Framework and IAS 17 Leases, Beta should recognise an asset and liability at the inception of the lease.
D  According to the Conceptual Framework and IAS 17 Leases, Beta should not recognise an asset and liability at the inception of the lease.

(FR ID 1.16)
Module 2

Question 2.1

The following is an extract from the 20X6 annual report of Status Ltd (Status).

1. Statement of accounting policies

   Basis of accounting

   The financial statements are drawn up on a historical cost basis and, except where stated, do not take into account changing money values and/or current valuations of non-current assets.

   Changes in accounting policies

   During the 20X6 financial year, Status voluntarily changed its policy on accounting for inventory. This did not materially affect the 20X6 financial statements, but will have a material impact on the financial statements in subsequent reporting periods.

In addition to the above accounting policy details, what must the accountant for Status include as disclosures? Select which two options are correct.

   A  the nature and reason for the accounting policy change
   B  the fact that the financial report has been prepared on a going concern basis
   C  the financial effects of the accounting policy change on subsequent reporting periods
   D  the fact that the financial report has been prepared in accordance with International Financial Reporting Standards

Question 2.2

In preparing the 20X4 financial statements of Medal Ltd (Medal), there was a voluntary change of accounting policy in relation to inventories. The accountant for Medal noted that this change would not require any adjustment in the financial report for the reporting period ending on 30 June 20X4. However, the accountant considered that the change in accounting policy would have a material effect on the subsequent reporting period.

In accordance with IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors, which one of the following actions should be taken when preparing the financial report for the year ended 30 June 20X4?

   A  No information about the accounting policy change needs to be disclosed.
   B  Disclosure of the nature and reason for the change and its estimated financial effect in the subsequent reporting period.
   C  Disclosure of the nature and reason for the change and that no adjustments were recognised in the 20X4 financial statements.
   D  Inclusion of a note stating that an accounting policy had been changed but no adjustments were required in the 20X4 financial statements.
Question 2.3

In preparing the accounts of Oscar Ltd (Oscar) for the financial year ended 30 June 20X7, the following items were considered. In accordance with IAS 1 Presentation of Financial Statements, IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors and IAS 10 Events after the Reporting Period, which of the following items would be included in the determination of profit after income tax?

Select which three options are correct.

A  the loss from a major fire that closed the plant during April 20X7
B  a reassessment of the useful life of plant and equipment in December 20X6
C  a major currency realignment on 11 July 20X7 that affected the amount of Oscar’s foreign currency receivables
D  a change in accounting estimate related to the determination of the bad debts write-off for the 20X6 financial statements

Question 2.4

In accordance with IAS 1 Presentation of Financial Statements, which one of the following statements is correct?

A  Assets and liabilities must be presented broadly in the order of their liquidity.
B  Assets and liabilities can be offset if they result from the same transaction or event.
C  Intangible assets must be presented separately in the statement of financial position.
D  Even if less than 12 months, the length of an entity’s operating cycle must be disclosed.

Question 2.5

In accordance with IAS 1 Presentation of Financial Statements, which one of the following statements in relation to the statement of profit or loss and other comprehensive income is correct?

A  A reclassification adjustment is made to other comprehensive income when a revalued item of plant and equipment is sold.
B  Items of income and expense that are outside the ordinary operations of an entity are included in other comprehensive income.
C  Where an entity has an investment in an associate, the profit of the entity would include a line item ‘Share of profit or loss and other comprehensive income of associate’.
D  The components of other comprehensive income may be presented in the statement of profit or loss and other comprehensive income before tax with an aggregate amount of tax for all components.
Question 2.6
Sandal Ltd (Sandal) prepares consolidated financial statements. During the financial year ended 30 June 20X4, Sandal disposed of an investment in a foreign operation. Up to the date of disposal, Sandal had to translate the financial statement of the foreign operation from another currency for inclusion in its consolidated financial statements. During prior reporting periods, $14,000 of exchange difference gains net of tax (pre-tax exchange difference gains $20,000) had been recognised in other comprehensive income in the consolidated financial statements of Sandal. During the 20X4 reporting period, a $3,500 exchange difference gain net of tax (pre-tax exchange difference gain $5,000) up to the date of disposal of the foreign operation had been recognised in other comprehensive income.

In accordance with IAS 1 Presentation of Financial Statements, which one of the following statements is correct in relation to the treatment of the disposal of the foreign operation in the consolidated statement of profit or loss and other comprehensive income of Sandal for the year ended 30 June 20X4?

A Other comprehensive income would include an exchange difference net of tax gain of $3,500.
B Other comprehensive income would include a reclassification adjustment net of tax of $14,000.
C Other comprehensive income would include a reclassification adjustment net of tax of $17,500.
D No reclassification adjustment from other comprehensive income to profit or loss is necessary on disposal of the foreign operation.

Question 2.7
In accordance with IAS 1 Presentation of Financial Statements, which one of the following items does not have to be separately presented in the statement of profit or loss and other comprehensive income?

A finance costs
B share of losses from associates
C expenses from ordinary activities
D profit attributable to non-controlling interests

Question 2.8
Salter Ltd has completed its 20X5 financial statements which reveal, in part, the following information.

- Profit for the year—$110,000
- Total comprehensive income—$130,000
- Other comprehensive income relates to the revaluation of land and buildings to fair value
- Dividends paid—$35,000
- Opening equity balances—share capital $300,000, retained earnings $220,000, asset revaluation surplus $60,000
- No more share capital was issued during the reporting period

In accordance with IAS 1 Presentation of Financial Statements, which one of the following items would correctly be included in the statement of changes in equity for the year ended 30 June 20X5?

A Closing retained earnings—$295,000
B Closing retained earnings—$315,000
C Total closing equity—$655,000
D Total closing equity—$695,000
Question 2.9

In accordance with the requirements of IAS 1 Presentation of Financial Statements, which one of the following statements is correct?

A  Reclassification adjustments relating to components of other comprehensive income must be disclosed.
B  The share of profit or loss of associates determined using the equity method must be included in other comprehensive income.
C  Every item that appears in other comprehensive income will require a reclassification adjustment in future reporting periods when the item involved is derecognised.
D  Retrospective adjustments arising from a change in accounting policy in accordance with IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors must be included in other comprehensive income.

Question 2.10

The accountant for Indra Ltd (Indra) has determined the following information for the year ended 30 June 20X6.

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
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<tbody>
<tr>
<td>Profit or loss</td>
<td>$300 000</td>
</tr>
<tr>
<td>Share of total comprehensive income after tax of associates</td>
<td>$20 000</td>
</tr>
<tr>
<td>Share of profit (after tax) of associates</td>
<td>$15 000</td>
</tr>
<tr>
<td>Exchange difference gain (net of tax of $3000) on translation of foreign operation up to the date sold (1 March 20X6)</td>
<td>$7 000</td>
</tr>
<tr>
<td>Exchange difference gain (net of tax of $9000) on disposal of foreign operation recognised in profit for the year</td>
<td>$21 000</td>
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<tr>
<td>Increase in asset revaluation surplus (net of tax)</td>
<td>$45 000</td>
</tr>
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In accordance with the requirements of IAS 1 Presentation of Financial Statements, what is the total amount of other comprehensive income for Indra for the year ended 30 June 20X6?

A  $36 000
B  $51 000
C  $57 000
D  $72 000

Question 2.11

In accordance with IAS 1 Presentation of Financial Statements, which one of the following items must be separately presented in the statement of financial position?

A  net assets
B  non-financial assets
C  asset revaluation surplus
D  issued capital and reserves
**Question 2.12**

The following information relates to the affairs of Funny Money Ltd.

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<tr>
<td>Trade receivables</td>
<td>$150 Debit</td>
<td>$120 Debit</td>
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<tr>
<td>Allowance for doubtful debts</td>
<td>8 Credit</td>
<td>12 Credit</td>
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</table>

**Year ended 30 June 20X3**

- Sales revenue: $500,000
- Doubtful debts expense: $15,000

Bad debts incurred during the year were written off against the allowance for doubtful debts.

What is the amount of cash collected from trade receivables during 20X3?

- **A** $481,000
- **B** $485,000
- **C** $515,000
- **D** $519,000

**Question 2.13**

**Note:** This question provides information on receivables net of allowance for doubtful debts. There is a need to use the data to determine the change in gross receivables and bad debt write-off for the period.

The following information relates to Cashflow Ltd for the year ended 30 June 20X6.

- Sales revenue: $450,000
- Opening balance of trade receivables (net of allowance): $100,000
- Closing balance of trade receivables (net of allowance): $132,500
- Doubtful debts expense: $5,000
- Increase in allowance for doubtful debts: $2,000
- Bad debts are written off against the allowance for doubtful debts

What is the amount of cash collected from customers during the year ended 30 June 20X6?

- **A** $412,500
- **B** $418,500
- **C** $481,500
- **D** $487,500
Question 2.14

Balances of the deferred tax accounts of Taxflow Ltd were as follows.

<table>
<thead>
<tr>
<th></th>
<th>30 June 20X3</th>
<th>30 June 20X4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deferred tax liability</td>
<td>3 200 Credit</td>
<td>2 000 Credit</td>
</tr>
<tr>
<td>Deferred tax asset</td>
<td>2 650 Debit</td>
<td>1 900 Debit</td>
</tr>
</tbody>
</table>

Income tax expense for the year ended 30 June 20X4 was $1750. The current tax payable at 30 June 20X4 is $200 less than the current tax payable at the preceding year end.

What was the amount of income tax paid during the year ended 30 June 20X4?

A  Nil
B  $1500
C  $2400
D  $3900

Question 2.15

The following information relates to the activities of Cashin Ltd. Income tax may be ignored.

<table>
<thead>
<tr>
<th></th>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net cash inflows from operating activities</td>
<td>720 000</td>
</tr>
<tr>
<td>Decrease in trade payables</td>
<td>23 000</td>
</tr>
<tr>
<td>Decrease in inventory</td>
<td>11 500</td>
</tr>
<tr>
<td>Increase in trade receivables</td>
<td>24 600</td>
</tr>
<tr>
<td>Cash proceeds from sale of plant (book value of $25 000)</td>
<td>14 000</td>
</tr>
<tr>
<td>Increase in allowance for doubtful debts</td>
<td>1 000</td>
</tr>
</tbody>
</table>

What is the profit for the period?

A  $698 100
B  $730 100
C  $744 100
D  $767 100
Module 3

Question 3.1
In relation to provisions, for a present obligation to exist, which one of the following factors must be present?

A  The obligation must be capable of being reliably measured.
B  The entity must have a legal obligation that can be enforced by law.
C  The entity must have no realistic alternative to settling the obligation.
D  It must be more likely than less likely that there will be a future flow of economic benefits.

Question 3.2
In accordance with the requirements of IAS 37 Provisions, Contingent Liabilities and Contingent Assets, where measurement uncertainty exists, which one of the following methods is not an appropriate valuation for a provision based on accounting standards?

A  the mid-point of a range of equally likely outcomes of expenditure
B  no provision should be recognised where measurement uncertainty exists
C  the minimum amount expected to represent a best estimate, where the other option is omission
D  the most likely amount expected to represent a best estimate, where there is a single obligation

Question 3.3
A manufacturer provides warranties at the time of sale to purchasers of its product lines. Under the terms of the warranty, the manufacturer undertakes to repair or replace items that fail to perform satisfactorily within a period of two years from the date of sale. When should the manufacturer recognise the provision? Select which one of the following is correct.

A  At the time of sale.
B  At the end of the warranty period.
C  When the company is notified of a claim.
D  Never. A provision should not be recognised; rather the costs associated with the warranty should be expensed as incurred.
Question 3.4
Which one of the following is a correct statement in relation to IFRS 15 Revenue from Contracts with Customers?

A. The 'expected value' method may better predict variable consideration if the contract has only two possible outcomes.
B. The 'expected value' method requires an entity to identify the probability of each possible outcome of a contract occurring.
C. The 'expected value' method can be adopted as an entity’s accounting policy to estimate variable consideration for every contract.
D. The transaction price determined at the start of a contract is not updated for any changes in an entity’s assessment of the amount of consideration to which it expects to be entitled.

Question 3.5
Zulu Ltd (Zulu) enters into a contract with a customer to deliver a phone package to the customer in return for an upfront payment of $1000. Under the terms of the contract the customer will receive a ‘free’ phone upon signing the contract, and phone service for two years. Zulu also sells phones and phone services separately.

Which one of the following statements is correct?

A. At contract inception, Zulu recognises revenue of $1000.
B. At contract inception, Zulu recognises a contract liability of $1000.
C. Zulu identifies one performance obligation in the phone package.
D. Zulu identifies two performance obligations in the phone package.

Question 3.6
Which one of the following is included in the scope of IAS 37 Provisions, Contingent Liabilities and Contingent Assets?

A. provisions related to employee benefits
B. all financial instruments within the scope of IFRS 9
C. all provisions related to owned long-lived assets, such as oil rigs
D. all provisions related to insurance contracts within the scope of IFRS 4
Question 3.7

The Acme Building Company Ltd is aware of draft legislation that, when enacted, will require the company to refund certain amounts previously charged to its customers. The company intends to lobby against the legislation. At the reporting date, the planned legislative changes have been approved and are now effective.

Which one of the following treatments would be required at the reporting date?

A Recognise a provision as the legislation has been enacted.
B Make no disclosure as the company has not yet started refunding the amounts.
C Make no disclosure if the company does not intend to comply with the legislation.
D Disclose a contingent liability as the company intends to lobby against the legislation.

Question 3.8

Which of the following circumstances would result in a disclosure of a contingent liability?
Select which two options are correct.

A An event has caused the possibility of a sacrifice of future economic benefits, but the likelihood is remote.
B A present obligation has been determined and the future sacrifice of economic benefits is probable and may be reliably measured.
C The occurrence of an event has resulted in a probable sacrifice of future economic benefits, but the amount cannot be reliably measured.
D As a consequence of an event, the existence of a present obligation is not clear and the future sacrifice of economic benefits cannot be reliably measured.

Question 3.9

Which one of the following is a correct statement in relation to provisions and contingencies?

A An item of a contingent nature may be recognised, but not disclosed, in the body of the financial statements.
B IAS 37 Provisions, Contingent Liabilities and Contingent Assets applies to provisions to perform land rehabilitation activity.
C IAS 37 Provisions, Contingent Liabilities and Contingent Assets applies to contingent liabilities and contingent assets of insurers that result from insurance contracts.
D A present obligation exists in all circumstances where a company may have some choice in whether or not to make a future sacrifice of economic benefits in settlement of an obligation.
Question 3.10
Which one of the following represents an appropriate discount rate for measuring a provision based on IAS 37 Provisions, Contingent Liabilities and Contingent Assets?

A market yields on national government bonds
B market yields on high-quality corporate bonds
C pre-tax rate that reflects current market assessment of the time value of money and the risks specific to the liability
D pre-tax rate that reflects current market assessment of the time value of money and the risks specific to the entity

Question 3.11
Beta Ltd (Beta) enters into a contract with a customer to provide 100 widgets at a price of $50 per widget. Under the contract terms, unused widgets may be returned within 30 days of sale for a full refund. Based on past experience, Beta attaches the following probabilities to the estimated number of widgets the customer will return:

<table>
<thead>
<tr>
<th>Widgets returned</th>
<th>Probability of outcome</th>
<th>Probability-weighted consideration</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>10%</td>
<td>$500</td>
</tr>
<tr>
<td>10</td>
<td>10%</td>
<td>$450</td>
</tr>
<tr>
<td>15</td>
<td>60%</td>
<td>$2550</td>
</tr>
<tr>
<td>20</td>
<td>15%</td>
<td>$600</td>
</tr>
<tr>
<td>30</td>
<td>5%</td>
<td>$175</td>
</tr>
</tbody>
</table>

Which two of the following statements are correct?

A Under the ‘expected value’ method, the transaction price is $2550.
B Under the ‘expected value’ method, the transaction price is $4275.
C Under the ‘most likely amount’ method, the transaction price is $2550.
D Under the ‘most likely amount’ method, the transaction price is $4250.

Question 3.12
As at 30 June 20X8 (reporting date), STU Ltd (STU) is involved in a legal dispute with a supplier in relation to the early termination of the exclusive licence agreement between the two entities. The supplier is seeking damages of $40 million. The directors of STU believe they will be successful in defending the claim. STU’s lawyers have advised that it is 90 per cent probable the entity would not be found liable.

In accordance with IAS 37 Provisions, Contingent Liabilities and Contingent Assets, which one of the following is the most appropriate option for STU when preparing its financial report for 30 June 20X8?

A Do nothing.
B Disclose information about the possible liability as a contingent liability.
C Recognise a provision for the best estimate of the obligation to the supplier.
D Recognise a contingent liability for the best estimate of the obligation to the supplier.
Module 4

Question 4.1

The accounting profit before tax of Gamma Ltd (Gamma) for the year ended 30 June 20Y0 was $100 000 after charging all expenses and recognising all items of revenue. The carrying amounts in the books of Gamma of those assets and liabilities relevant to income taxes were as follows.

<table>
<thead>
<tr>
<th></th>
<th>20X9</th>
<th>20Y0</th>
</tr>
</thead>
<tbody>
<tr>
<td>Depreciable asset</td>
<td>—</td>
<td>100 000</td>
</tr>
<tr>
<td>Accumulated depreciation</td>
<td>—</td>
<td>15 000</td>
</tr>
<tr>
<td>Carrying amount</td>
<td>—</td>
<td>85 000</td>
</tr>
<tr>
<td>Goodwill (less allowance for impairment)</td>
<td>95 000</td>
<td>80 000</td>
</tr>
<tr>
<td>Unearned insurance premiums</td>
<td>27 000</td>
<td>31 000</td>
</tr>
</tbody>
</table>

In preparing the tax return of the company, the accountant included the following item.

- Depreciation of equipment $25 000

Reductions in goodwill are not deductible for tax purposes. The company’s effective tax rate was 30 per cent. Assume that the recognition criteria were satisfied.

Which one of the following journal entries would Gamma process to recognise the income tax consequences of these transactions in accordance with IAS 12 Income Taxes?

<table>
<thead>
<tr>
<th>A</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Deferred tax expense</td>
<td>1 800</td>
<td>3 000</td>
</tr>
<tr>
<td>Deferred tax asset</td>
<td>1 200</td>
<td>1 800</td>
</tr>
<tr>
<td>Deferred tax liability</td>
<td>3 000</td>
<td>1 200</td>
</tr>
<tr>
<td>Current tax expense</td>
<td>32 700</td>
<td>36 300</td>
</tr>
<tr>
<td>Tax payable</td>
<td>32 700</td>
<td>36 300</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>B</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Deferred tax asset</td>
<td>3 000</td>
<td>3 000</td>
</tr>
<tr>
<td>Deferred tax expense</td>
<td>1 800</td>
<td>1 800</td>
</tr>
<tr>
<td>Deferred tax liability</td>
<td>1 200</td>
<td>1 200</td>
</tr>
<tr>
<td>Current tax expense</td>
<td>36 300</td>
<td>36 300</td>
</tr>
<tr>
<td>Tax payable</td>
<td>36 300</td>
<td>36 300</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>C</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Deferred tax asset</td>
<td>5 700</td>
<td>5 700</td>
</tr>
<tr>
<td>Deferred tax income</td>
<td>2 700</td>
<td>2 700</td>
</tr>
<tr>
<td>Deferred tax liability</td>
<td>3 000</td>
<td>3 000</td>
</tr>
<tr>
<td>Current tax expense</td>
<td>32 700</td>
<td>32 700</td>
</tr>
<tr>
<td>Tax payable</td>
<td>32 700</td>
<td>32 700</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>D</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Deferred tax expense</td>
<td>2 700</td>
<td>5 700</td>
</tr>
<tr>
<td>Deferred tax asset</td>
<td>3 000</td>
<td>3 000</td>
</tr>
<tr>
<td>Deferred tax liability</td>
<td>27 300</td>
<td>27 300</td>
</tr>
<tr>
<td>Current tax expense</td>
<td>27 300</td>
<td>27 300</td>
</tr>
<tr>
<td>Tax payable</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

(FR ID 4.1)
Question 4.2
In relation to accounting for income taxes, which one of the following statements is correct?

A. Current tax expense is the sum of tax expense plus deferred tax expense.
B. Tax expense is the sum of current tax expense plus deferred tax expense.
C. Deferred tax liabilities are determined from deductible temporary differences.
D. All movements in deferred tax assets and liabilities are recognised in the statement of profit or loss and other comprehensive income.

Question 4.3
To calculate the tax base of a liability for employee benefits, which one of the following formulas would be used?

A. Carrying amount + Future assessable amounts
B. Carrying amount − Future non-assessable amounts of revenue
C. Carrying amount + Future deductible amounts − Future assessable amounts
D. Carrying amount − Future deductible amounts + Future assessable amounts

Question 4.4
At 30 June 20X3, the carrying amount of an asset is $100 000 and its tax base is $80 000. The tax rate is 30 per cent. At 30 June 20X3, in relation to this asset, which one of the following items would be recognised?

A. deferred tax asset of $6000
B. deferred tax liability of $6000
C. deferred tax asset of $24 000
D. deferred tax liability of $24 000

Question 4.5
For the year ended 30 June 20X5, Hope Ltd (Hope) had a taxable profit of $230 000. The following comparative information was ascertained from the tax calculations of Hope.

<table>
<thead>
<tr>
<th></th>
<th>20X4</th>
<th>20X5</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deferred tax asset</td>
<td>$78 000</td>
<td>$92 000</td>
</tr>
<tr>
<td>Deferred tax liability</td>
<td>$40 000</td>
<td>$34 000</td>
</tr>
</tbody>
</table>

The tax rate is 30 per cent.

What is the amount of tax expense of Hope for the year ended 30 June 20X5?

A. $20 000
B. $49 000
C. $61 000
D. $69 000
Question 4.6
For the year ended 30 June 20X7, Pringle Ltd (Pringle) had an accounting profit of $200,000 and a taxable profit of $170,000. The tax expense of Pringle for the year ended 30 June 20X7 was $60,000. At 30 June 20X7 it was determined that the company had a deferred tax liability of $27,000. Assume that there was no deferred tax asset at the beginning or end of the period.

The tax rate is 30 per cent.

Which one of the following statements is correct?

A  The deferred tax liability as at 30 June 20X6 was $0.
B  The deferred tax liability as at 30 June 20X6 was $18,000.
C  The current tax expense for the year ended 30 June 20X7 was $33,000.
D  The deferred tax expense for the year ended 30 June 20X7 was $27,000.

Question 4.7
At 30 June 20X3, the gross amount of the accounts receivable of Atom Ltd (Atom) was $10,000. At the same date, there was a related allowance for doubtful debts of $500. Revenue from sales is included in the statement of profit or loss and other comprehensive income in the same period as it is included in taxable profit. The tax rate is 30 per cent.

At 30 June 20X3, Atom would recognise which one of the following items in its statement of financial position?

A  deferred tax asset of $150
B  deferred tax liability of $150
C  deferred tax asset of $2850
D  deferred tax liability of $2850

Question 4.8
At 31 December 20X6, the statement of financial position of Multi Manufacturing Ltd (MM) contained a liability for employee benefits of $1,200,000. For tax purposes, a deduction for employee benefits is allowed in the reporting period in which they are paid. In addition, during the year ended 31 December 20X6, MM obtained a foreign currency loan of FC100,000 repayable in three years. During the year ended 31 December 20X6, the AUD equivalent of the foreign currency loan decreased from $200,000 on initial recognition to $180,000. Gains or losses on foreign currency loans are included in the determination of taxable profit in the period when the loan is settled. The tax rate is 30 per cent. Assume that for the purposes of statement of financial position presentation, deferred tax assets and deferred tax liabilities are netted off against each other.

At 31 December 20X6, in relation to the above liabilities, MM would recognise which one of the following items in its statement of financial position?

A  net deferred tax asset of $354,000
B  net deferred tax asset of $366,000
C  net deferred tax liability of $354,000
D  net deferred tax liability of $366,000
Question 4.9
The following information is available for Alpha Ltd (Alpha).

1. The taxable profit for the year ended 30 June 20X8 was $100,000.

2. Deductible temporary differences were:

<table>
<thead>
<tr>
<th></th>
<th>20X7</th>
<th>20X8</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts receivable</td>
<td>$10,000</td>
<td>$15,000</td>
</tr>
<tr>
<td>Provision for employee benefits</td>
<td>$65,000</td>
<td>$80,000</td>
</tr>
</tbody>
</table>

3. Taxable temporary differences were:

<table>
<thead>
<tr>
<th></th>
<th>20X7</th>
<th>20X8</th>
</tr>
</thead>
<tbody>
<tr>
<td>Prepaid insurance</td>
<td>$20,000</td>
<td>$30,000</td>
</tr>
</tbody>
</table>

Assume that the tax rate is 30 per cent. What was the amount of the tax expense of Alpha for the year ended 30 June 20X8?

A $24,000  
B $27,000  
C $30,000  
D $33,000

Question 4.10
Assetsale Ltd sold a fixed asset for $160,000. The following data are relevant.

- Cost of asset sold $100,000
- Capital gains tax cost base of asset $125,000
- Statement of financial position carrying amount $90,000
- Tax written-down amount of asset (tax cost less tax depreciation) $60,000
- The tax rate, including tax on taxable capital gains, is 30 per cent
- Capital gains are calculated by deducting the capital gains tax cost base from the sale proceeds

Which one of the following journal entries should be processed to record this transaction?

<table>
<thead>
<tr>
<th></th>
<th>$</th>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>9,000</td>
<td>9,000</td>
</tr>
<tr>
<td></td>
<td>Current tax expense</td>
<td>$19,500</td>
</tr>
<tr>
<td></td>
<td>Tax payable</td>
<td>$19,500</td>
</tr>
<tr>
<td>B</td>
<td>9,000</td>
<td>9,000</td>
</tr>
<tr>
<td></td>
<td>Deferred tax liability</td>
<td>$9,000</td>
</tr>
<tr>
<td></td>
<td>Current tax expense</td>
<td>$22,500</td>
</tr>
<tr>
<td></td>
<td>Tax payable</td>
<td>$22,500</td>
</tr>
<tr>
<td>C</td>
<td>9,000</td>
<td>9,000</td>
</tr>
<tr>
<td></td>
<td>Deferred tax liability</td>
<td>$9,000</td>
</tr>
<tr>
<td></td>
<td>Current tax expense</td>
<td>$4,500</td>
</tr>
<tr>
<td></td>
<td>Tax payable</td>
<td>$4,500</td>
</tr>
</tbody>
</table>
**Question 4.11**

On 31 December 20X9, SUFA Ltd (SUFA) revalued a depreciable asset to $160,000. The asset had not previously been revalued and the revaluation was recorded in accordance with the requirements of IAS 16 Property, Plant and Equipment. The following data are relevant:

- Cost of asset: $101,250
- Statement of financial position carrying amount: $90,000
- Tax written-down value (tax cost less tax depreciation): $75,000
- Capital gains tax is not taxable
- Effective life of asset at 1 January 20Y0: 8 years
- The tax rate is 30 per cent

SUFA expects to recover the carrying amount of the asset by using it until the end of its useful life.

Which one of the following journal entries should be processed to record the tax consequences of the revaluation?

<table>
<thead>
<tr>
<th></th>
<th>A</th>
<th>B</th>
<th>C</th>
<th>D</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Deferred tax expense</td>
<td>Other comprehensive income—revaluation surplus</td>
<td>Other comprehensive income—revaluation surplus</td>
<td>Deferred tax expense</td>
</tr>
<tr>
<td></td>
<td>Deferred tax liability</td>
<td>Deferred tax liability</td>
<td>Deferred tax liability</td>
<td>Deferred tax liability</td>
</tr>
<tr>
<td>$</td>
<td>3,375</td>
<td>7,875</td>
<td>21,000</td>
<td>25,500</td>
</tr>
<tr>
<td>$</td>
<td>3,375</td>
<td>7,875</td>
<td>21,000</td>
<td>25,500</td>
</tr>
</tbody>
</table>
Question 4.12
The following items appeared in the records of Changerate Ltd as at 30 June 20Y0.

<table>
<thead>
<tr>
<th>Statement of financial position item</th>
<th>Carrying amount</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rental revenue received in advance</td>
<td>80 000</td>
<td>Taxable when received in cash</td>
</tr>
<tr>
<td>Provision for employee benefits</td>
<td>20 000</td>
<td>Deductible for tax on a cash basis</td>
</tr>
<tr>
<td>Interest revenue receivable</td>
<td>50 000</td>
<td>Taxable on receipt in cash</td>
</tr>
<tr>
<td>Development costs carried forward</td>
<td>40 000</td>
<td>Claimed as an allowable deduction in a previous period</td>
</tr>
<tr>
<td>Plant and equipment less</td>
<td>100 000</td>
<td>Tax written-down amount of $40 000</td>
</tr>
</tbody>
</table>

Additional information
- Unused tax losses were $120 000.
- The recognition criteria for deferred tax assets and deferred tax liabilities were satisfied.
- On 31 May 20Y0, the responsible government minister announced that the rate of income tax was to be increased from 30 per cent to 35 per cent as from 1 July 20Y0. The government had a comfortable majority and it was highly probable, as at 30 June 20Y0, that the required legislation would be approved by the legislature.

Which one of the following choices correctly records the tax consequences of these events?

<table>
<thead>
<tr>
<th></th>
<th>$</th>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>A</strong> 30 June 20Y0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Deferred tax expense</td>
<td>3 500</td>
<td></td>
</tr>
<tr>
<td>Deferred tax asset</td>
<td>7 500</td>
<td></td>
</tr>
<tr>
<td>Deferred tax liability</td>
<td></td>
<td>11 000</td>
</tr>
<tr>
<td><strong>B</strong> 30 June 20Y0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Deferred tax expense</td>
<td>2 500</td>
<td></td>
</tr>
<tr>
<td>Deferred tax asset</td>
<td>5 000</td>
<td></td>
</tr>
<tr>
<td>Deferred tax liability</td>
<td></td>
<td>7 500</td>
</tr>
<tr>
<td><strong>C</strong> 30 June 20Y0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Deferred tax expense</td>
<td>4 500</td>
<td></td>
</tr>
<tr>
<td>Deferred tax asset</td>
<td>7 000</td>
<td></td>
</tr>
<tr>
<td>Deferred tax liability</td>
<td></td>
<td>11 500</td>
</tr>
<tr>
<td><strong>D</strong> 30 June 20Y0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Deferred tax asset</td>
<td>11 000</td>
<td></td>
</tr>
<tr>
<td>Deferred tax liability</td>
<td></td>
<td>7 500</td>
</tr>
<tr>
<td>Deferred tax income</td>
<td></td>
<td>3 500</td>
</tr>
</tbody>
</table>

(FR ID 4.12)
Question 4.13

XYZ Company (XYZ) paid $4000 in 20X1 for a piece of equipment that had an expected life of four years and a residual value of zero. Straight-line depreciation was used for accounting purposes and diminishing value for tax purposes. Accounting profit before tax and taxable profit for 20X1 and the next three years were as follows.

<table>
<thead>
<tr>
<th></th>
<th>Accounting profit before tax</th>
<th>Taxable profit</th>
</tr>
</thead>
<tbody>
<tr>
<td>20X1</td>
<td>$4 000</td>
<td>$3 000</td>
</tr>
<tr>
<td>20X2</td>
<td>$5 000</td>
<td>$5 400</td>
</tr>
<tr>
<td>20X3</td>
<td>$6 000</td>
<td>$6 400</td>
</tr>
<tr>
<td>20X4</td>
<td>$4 000</td>
<td>$4 200</td>
</tr>
</tbody>
</table>

Assume that
- a tax rate of 30 per cent applies;
- depreciation accounts for the difference between accounting profit before tax and taxable profit; and
- it is probable that future taxable profit will be sufficient to utilise any deductible temporary differences.

From the information above, what item would be included in the books of XYZ at the end of 20X1?

A a deferred tax asset of $300
B a deferred tax liability of $300
C a deferred tax asset of $1000
D a deferred tax liability of $1000
Question 4.14

XYZ Company (XYZ) paid $4000 in 20X1 for a piece of equipment that had an expected life of four years and a residual value of zero. Straight-line depreciation was used for accounting purposes and diminishing value for tax purposes. Accounting profit before tax and taxable profit for 20X1 and the next three years were as follows.

<table>
<thead>
<tr>
<th>Accounting profit before tax</th>
<th>Taxable profit</th>
</tr>
</thead>
<tbody>
<tr>
<td>$ 4 000</td>
<td>$ 3 000</td>
</tr>
<tr>
<td>$ 5 000</td>
<td>$ 5 400</td>
</tr>
<tr>
<td>$ 6 000</td>
<td>$ 6 400</td>
</tr>
<tr>
<td>$ 4 000</td>
<td>$ 4 200</td>
</tr>
</tbody>
</table>

Assume that
- a tax rate of 30 per cent applies;
- depreciation accounts for the difference between accounting profit before tax and taxable profit; and
- it is probable that future taxable profit will be sufficient to utilise any deductible temporary differences.

From the information above, when would the books of XYZ record a deferred tax asset of $180?

A 20X1
B 20X2
C 20X3
D Never
Question 4.15

The accounting profit before tax of Overseas Ltd for the year ended 30 June 20Y0 was $100 000 after charging all expenses and recognising all items of revenue.

The carrying amounts of assets and liabilities relevant to the calculation of income tax were as follows.

<table>
<thead>
<tr>
<th>Liabilities</th>
<th>20X9</th>
<th>20Y0</th>
</tr>
</thead>
<tbody>
<tr>
<td>Statutory fines payable</td>
<td>0</td>
<td>5 000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Assets</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Dividends receivable from other companies</td>
<td>18 000</td>
<td>8 000</td>
</tr>
<tr>
<td>Foreign currency loan receivable</td>
<td>100 000</td>
<td>110 000</td>
</tr>
<tr>
<td>Inventory</td>
<td>35 000</td>
<td>24 000</td>
</tr>
<tr>
<td>Less: Allowance for write-down to recoverable amount</td>
<td>0</td>
<td>(4 000)</td>
</tr>
</tbody>
</table>

The following information is also relevant for the purposes of income tax calculations.

(a) Statutory fines were not deductible for tax purposes.
(b) The increase in the foreign currency loan receivable was attributable to a foreign exchange gain that was not taxable until the asset was recovered.
(c) Dividends from other companies were exempt from income tax. Dividends received during the year ended 30 June 20Y0 amounted to $18 000.
(d) Inventory write-downs were not deductible for tax purposes until the period in which the inventory was sold or used to produce goods or services.
(e) As at 30 June 20X9, unused tax losses were $60 000. A deferred tax asset for these unused losses had been recognised.

The company's effective tax rate was 30 per cent. Assume that the recognition criteria were satisfied as at 30 June 20X9 and 30 June 20Y0.

Which one of the following options correctly presents the explanation of the relationship between tax expense and accounting profit for the year ended 30 June 20Y0 required to be disclosed by paragraph 81(c) of IAS 12 Income Taxes?

<table>
<thead>
<tr>
<th>Option</th>
<th>I</th>
<th>II</th>
<th>III</th>
<th>IV</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounting profit before tax</td>
<td>$100 000</td>
<td>$100 000</td>
<td>$100 000</td>
<td>$100 000</td>
</tr>
<tr>
<td>Tax at the applicable tax rate of 30%</td>
<td>$30 000</td>
<td>$30 000</td>
<td>$30 000</td>
<td>$30 000</td>
</tr>
</tbody>
</table>

Tax effect of

- Inventory write-down: (1 200)
- Foreign currency gain (loss): 3 000
- Exempt dividends: —
- Non-deductible statutory fines: —
- Benefit of previously unrecognised tax loss: (18 000)

Tax expense

- Option I: 31 800
- Option II: 29 100
- Option III: 30 900
- Option IV: 10 200

A Option I
B Option II
C Option III
D Option IV
Question 4.16
The accounting profit before tax of Overseas Ltd (Overseas) for the year ended 30 June 20Y0 was $100 000 after charging all expenses and recognising all items of revenue.

The carrying amounts of assets and liabilities relevant to the calculation of income tax were as follows.

<table>
<thead>
<tr>
<th></th>
<th>20X9</th>
<th>20Y0</th>
</tr>
</thead>
<tbody>
<tr>
<td>Liabilities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Statutory fines payable</td>
<td>0</td>
<td>5 000</td>
</tr>
<tr>
<td>Assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dividends receivable from other companies</td>
<td>18 000</td>
<td>8 000</td>
</tr>
<tr>
<td>Foreign currency loan receivable</td>
<td>100 000</td>
<td>110 000</td>
</tr>
<tr>
<td>Inventory</td>
<td>35 000</td>
<td>24 000</td>
</tr>
<tr>
<td>Less: Allowance for write-down to recoverable amount</td>
<td>0</td>
<td>(4 000)</td>
</tr>
<tr>
<td></td>
<td>35 000</td>
<td>20 000</td>
</tr>
</tbody>
</table>

The following information is also relevant for the purposes of income tax calculations.
(a) Statutory fines were not deductible for tax purposes.
(b) The increase in the foreign currency loan receivable was attributable to a foreign exchange gain that was not taxable until the asset was recovered.
(c) Dividends from other companies were exempt from income tax. Dividends received during the year ended 30 June 20Y0 amounted to $18 000.
(d) Inventory write-downs were not deductible for tax purposes until the period in which the inventory was sold or used to produce goods or services.
(e) As at 30 June 20X9, unused tax losses were $60 000. A deferred tax asset for these unused losses had been recognised.

The company’s effective tax rate was 30 per cent. Assume that the recognition criteria were satisfied as at 30 June 20X9 and 30 June 20Y0.

Which one of the following options correctly reflects the necessary adjustments to derive current tax expense (income) and deferred tax expense (income) of Overseas for the year ended 30 June 20Y0?

<table>
<thead>
<tr>
<th></th>
<th>I</th>
<th>II</th>
<th>III</th>
<th>IV</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current tax expense (income)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tax on taxable profit</td>
<td>9 300</td>
<td>12 900</td>
<td>9 300</td>
<td>11 100</td>
</tr>
<tr>
<td>Tax benefit from recoupment of previously unrecognised tax losses—(para. 80(e))</td>
<td>18 000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current tax expense (income)—(para. 80(a))</td>
<td>27 300</td>
<td>12 900</td>
<td>9 300</td>
<td>11 100</td>
</tr>
<tr>
<td>Deferred tax expense (income)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Deferred tax expense (income) relating to origination and reversal of temporary differences—(para. 80(c))</td>
<td>1 800</td>
<td>(1 800)</td>
<td>1 800</td>
<td>—</td>
</tr>
<tr>
<td>Deferred tax expense relating to recoupment of previously recognised tax losses</td>
<td></td>
<td>18 000</td>
<td>18 000</td>
<td>18 000</td>
</tr>
<tr>
<td>Deferred tax expense</td>
<td>1 800</td>
<td>16 200</td>
<td>19 800</td>
<td>18 000</td>
</tr>
</tbody>
</table>

A  Option I
B  Option II
C  Option III
D  Option IV
**Question 4.17**

During the year ended 31 December 20Y0, Epsilon Ltd (Epsilon) incurred a loss of $100,000 on the sale of a non-depreciable asset. The loss was deductible for tax purposes. Epsilon also received royalty payments of $150,000 during that year, only $70,000 of which was recognised as income in the statement of profit or loss and other comprehensive income. Royalties are taxed when received in cash. As at 31 December 20Y0, it was expected that the company would generate sufficient future taxable profit to utilise the benefit of deductible temporary differences and tax losses. The tax rate is 30 per cent.

Which one of the following journal entries should Epsilon process?

<table>
<thead>
<tr>
<th></th>
<th>$</th>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>Deferred tax asset</td>
<td>24,000</td>
</tr>
<tr>
<td></td>
<td>Deferred tax income</td>
<td>24,000</td>
</tr>
<tr>
<td></td>
<td>Current tax expense</td>
<td>15,000</td>
</tr>
<tr>
<td></td>
<td>Current tax payable</td>
<td>15,000</td>
</tr>
<tr>
<td>B</td>
<td>Deferred tax asset</td>
<td>54,000</td>
</tr>
<tr>
<td></td>
<td>Deferred tax liability</td>
<td>24,000</td>
</tr>
<tr>
<td></td>
<td>Deferred tax income</td>
<td>30,000</td>
</tr>
<tr>
<td>C</td>
<td>Deferred tax asset</td>
<td>33,000</td>
</tr>
<tr>
<td></td>
<td>Deferred tax liability</td>
<td>24,000</td>
</tr>
<tr>
<td></td>
<td>Deferred tax income</td>
<td>9,000</td>
</tr>
<tr>
<td>D</td>
<td>Deferred tax asset</td>
<td>24,000</td>
</tr>
<tr>
<td></td>
<td>Deferred tax income</td>
<td>24,000</td>
</tr>
<tr>
<td></td>
<td>Current tax expense</td>
<td>45,000</td>
</tr>
<tr>
<td></td>
<td>Current tax payable</td>
<td>45,000</td>
</tr>
</tbody>
</table>

**Question 4.18**

The financial statements of Taxloss Ltd included the following carrying amounts for liabilities for product warranties.

<table>
<thead>
<tr>
<th>Liability for product warranties</th>
<th>30 June 20X7</th>
<th>30 June 20X8</th>
<th>30 June 20X9</th>
<th>30 June 20Y0</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>40,000</td>
<td>20,000</td>
<td>30,000</td>
<td>50,000</td>
</tr>
</tbody>
</table>

Reconciliations between accounting profit before tax and taxable profit for each of the last three years were as follows.

**Reconciliation between accounting profit before tax and taxable profit**

<table>
<thead>
<tr>
<th>Year ended</th>
<th>30 June 20X8</th>
<th>Year ended</th>
<th>30 June 20X9</th>
<th>Year ended</th>
<th>30 June 20Y0</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounting profit (loss) before income tax</td>
<td>(30,000)</td>
<td>25,000</td>
<td>40,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Adjustments for movements in temporary differences</td>
<td>$</td>
<td>$</td>
<td>$</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Increase (decrease) in liability for product warranties</td>
<td>(20,000)</td>
<td>10,000</td>
<td>20,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Taxable profit (Tax loss)</td>
<td>(50,000)</td>
<td>35,000</td>
<td>60,000</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
As at 30 June of each year, the recognition criteria for assets and liabilities discussed in IAS 12 were satisfied. The tax rate is 30 per cent.

Which one of the following sets of journal entries correctly records the income tax consequences of the events described above?

A

<table>
<thead>
<tr>
<th>30 June 20X8</th>
<th>30 June 20X9</th>
<th>30 June 20Y0</th>
</tr>
</thead>
<tbody>
<tr>
<td>$</td>
<td>$</td>
<td>$</td>
</tr>
<tr>
<td>Deferred tax asset 9 000</td>
<td>Deferred tax asset 13 500</td>
<td>Deferred tax expense 1 500</td>
</tr>
<tr>
<td>Deferred tax expense 6 000</td>
<td>Deferred tax income 13 500</td>
<td>Deferred tax asset 1 500</td>
</tr>
<tr>
<td>Current tax income 15 000</td>
<td>Current tax expense 13 500</td>
<td>Tax payable 13 500</td>
</tr>
</tbody>
</table>

B

<table>
<thead>
<tr>
<th>30 June 20X8</th>
<th>30 June 20X9</th>
<th>30 June 20Y0</th>
</tr>
</thead>
<tbody>
<tr>
<td>$</td>
<td>$</td>
<td>$</td>
</tr>
<tr>
<td>Deferred tax asset 15 000</td>
<td>Deferred tax asset 7 500</td>
<td>Deferred tax expense 1 500</td>
</tr>
<tr>
<td>Current tax income 15 000</td>
<td>Deferred tax income 7 500</td>
<td>Deferred tax asset 1 500</td>
</tr>
</tbody>
</table>

C

<table>
<thead>
<tr>
<th>30 June 20X8</th>
<th>30 June 20X9</th>
<th>30 June 20Y0</th>
</tr>
</thead>
<tbody>
<tr>
<td>$</td>
<td>$</td>
<td>$</td>
</tr>
<tr>
<td>Deferred tax asset 9 000</td>
<td>Deferred tax expense 6 000</td>
<td>Deferred tax asset 1 500</td>
</tr>
<tr>
<td>Current tax income 15 000</td>
<td>Deferred tax asset 7 500</td>
<td>Deferred tax income 1 500</td>
</tr>
</tbody>
</table>

D

<table>
<thead>
<tr>
<th>30 June 20X8</th>
<th>30 June 20X9</th>
<th>30 June 20Y0</th>
</tr>
</thead>
<tbody>
<tr>
<td>$</td>
<td>$</td>
<td>$</td>
</tr>
<tr>
<td>Deferred tax asset 15 000</td>
<td>Deferred tax asset 13 500</td>
<td>Deferred tax expense 1 500</td>
</tr>
<tr>
<td>Current tax income 15 000</td>
<td>Deferred tax income 13 500</td>
<td>Deferred tax expense 1 500</td>
</tr>
</tbody>
</table>

Module 5

Question 5.1

IFRS 9 Financial Instruments requires that all investments in equity instruments and contracts on those instruments must be measured at fair value. However, in limited circumstances, cost may be an appropriate estimate of fair value. Which of the following circumstances are likely to suggest cost is not an appropriate estimate of fair value in accordance with IFRS 9?

Select which two options are correct.

A The CEO retires at the end of his contracted term.
B There is a significant improvement in the market for the company’s product.
C There is a significant downturn in the economy in which the company operates.
D There is an allegation of low-level fraud by an employee of the company. Management does not consider the fraud to be a significant internal problem or widespread.
Question 5.2
A company holds two main portfolios of debt securities. Both portfolios provide cash flows that meet the test of solely payments of interest and principal in IFRS 9. Securities held in portfolio A are sold on a regular basis, based on movements in the prices of the securities in the portfolio. Securities held in portfolio B are never sold but are held to maturity.

How should the portfolios be classified and measured? Select which one of the following is correct.

A both at fair value  
B both at amortised cost  
C portfolio A at fair value and portfolio B at amortised cost  
D portfolio A at amortised cost and portfolio B at fair value

Question 5.3
Which one of the following instruments does not satisfy the sole payments of interest and principal requirement in IFRS 9?

A a variable rate loan where the rate varies based on LIBOR up to a specified upper cap  
B a variable rate loan where the rate varies based on LIBOR and any changes in the credit risk  
C a variable rate loan where, if the loan is repaid before maturity, the borrower pays a 25 per cent premium as a penalty for early repayment  
D a variable rate loan where the loan can be extended and the amount to be repaid is determined based on the amount outstanding at the applicable interest rate at the time of extension

Question 5.4
Given the definition adopted in IAS 32 Financial Instruments: Presentation, which one of the following would not be a financial instrument?

A cash at bank  
B bill of exchange  
C prepaid insurance  
D forward exchange contract

Question 5.5
A company has issued preference shares that are redeemable at the option of the holder. Three months before the end of the year, it was probable that the holders would require redemption.

Which one of the following is the appropriate classification for the annual payment of $12 000 to preference shareholders at year end?

A dividend $12 000  
B interest expense $12 000  
C dividend $3000, interest expense $9000  
D dividend $9000, interest expense $3000
Question 5.6
A derivative financial asset is designated as the hedging instrument in a fair value hedge. The following details are available concerning its cost and fair value for three years.

<table>
<thead>
<tr>
<th></th>
<th>Fair value</th>
<th>Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>Year 0</td>
<td>$90,000</td>
<td>$90,000</td>
</tr>
<tr>
<td>Year 1</td>
<td>$100,000</td>
<td>$90,000</td>
</tr>
<tr>
<td>Year 2</td>
<td>$85,000</td>
<td>$90,000</td>
</tr>
<tr>
<td>Year 3</td>
<td>$85,000</td>
<td>$90,000</td>
</tr>
</tbody>
</table>

In accordance with the accounting required by IFRS 9, which one of the following would be the gain or (loss) recorded in the statement of profit or loss and other comprehensive income in year 2?

A  ($15,000)
B  ($5,000)
C  Nil
D  $10,000

Question 5.7
The term ‘market risk’ includes which two of the following risks?

A  currency credit risk
B  currency risk
C  liquidity risk
D  interest rate risk

Question 5.8
According to IAS 32, which one of the following instruments would be classified as equity?

A  redeemable preference shares with a fixed redemption date
B  redeemable preference shares redeemable at the discretion of the issuer
C  redeemable preference shares redeemable in five years at the request of the holder
D  redeemable preference shares redeemable at the discretion of the issuer, who has given formal notification of such intention
**Question 5.9**

A company discloses the following information in relation to its receivables in the notes to its financial statements.

- Gross amount receivable: $80m
- Provision for doubtful debts: $6m
- Net carrying amount of receivables: $74m

Which one of the following is the maximum credit risk that it must also disclose in the notes to comply with IFRS 7?

A. $6m  
B. $74m  
C. $80m  
D. No disclosure is required.

**Question 5.10**

XYZ issues a $1000 note with no maturity date that is redeemable at the discretion of the issuer, but can be converted by the holder for 10 ordinary shares of XYZ at any time. According to IAS 32, XYZ should classify the instrument as which one of the following?

A. equity because the holder is exposed to changes in the fair value of the issuer’s shares  
B. a liability because the holder is exposed to changes in the fair value of the issuer’s shares  
C. equity because the holder is not exposed to changes in the fair value of the issuer’s shares  
D. a liability because the holder is not exposed to changes in the fair value of the issuer’s shares

**Question 5.11**

Which one of the following statements is correct?

A. A reclassification of a financial liability is prohibited.  
B. Reclassification of financial assets is permitted and is likely to be frequent.  
C. A reclassification of a financial asset from amortised cost to fair value is prohibited.  
D. A reclassification of a financial asset from fair value to amortised cost is prohibited.
Question 5.12

On 1 January 20X6, XYZ Company (XYZ) issues a new instrument with the following characteristics.

1. Face value $100, issue price $90.
2. Cumulative dividend payable at 5 per cent per annum for 10 years. After 10 years, the dividend is payable at the discretion of the issuer.
3. The holder of the note has the option to convert to ordinary shares of XYZ after 10 years, and conversion will be 10 ordinary shares for each instrument.
4. The holder can demand redemption for the face value at any time, with six months’ notice up until the end of 10 years. After 10 years, redemption is at the discretion of the issuer.
5. There is no fixed maturity date.

How should the instrument be classified by XYZ in the first 10 years in accordance with IAS 32? Select which one of the following is correct.

A as equity  
B as a liability  
C as either equity or liability  
D as a compound instrument

Question 5.13

On 1 January 20X6, XYZ Company (XYZ) issues a new instrument with the following characteristics.

1. Face value $100, issue price $90.
2. Cumulative dividend payable at 5 per cent per annum for 10 years. After 10 years, the dividend is payable at the discretion of the issuer.
3. The holder of the note has the option to convert to ordinary shares of XYZ after 10 years, and conversion will be 10 ordinary shares for each instrument.
4. The holder can demand redemption for the face value at any time, with six months’ notice up until the end of 10 years. After 10 years, redemption is at the discretion of the issuer.
5. There is no fixed maturity date.

How should the instrument be classified by XYZ after year 10 in accordance with IAS 32? Select which one of the following is correct.

A as equity  
B as a liability  
C as either equity or liability  
D as a compound instrument
Question 5.14
On 1 January 20X6, XYZ Company (XYZ) issues a new instrument with the following characteristics.

1. Face value $100, issue price $90.
2. Cumulative dividend payable at 5 per cent per annum for 10 years. After 10 years, the dividend is payable at the discretion of the issuer.
3. The holder of the note has the option to convert to ordinary shares of XYZ after 10 years, and conversion will be 10 ordinary shares for each instrument.
4. The holder can demand redemption for the face value at any time, with six months’ notice up until the end of 10 years. After 10 years, redemption is at the discretion of the issuer.
5. There is no fixed maturity date.

Assume that in year 12 the issuer formally notifies the holders of the instrument that the notes are to be redeemed. How should the notes be classified in year 12 in accordance with IAS 32?

Select which one of the following is correct.

A as equity
B as a liability
C as either equity or liability
D as a compound instrument

Question 5.15
XYZ Ltd issues five-year interest-bearing bonds. The bonds are convertible to a fixed number of equity instruments of the issuer at the discretion of the holder. How should the bonds be classified under IAS 32?

Select which one of the following is correct.

A as equity
B as a liability
C as either equity or a liability
D as having equity and liability components

Question 5.16
A company issues $100,000 of convertible notes in 20X1. Holders of the notes have the right to convert the notes into shares only in December 20X3. At the date of issue, the fair value of a note without a similar conversion right was $90,000. The company considered that it was probable that all holders of the notes would convert their notes into shares.

Under IAS 32, how should the convertible notes be recognised in the issuer’s statement of financial position on the date of issue? Select which one of the following is correct.

<table>
<thead>
<tr>
<th>Liability</th>
<th>Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>A $100,000</td>
<td></td>
</tr>
<tr>
<td>B $90,000</td>
<td>$10,000</td>
</tr>
<tr>
<td>C $10,000</td>
<td>$90,000</td>
</tr>
<tr>
<td>D $90,000</td>
<td></td>
</tr>
</tbody>
</table>
Question 5.17

A company enters a forward exchange contract to hedge a USD receivable. Assuming that the receivable is measured at fair value, what is the required measurement of the forward exchange contract if the entity accounts for this as a fair value hedge under IFRS 9 Financial Instruments?

Select which one of the following is correct.

A. cost  
B. fair value  
C. lower of cost and fair value  
D. any of the above

(FR ID 5.17)

Question 5.18

XYZ Ltd (XYZ) sells a financial asset to ABC Ltd (ABC) for $350,000. The carrying amount of the financial asset is $300,000, and its fair value is not expected to change materially in the next three months. At the same time, XYZ enters a repurchase agreement with ABC, whereby XYZ agrees to repurchase the financial asset in three months for $365,000. In applying the IFRS 9 principles for the derecognition of financial assets, how would XYZ record the transaction?

Select which one of the following is correct.

<table>
<thead>
<tr>
<th></th>
<th>$</th>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td>A.</td>
<td>Cash</td>
<td>350,000</td>
</tr>
<tr>
<td></td>
<td>Gain on sale</td>
<td>50,000</td>
</tr>
<tr>
<td></td>
<td>Financial asset</td>
<td>300,000</td>
</tr>
<tr>
<td>B.</td>
<td>Cash</td>
<td>350,000</td>
</tr>
<tr>
<td></td>
<td>Loan</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Financial asset</td>
<td>300,000</td>
</tr>
<tr>
<td>C.</td>
<td>Cash</td>
<td>350,000</td>
</tr>
<tr>
<td></td>
<td>Loan</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>350,000</td>
</tr>
<tr>
<td>D.</td>
<td>Cash</td>
<td>350,000</td>
</tr>
<tr>
<td></td>
<td>Loss on sale</td>
<td>15,000</td>
</tr>
<tr>
<td></td>
<td>Loan</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>365,000</td>
</tr>
</tbody>
</table>

(FR ID 5.18)
Question 5.19

On 1 January 20X6, an Australian company signs a firm and binding contract to supply a new ferry to a company in Hong Kong on 31 December 20X6. There are significant penalties for non-performance for the Australian company. The company will receive payment in Hong Kong dollars (HKD) when the ferry is delivered. It enters a forward foreign exchange (FX) contact to sell HKD for AUD in 12 months. At 30 June 20X6, the fair value to the entity of the forward FX contract has increased by AUD 165,000. At 31 December 20X6, the fair value of the forward FX contract has increased in value by AUD 130,000 since 30 June.

The company has designated the FX contract as the hedging instrument in a fair value hedge. The company has a balance date of 30 June. The ferry was delivered on 31 December and the company was paid in HKD.

Under the provisions of IFRS 9 Financial Instruments, what should the company do in relation to the forward FX contract as at 30 June 20X6? Select which one of the following is correct.

A record a loss of AUD 165,000 in profit or loss
B record a gain of AUD 165,000 in profit or loss
C record an increase of AUD 165,000 in other comprehensive income
D record a decrease of AUD 165,000 in other comprehensive income

Module 6

Question 6.1

On 1 July 20X7, Investor Ltd (Investor) acquired all of the ordinary shares in Investee Ltd (Investee) for cash consideration. At that date, the shareholders’ equity of Investee was as follows.

<table>
<thead>
<tr>
<th></th>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Issued capital (100,000 shares issued)</td>
<td>100,000</td>
</tr>
<tr>
<td>Retained profits</td>
<td>80,000</td>
</tr>
<tr>
<td></td>
<td>180,000</td>
</tr>
</tbody>
</table>

Acquisition costs totalled $2000.

On acquisition, Investor revalued the assets of Investee to fair value, resulting in a revaluation increment of $20,000. The revaluation led to the recognition of a deferred tax liability of $6,000. The amount of goodwill included in the consolidated statement of financial position was $10,000.

What was the consideration paid by Investor for the shares in Investee?

A $202,000
B $204,000
C $210,000
D $212,000
Question 6.2
On the acquisition of a subsidiary, purchased goodwill should

A  be recorded as a consolidation adjusting entry.
B  not be separately recognised in any financial statements.
C  be recorded separately in the financial statements of the subsidiary.
D  be recognised separately in the financial statements of the investor.

FR ID 6.2

Question 6.3
On 8 August 20X3, Alpha Ltd (Alpha) acquired 20,000 shares in Beta Ltd (Beta) in return for an issue of 10,000 of its own shares. At that date, Alpha’s shares had a current market value of $2.70 each. Shares of Beta have a current market value of $1.30 each. Fees paid to legal advisers for the transaction totalled $2000. What is the amount of the consideration transferred?

A  $26,000
B  $27,000
C  $28,000
D  $29,000

FR ID 6.3

Question 6.4
In relation to goodwill arising from a business combination, which one of the following statements is in accordance with IFRS 3 Business Combinations?

A  Goodwill should be measured at cost less accumulated amortisation.
B  Goodwill should be amortised on a straight-line basis over its useful life.
C  Goodwill should be measured at cost less accumulated impairment losses.
D  Goodwill is only tested for impairment if circumstances indicate it may be impaired.

FR ID 6.4

Question 6.5
Which one of the following statements is not a key feature of the acquisition method?

A  An acquirer being identified for each business combination.
B  The measurement of acquired identifiable assets at fair value.
C  Cost of the business combination is measured at the fair value of the net assets received from the acquiree.
D  Goodwill is measured as the consideration transferred plus the amount of any non-controlling interest, plus the fair value of any previously held equity interest in the acquiree, less the fair value of the identifiable net assets acquired.

FR ID 6.5
Question 6.6

On 1 July 20X7, Big Ltd (Big) agreed to purchase the assets and liabilities of Small Ltd (Small) for $400 000 cash, plus 1 million shares in Big. At this date, the fair value of each share in Big was at $1.20.

Costs directly attributable to the business combination totalled $5000.

The statement of financial position of Small as at the date of purchase is presented below.

Small Ltd: Statement of financial position as at 1 July 20X7

<table>
<thead>
<tr>
<th>Assets</th>
<th>$000</th>
<th>Liabilities</th>
<th>$000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trade receivables</td>
<td>250</td>
<td>Bank overdraft</td>
<td>50</td>
</tr>
<tr>
<td>Inventory</td>
<td>520</td>
<td>Creditors</td>
<td>300</td>
</tr>
<tr>
<td>Land and buildings</td>
<td>800</td>
<td>Capital and retained earnings</td>
<td>1 220</td>
</tr>
<tr>
<td>(net of depreciation)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>1 570</td>
<td></td>
<td>1 570</td>
</tr>
</tbody>
</table>

In the negotiation process, Big has determined the following fair values for Small’s assets and liabilities (assume that no deferred tax assets or liabilities arose from the business combination).

<table>
<thead>
<tr>
<th>$000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trade receivables</td>
</tr>
<tr>
<td>Inventory</td>
</tr>
<tr>
<td>Land and buildings</td>
</tr>
<tr>
<td>Bank overdraft</td>
</tr>
<tr>
<td>Creditors</td>
</tr>
<tr>
<td></td>
</tr>
</tbody>
</table>

At what figure would the goodwill purchased by Big be measured?

A  $210 000
B  $215 000
C  $380 000
D  $385 000
Question 6.7

On 1 August 20X2, Parent Ltd (Parent) acquired a 70 per cent interest in Sub Ltd (Sub). At that date, the equity section of Sub’s statement of financial position revealed the following.

<table>
<thead>
<tr>
<th>$000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Issued capital</td>
</tr>
<tr>
<td>General reserve</td>
</tr>
<tr>
<td>Retained earnings</td>
</tr>
<tr>
<td>Owner’s equity</td>
</tr>
</tbody>
</table>

At acquisition date, Sub revalued its non-current assets to fair value (an increase of $200,000, net of tax).

Parent determined that it had paid $100,000 for goodwill. Any NCI is measured at the proportionate share of the fair value of the identifiable net assets of Sub.

Which one of the following proforma entries would be processed in the consolidation worksheet for the year ended 30 June 20X3?

<table>
<thead>
<tr>
<th>Debit $000</th>
<th>Credit $000</th>
</tr>
</thead>
<tbody>
<tr>
<td>A Issued capital 350</td>
<td>General reserve 70</td>
</tr>
<tr>
<td>Retained earnings (o/b) 35</td>
<td>Asset revaluation reserve 140</td>
</tr>
<tr>
<td>Goodwill 100</td>
<td>Investment in Sub 695</td>
</tr>
<tr>
<td>B Issued capital 500</td>
<td>General reserve 100</td>
</tr>
<tr>
<td>Retained earnings (o/b) 50</td>
<td>Goodwill 100</td>
</tr>
<tr>
<td>Investment in Sub 750</td>
<td></td>
</tr>
<tr>
<td>C Issued capital 350</td>
<td>General reserve 70</td>
</tr>
<tr>
<td>Retained earnings (o/b) 35</td>
<td>Goodwill 100</td>
</tr>
<tr>
<td>Investment in Sub 555</td>
<td></td>
</tr>
<tr>
<td>D Issued capital 500</td>
<td>General reserve 100</td>
</tr>
<tr>
<td>Retained earnings (o/b) 50</td>
<td>Asset revaluation reserve 200</td>
</tr>
<tr>
<td>Goodwill 100</td>
<td>Investment in Sub 950</td>
</tr>
</tbody>
</table>

(FR ID 6.7)
Question 6.8
Small Ltd (Small) is a wholly owned subsidiary of Large Ltd (Large). During the 20X3 financial year, Small declared and paid an interim dividend of $10 000 and declared a final dividend of $20 000 (which remains payable at year end). Large accounts for dividends when they are declared and payable.

Which one of the following proforma entries would be processed in the consolidation worksheet during the financial year ending on 30 June 20X3 in relation to the dividends?

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>$000</td>
<td>$000</td>
</tr>
<tr>
<td>A   Dividend income</td>
<td>30</td>
</tr>
<tr>
<td>Retained earnings (interim dividend)</td>
<td>10</td>
</tr>
<tr>
<td>Retained earnings (final dividend)</td>
<td>20</td>
</tr>
<tr>
<td>Dividends receivable</td>
<td></td>
</tr>
<tr>
<td>B   Dividends payable</td>
<td>20</td>
</tr>
<tr>
<td>Dividend income</td>
<td>30</td>
</tr>
<tr>
<td>Retained earnings (interim dividend)</td>
<td>10</td>
</tr>
<tr>
<td>Retained earnings (final dividend)</td>
<td>20</td>
</tr>
<tr>
<td>Dividends receivable</td>
<td>20</td>
</tr>
<tr>
<td>C   Dividend income</td>
<td>20</td>
</tr>
<tr>
<td>Dividends receivable</td>
<td>20</td>
</tr>
<tr>
<td>Retained earnings (final dividend)</td>
<td>20</td>
</tr>
<tr>
<td>Dividends payable</td>
<td>20</td>
</tr>
<tr>
<td>D   Dividends payable</td>
<td>30</td>
</tr>
<tr>
<td>Dividend income</td>
<td>30</td>
</tr>
<tr>
<td>Retained earnings (interim dividend)</td>
<td>10</td>
</tr>
<tr>
<td>Retained earnings (final dividend)</td>
<td>20</td>
</tr>
<tr>
<td>Dividends receivable</td>
<td>30</td>
</tr>
</tbody>
</table>

Question 6.9
In accordance with IFRS 10 Consolidated Financial Statements and IFRS 12 Disclosure of Interests in Other Entities, a consolidated statement of financial position (or notes thereto) would not present information relating to which one of the following?

A investments in subsidiaries
B goodwill acquired by the group
C loans to entities not related to the group
D non-controlling interests’ share of consolidated net assets
Question 6.10

On 15 August 20X2, Parent Ltd (Parent) acquired control of a subsidiary via a 60 per cent shareholding. During the year ended 30 June 20X5, the subsidiary company declared and paid an interim dividend of $10 000.

On 30 June 20X5, the subsidiary declared a dividend of $20 000. Parent accounts for dividends on an accrual basis. Assume that Parent is exempt from income tax on dividends received from group entities. The tax rate is 30 per cent.

Which one of the following pro forma entries would be processed in the consolidation worksheet for the year ended 30 June 20X5?

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>A</strong> Dividend income</td>
<td>30 000</td>
</tr>
<tr>
<td>Dividends payable</td>
<td>20 000</td>
</tr>
<tr>
<td>Retained earnings (interim dividend)</td>
<td>10 000</td>
</tr>
<tr>
<td>Retained earnings (final dividend)</td>
<td>20 000</td>
</tr>
<tr>
<td>Dividends receivable</td>
<td>20 000</td>
</tr>
<tr>
<td><strong>B</strong> Deferred tax asset</td>
<td>9 000</td>
</tr>
<tr>
<td>Dividend income</td>
<td>30 000</td>
</tr>
<tr>
<td>Dividends payable</td>
<td>20 000</td>
</tr>
<tr>
<td>Income tax expense</td>
<td>9 000</td>
</tr>
<tr>
<td>Retained earnings (interim dividend)</td>
<td>20 000</td>
</tr>
<tr>
<td>Retained earnings (final dividend)</td>
<td>10 000</td>
</tr>
<tr>
<td>Dividends receivable</td>
<td>20 000</td>
</tr>
<tr>
<td><strong>C</strong> Dividend income</td>
<td>18 000</td>
</tr>
<tr>
<td>Dividends payable</td>
<td>12 000</td>
</tr>
<tr>
<td>Retained earnings (interim dividend)</td>
<td>6 000</td>
</tr>
<tr>
<td>Retained earnings (final dividend)</td>
<td>12 000</td>
</tr>
<tr>
<td>Dividends receivable</td>
<td>12 000</td>
</tr>
<tr>
<td><strong>D</strong> Deferred tax asset</td>
<td>5 400</td>
</tr>
<tr>
<td>Dividend income</td>
<td>18 000</td>
</tr>
<tr>
<td>Dividends payable</td>
<td>12 000</td>
</tr>
<tr>
<td>Income tax expense</td>
<td>5 400</td>
</tr>
<tr>
<td>Retained earnings (interim dividend)</td>
<td>6 000</td>
</tr>
<tr>
<td>Retained earnings (final dividend)</td>
<td>12 000</td>
</tr>
<tr>
<td>Dividends receivable</td>
<td>12 000</td>
</tr>
</tbody>
</table>
Question 6.11
IFRS 10 Consolidated Financial Statements sets out how to determine whether one entity has control over another entity.

Which one of the following statements is in accordance with the IFRS 10 requirements and guidance for control to exist over another entity?

A. The investor must be the only party that receives variable returns from the investee.
B. The investor must have greater than 50% of the voting rights in the other entity.
C. The investor must have existing rights that give it the current ability to direct relevant activities.
D. The investor must be represented on the board of directors or governing body of the other entity.

(IFR ID 6.11)
Question 6.12

On 1 July 20X2, Holding Ltd (Holding) purchased all the issued capital of Subsidiary Ltd (Subsidiary) for $400,000. At acquisition date, the equity section of the statement of financial position of Subsidiary contained the following accounts.

$000

Issued capital 200
Retained earnings 110
Total 310

In addition, Holding determined that Subsidiary held equipment with a fair value of $60,000, which was disclosed in the statement of financial position at a cost of $80,000 and accumulated depreciation of $40,000.

The tax rate is 30 per cent.

Which one of the following consolidation adjusting entries would be processed on acquisition date?

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>$000</td>
<td>$000</td>
</tr>
<tr>
<td>A</td>
<td></td>
</tr>
<tr>
<td>Issued capital</td>
<td>200</td>
</tr>
<tr>
<td>Retained earnings</td>
<td>110</td>
</tr>
<tr>
<td>Deferred tax asset</td>
<td>6</td>
</tr>
<tr>
<td>Accumulated depreciation</td>
<td>40</td>
</tr>
<tr>
<td>Goodwill</td>
<td>64</td>
</tr>
<tr>
<td>Equipment</td>
<td>20</td>
</tr>
<tr>
<td>Investment in Subsidiary</td>
<td>400</td>
</tr>
<tr>
<td>B</td>
<td></td>
</tr>
<tr>
<td>Issued capital</td>
<td>200</td>
</tr>
<tr>
<td>Retained earnings</td>
<td>110</td>
</tr>
<tr>
<td>Accumulated depreciation</td>
<td>40</td>
</tr>
<tr>
<td>Goodwill</td>
<td>76</td>
</tr>
<tr>
<td>Equipment</td>
<td>20</td>
</tr>
<tr>
<td>Deferred tax liability</td>
<td>6</td>
</tr>
<tr>
<td>Investment in Subsidiary</td>
<td>400</td>
</tr>
<tr>
<td>C</td>
<td></td>
</tr>
<tr>
<td>Issued capital</td>
<td>200</td>
</tr>
<tr>
<td>Retained earnings</td>
<td>110</td>
</tr>
<tr>
<td>Accumulated depreciation</td>
<td>40</td>
</tr>
<tr>
<td>Goodwill</td>
<td>70</td>
</tr>
<tr>
<td>Equipment</td>
<td>20</td>
</tr>
<tr>
<td>Investment in Subsidiary</td>
<td>400</td>
</tr>
<tr>
<td>D</td>
<td></td>
</tr>
<tr>
<td>Issued capital</td>
<td>200</td>
</tr>
<tr>
<td>Retained earnings</td>
<td>110</td>
</tr>
<tr>
<td>Goodwill</td>
<td>90</td>
</tr>
<tr>
<td>Investment in Subsidiary</td>
<td>400</td>
</tr>
</tbody>
</table>
Question 6.13
Which one of the following statements is consistent with the principle of control as defined by FRS 10 Consolidated Financial Statements?

A  The investor must be exposed to a return from the investee.
B  The investor has the ability to use its power over the investee to affect the investor’s returns from the investee.
C  An investor’s power over an investee relates to their ability to determine the amount of returns received from the investee.
D  If two or more investors have existing rights to direct different relevant activities, no investor can have control over the investee.

[FR ID 6.13]

Question 6.14
Alpha Ltd (Alpha) owns 25 per cent of the shares (and voting rights) in Beta Ltd (Beta) but has no representation on the board of directors of the company. In accordance with IAS 28 Investments in Associates and Joint Ventures, Alpha

A will need to have board representation to ensure it has significant influence over Beta.
B will have significant influence over Alpha if it has both 20 per cent of the share capital and board representation.
C will be presumed to have significant influence over Beta as it holds more than 20 per cent of the voting power in that company.
D is presumed to have significant influence over Beta because it has greater than 20 per cent of the share capital of that company.

[FR ID 6.14]

Question 6.15
Investor Ltd (Investor) acquired an interest in an associate, Investee Ltd (Investee), on 1 January 20X8, on which date the purchased goodwill was measured at $300,000. The goodwill should

A be recorded in the books of Investor.
B be recorded in the books of Investee.
C not be recorded separately in any financial statements.
D be included in the consolidated financial statements of Investor.

[FR ID 6.15]
Question 6.16

Which one of the following events would change the amount of the item 'Investment in associate' in a company's consolidated financial report?

A The directors of the associate decide to issue bonus shares from the general reserves of the associate.
B There is sale of inventory from the investor to the associate, which results in unrealised profit at the end of reporting period.
C Subsequent to acquisition, the associate revalues its assets, which then reflect the fair values of the assets at the acquisition date.
D The directors of the associated company decide to transfer an amount from the retained earnings account to the general reserve.

(FR ID 6.16)

Question 6.17

When an investment in an associate is acquired, the initial amount of the investment should be

A recorded at cost to the investor.
B adjusted to reflect fair value of the assets acquired.
C reduced by the goodwill component of the cost to the investor.
D recorded at the investor's share of the fair value of the investee's assets.

(FR ID 6.17)

Question 6.18

Raven Ltd (Raven) is a parent entity that invested in an associate. In accordance with IFRS 3 Business Combinations, Raven determined that the acquisition involved a gain of $200 000. In accordance with IAS 28 Investments in Associates and Joint Ventures, the gain should be

A included in the carrying amount of the investment.
B deducted from the assets in the consolidated financial statements of Raven.
C amortised as income in the determination of the investor's share of the associate's profit over the period the investment is held.
D included as income in the determination of the investor's share of the associate's profit in the period the investment was acquired.

(FR ID 6.18)
**Question 6.19**

Parent Ltd (Parent) acquired 70 per cent interest in Subsidiary Ltd (Subsidiary) on 1 July 20X0. During the year ended 30 June 20X1, Subsidiary sold inventory to Parent for $8000. The original cost to Subsidiary was $6000. Half of the inventory was still on hand as at 30 June 20X1. During the year ended 30 June 20X2, the remainder of the inventory was sold to parties external to the group.

Assume a tax rate of 30 per cent.

Which one of the following proforma journal entries would be processed in the consolidation worksheet for the year ended 30 June 20X1?

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>A</td>
<td></td>
</tr>
<tr>
<td>Sales</td>
<td>8 000</td>
</tr>
<tr>
<td>Income tax expense</td>
<td>300</td>
</tr>
<tr>
<td>Cost of goods sold</td>
<td>7 000</td>
</tr>
<tr>
<td>Inventory</td>
<td>1 000</td>
</tr>
<tr>
<td>Deferred tax liability</td>
<td>300</td>
</tr>
<tr>
<td>B</td>
<td></td>
</tr>
<tr>
<td>Sales</td>
<td>8 000</td>
</tr>
<tr>
<td>Deferred tax asset</td>
<td>600</td>
</tr>
<tr>
<td>Cost of goods sold</td>
<td>6 000</td>
</tr>
<tr>
<td>Inventory</td>
<td>2 000</td>
</tr>
<tr>
<td>Income tax expense</td>
<td>600</td>
</tr>
<tr>
<td>C</td>
<td></td>
</tr>
<tr>
<td>Sales</td>
<td>8 000</td>
</tr>
<tr>
<td>Deferred tax asset</td>
<td>300</td>
</tr>
<tr>
<td>Cost of goods sold</td>
<td>7 000</td>
</tr>
<tr>
<td>Inventory</td>
<td>1 000</td>
</tr>
<tr>
<td>Income tax expense</td>
<td>300</td>
</tr>
<tr>
<td>D</td>
<td></td>
</tr>
<tr>
<td>Sales</td>
<td>8 000</td>
</tr>
<tr>
<td>Income tax expense</td>
<td>600</td>
</tr>
<tr>
<td>Cost of goods sold</td>
<td>6 000</td>
</tr>
<tr>
<td>Inventory</td>
<td>2 000</td>
</tr>
<tr>
<td>Deferred tax liability</td>
<td>600</td>
</tr>
</tbody>
</table>
Question 6.20

Parent Ltd (Parent) acquired 70 per cent interest in Subsidiary Ltd (Subsidiary) on 1 July 20X0. During the year ended 30 June 20X1, Subsidiary sold inventory to Parent for $8000. The original cost to Subsidiary was $6000. Half of the inventory was still on hand as at 30 June 20X1. During the year ended 30 June 20X2, the remainder of the inventory was sold to parties external to the group.

Which one of the following proforma journal entries would be processed in the consolidation worksheet for the year ended 30 June 20X2?

<table>
<thead>
<tr>
<th></th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>Retained earnings (o/b) 700</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Income tax expense 300</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Cost of goods sold 1 000</td>
<td></td>
</tr>
<tr>
<td>B</td>
<td>Retained earnings (o/b) 1 000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Income tax expense 300</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Cost of goods sold 1 000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Deferred tax asset 300</td>
<td></td>
</tr>
<tr>
<td>C</td>
<td>Retained earnings (o/b) 1 400</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Income tax expense 600</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Cost of goods sold 2 000</td>
<td></td>
</tr>
<tr>
<td>D</td>
<td>Retained earnings (o/b) 1 300</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Income tax expense 300</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Cost of goods sold 1 000</td>
<td></td>
</tr>
</tbody>
</table>

(FR ID 6.20)
Question 6.21

- Big Ltd (Big) owns 80 per cent of Little Ltd (Little).
- On 1 July 20X3, Little sold equipment to Big for $40 000. At the time of the sale, the carrying amount of the equipment in the books of Little was $30 000. Both entities depreciate the equipment at 10 per cent on cost.
- During the year ended 30 June 20X5, Big sold Little land at a profit of $5000. The profit was taxable.
- The 20X5 consolidation worksheet contains the following.

<table>
<thead>
<tr>
<th></th>
<th>Big Ltd</th>
<th>Little Ltd</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit for the year</td>
<td>80 000</td>
<td>20 000</td>
</tr>
<tr>
<td>Retained earnings (closing bal.)</td>
<td>25 000</td>
<td>10 000</td>
</tr>
</tbody>
</table>

**Note:** The tax rate was 30 per cent.

Which one of the following proforma entries would be processed in the consolidation worksheet for the year ended 30 June 20X5 in regard to the equipment sold during the 20X4 financial year?

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accumulated depreciation</td>
<td>$1 000</td>
</tr>
<tr>
<td>Income tax expense</td>
<td>$300</td>
</tr>
<tr>
<td>Retained earnings (o/b)</td>
<td>$10 000</td>
</tr>
<tr>
<td>Depreciation expense</td>
<td>$1 000</td>
</tr>
<tr>
<td>Deferred tax asset</td>
<td>$300</td>
</tr>
<tr>
<td>Equipment</td>
<td>$10 000</td>
</tr>
</tbody>
</table>

**A**

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accumulated depreciation</td>
<td>$2 000</td>
</tr>
<tr>
<td>Income tax expense</td>
<td>$300</td>
</tr>
<tr>
<td>Deferred tax asset</td>
<td>$2 400</td>
</tr>
<tr>
<td>Retained earnings (o/b)</td>
<td>$6 300</td>
</tr>
<tr>
<td>Depreciation expense</td>
<td>$1 000</td>
</tr>
<tr>
<td>Equipment</td>
<td>$10 000</td>
</tr>
</tbody>
</table>

**B**

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accumulated depreciation</td>
<td>$1 000</td>
</tr>
<tr>
<td>Income tax expense</td>
<td>$300</td>
</tr>
<tr>
<td>Deferred tax asset</td>
<td>$2 700</td>
</tr>
<tr>
<td>Retained earnings (o/b)</td>
<td>$7 000</td>
</tr>
<tr>
<td>Depreciation expense</td>
<td>$1 000</td>
</tr>
<tr>
<td>Equipment</td>
<td>$10 000</td>
</tr>
</tbody>
</table>

**C**

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accumulated depreciation</td>
<td>$2 000</td>
</tr>
<tr>
<td>Income tax expense</td>
<td>$600</td>
</tr>
<tr>
<td>Deferred tax asset</td>
<td>$2 400</td>
</tr>
<tr>
<td>Retained earnings (o/b)</td>
<td>$7 000</td>
</tr>
<tr>
<td>Depreciation expense</td>
<td>$2 000</td>
</tr>
<tr>
<td>Equipment</td>
<td>$10 000</td>
</tr>
</tbody>
</table>

**D**

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accumulated depreciation</td>
<td>$1 000</td>
</tr>
<tr>
<td>Income tax expense</td>
<td>$300</td>
</tr>
<tr>
<td>Deferred tax asset</td>
<td>$2 700</td>
</tr>
<tr>
<td>Retained earnings (o/b)</td>
<td>$7 000</td>
</tr>
<tr>
<td>Depreciation expense</td>
<td>$1 000</td>
</tr>
<tr>
<td>Equipment</td>
<td>$10 000</td>
</tr>
</tbody>
</table>
**Question 6.22**

- Big Ltd (Big) owns 80 per cent of Little Ltd (Little).
- On 1 July 20X3, Little sold equipment to Big for $40 000. At the time of the sale, the carrying amount of the equipment in the books of Little was $30 000. Both entities depreciate the equipment at 10 per cent on cost.
- During the year ended 30 June 20X5, Big sold Little land at a profit of $5000. The profit was taxable.
- The 20X5 consolidation worksheet contains the following.

<table>
<thead>
<tr>
<th></th>
<th>Big Ltd</th>
<th>Little Ltd</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit for the year</td>
<td>80 000</td>
<td>20 000</td>
</tr>
<tr>
<td>Retained earnings (closing bal.)</td>
<td>25 000</td>
<td>10 000</td>
</tr>
</tbody>
</table>

**Note:** The tax rate was 30 per cent.

The non-controlling interest in the profit for the year of the group is

- **A** $3440.
- **B** $4000.
- **C** $4140.
- **D** $4200.

**Question 6.23**

- Big Ltd (Big) owns 80 per cent of Little Ltd (Little).
- On 1 July 20X3, Little sold equipment to Big for $40 000. At the time of the sale, the carrying amount of the equipment in the books of Little was $30 000. Both entities depreciate the equipment at 10 per cent on cost.
- During the year ended 30 June 20X5, Big sold Little land at a profit of $5000. The profit was taxable.
- The 20X5 consolidation worksheet contains the following.

<table>
<thead>
<tr>
<th></th>
<th>Big Ltd</th>
<th>Little Ltd</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit for the year</td>
<td>80 000</td>
<td>20 000</td>
</tr>
<tr>
<td>Retained earnings (closing bal.)</td>
<td>25 000</td>
<td>10 000</td>
</tr>
</tbody>
</table>

**Note:** The tax rate was 30 per cent.

The non-controlling interest in the closing retained earnings of the group is

- **A** $180.
- **B** $400.
- **C** $880.
- **D** $2000.
Question 6.24

Parent Ltd (Parent) controls a subsidiary Sub Ltd (Sub), in which it owns 70 per cent of the issued capital. The following transactions are relevant to the preparation of the consolidated financial statements for the financial year ending 30 June 20X7.

Transaction 1: During the 20X4 financial year, Sub sold an item of plant to Parent at a loss. Parent is still using the plant.

Transaction 2: Sub paid an interim dividend in August 20X6. Parent is exempt from income tax on dividends received from the subsidiary.

Transaction 3: During the 20X7 financial year, Parent sold inventory to Sub for a price greater than its cost to Parent. One third of this inventory is still on hand at 30 June 20X7.

Transaction 4: In November 20X6, Parent borrowed $50,000 from Sub at an interest rate of 10 per cent. The interest on the loan is payable semi-annually.

Transactions 1 to 4 above each require an entry in the consolidation worksheet. Some of these consolidation worksheet entries will affect items in the consolidated statement of profit or loss and other comprehensive income.

Which three of the transactions would result in a consolidation entry that increased or decreased the consolidated profits for the year, as compared with the sum of the profits for the year of Parent and Sub?

A  transaction 1
B  transaction 2
C  transaction 3
D  transaction 4

Question 6.25

Parent Ltd (Parent) controls a subsidiary Sub Ltd (Sub), in which it owns 70 per cent of the issued capital. The following transactions are relevant to the preparation of the consolidated financial statements for the financial year ending 30 June 20X7.

Transaction 1: During the 20X4 financial year, Sub sold an item of plant to Parent at a loss. Parent is still using the plant.

Transaction 2: Sub paid an interim dividend in August 20X6. Parent is exempt from income tax on dividends received from the subsidiary.

Transaction 3: During the 20X7 financial year, Parent sold inventory to Sub for a price greater than its cost to Parent. One third of this inventory is still on hand at 30 June 20X7.

Transaction 4: In November 20X6, Parent borrowed $50,000 from Sub at an interest rate of 10 per cent. The interest on the loan is payable semi-annually.

Which two of the transactions will require tax-effect entries in the consolidation worksheet that result in a net adjustment to recognised tax balances?

A  transaction 1
B  transaction 2
C  transaction 3
D  transaction 4


**Question 6.26**

Parent Ltd (Parent) controls a subsidiary Sub Ltd (Sub), in which it owns 70 per cent of the issued capital. The following transactions are relevant to the preparation of the consolidated financial statements for the financial year ending 30 June 20X7.

Transaction 1: During the 20X4 financial year, Sub sold an item of plant to Parent at a loss. Parent is still using the plant.

Transaction 2: Sub paid an interim dividend in August 20X6. Parent is exempt from income tax on dividends received from the subsidiary.

Transaction 3: During the 20X7 financial year, Parent sold inventory to Sub for a price greater than its cost to Parent. One third of this inventory is still on hand at 30 June 20X7.

Transaction 4: In November 20X6, Parent borrowed $50,000 from Sub at an interest rate of 10 per cent. The interest on the loan is payable semi-annually.

Which one of the transactions will affect the calculation of the non-controlling interest in the consolidated profit for the financial year ended 30 June 20X7?

A transaction 1
B transaction 2
C transaction 3
D transaction 4

**Question 6.27**

- On 1 July 20X7, Investor Ltd (Investor) acquired 40,000 shares in Investee Ltd (Investee) at a cost of $75,000. At that date, the equity section of the statement of financial position of Investee was as follows.

<table>
<thead>
<tr>
<th></th>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Issued capital</td>
<td>100,000</td>
</tr>
<tr>
<td>Retained earnings</td>
<td>80,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>180,000</strong></td>
</tr>
</tbody>
</table>

- Investor used its significant influence to have the assets of Investee revalued to fair value, yielding a revaluation increment of $20,000 (net of tax).
- For the year ending 30 June 20X8, the following information was available for Investee.

<table>
<thead>
<tr>
<th></th>
<th>$000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit before tax</td>
<td>120</td>
</tr>
<tr>
<td>Less: Income tax expense</td>
<td>(36)†</td>
</tr>
<tr>
<td><strong>Profit for the year</strong></td>
<td><strong>84</strong></td>
</tr>
<tr>
<td>Retained earnings 1 July 20X7</td>
<td><strong>80</strong></td>
</tr>
<tr>
<td>Dividend paid</td>
<td>164</td>
</tr>
<tr>
<td>Dividend declared</td>
<td>(20)</td>
</tr>
<tr>
<td><strong>Retained earnings 30 June 20X8</strong></td>
<td><strong>114</strong></td>
</tr>
</tbody>
</table>

† Assume a tax rate of 30 per cent.
• Investor recognises dividends as revenue when they are declared.
• During the year ended 30 June 20X8, Investee sold $15,000 of inventory to Investor.
The inventory originally cost $5,000. One half of the inventory is still on hand at 30 June 20X8.
• Investor prepares consolidated financial statements.

The consolidated statement of profit or loss and other comprehensive income for the financial year ended 30 June 20X8 would reveal the item ‘Share of profit of associates’.

Which one of the following would be the amount of this item?

A $17,200
B $32,200
C $37,200
D $38,600

Question 6.28

• On 1 July 20X7, Investor Ltd (Investor) acquired 40,000 shares in Investee Ltd (Investee) at a cost of $75,000. At that date, the equity section of the statement of financial position of Investee was as follows.

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Issued capital (100,000 shares issued)</td>
<td>$100,000</td>
</tr>
<tr>
<td>Retained earnings</td>
<td>$80,000</td>
</tr>
<tr>
<td></td>
<td>$180,000</td>
</tr>
</tbody>
</table>

• Investor used its significant influence to have the assets of Investee revalued to fair value, yielding a revaluation increment of $20,000 (net of tax).
• For the year ending on 30 June 20X8, the following information was available for Investee.

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit before tax</td>
<td>$120</td>
</tr>
<tr>
<td>Less: Income tax expense</td>
<td>(36)†</td>
</tr>
<tr>
<td>Profit for the year</td>
<td>84</td>
</tr>
<tr>
<td>Retained earnings 1 July 20X7</td>
<td>80</td>
</tr>
<tr>
<td></td>
<td>164</td>
</tr>
<tr>
<td>Dividend paid</td>
<td>(20)</td>
</tr>
<tr>
<td>Dividend declared</td>
<td>(30)</td>
</tr>
<tr>
<td>Retained earnings 30 June 20X8</td>
<td>114</td>
</tr>
</tbody>
</table>

† Assume a tax rate of 30 per cent.

• Investor recognises dividends as revenue when they are declared.
• During the year ended 30 June 20X8, Investee sold $15,000 of inventory to Investor.
The inventory originally cost $5,000. One half of the inventory is still on hand at 30 June 20X8.
• Investor prepares consolidated financial statements.

The consolidated statement of financial position would reveal the item ‘Investment in associates’.

Which one of the following would be the amount of this item?

A $87,200
B $92,200
C $93,600
D $112,200
Question 6.29

- On 1 July 20X7, Investor Ltd (Investor) acquired 40,000 shares in Investee Ltd (Investee) at a cost of $75,000. At that date, the equity section of the statement of financial position of Investee was as follows.

<table>
<thead>
<tr>
<th>$</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Issued capital (100,000 shares issued)</td>
<td>100,000</td>
</tr>
<tr>
<td>Retained earnings</td>
<td>80,000</td>
</tr>
<tr>
<td></td>
<td>180,000</td>
</tr>
</tbody>
</table>

- Investor used its significant influence to have the assets of Investee revalued to fair value, yielding a revaluation increment of $20,000 (net of tax).
- For the year ending on 30 June 20X8, the following information was available for Investee.

<table>
<thead>
<tr>
<th>$000</th>
<th>$000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit before tax</td>
<td>120</td>
</tr>
<tr>
<td>Less: Income tax expense</td>
<td>(36)*</td>
</tr>
<tr>
<td>Profit for the year</td>
<td>84</td>
</tr>
<tr>
<td>Retained earnings 1 July 20X7</td>
<td>80</td>
</tr>
<tr>
<td>Dividend paid</td>
<td>(20)</td>
</tr>
<tr>
<td>Dividend declared</td>
<td>(30)</td>
</tr>
<tr>
<td>Retained earnings 30 June 20X8</td>
<td>114</td>
</tr>
</tbody>
</table>

* Assume a tax rate of 30 per cent.

- Investor recognises dividends as revenue when they are declared.
- During the year ended 30 June 20X8, Investee sold $15,000 of inventory to Investor. The inventory originally cost $5,000. One half of the inventory is still on hand at 30 June 20X8.
- Investor prepares consolidated financial statements.

If the inventory had been sold from Investor to Investee, this would have affected the consolidated financial statements via

A a reduction in ‘Inventory on hand’.

B an increase in ‘Investment in associates’.

C a reduction in ‘Investment in associates’.

D an increase in ‘Share of profit of associates’.

(FR ID 6.29)
Module 7

Question 7.1
In accordance with IAS 36 Impairment of Assets, which one of the following statements is correct?

A Investment properties carried at fair value must be tested annually for impairment.
B Goodwill must be tested for impairment only when there is an indication that it is impaired.
C Intangible assets with indefinite useful lives must be tested at least annually for impairment.
D Inventory must be tested for impairment only when there is an indication that it is impaired.

Question 7.2
In accordance with IAS 36 Impairment of Assets, which one of the following statements could be an indicator that an asset may be impaired?

A evidence that the asset is physically damaged
B a fall in interest rates that materially affects the asset's value in use
C a decline in the asset's market value, as would be expected from normal use
D the market capitalisation of the entity is greater than the carrying amount of its net assets

Question 7.3
In accordance with IAS 36 Impairment of Assets, which one of the following situations is most likely to be an impairment indicator?

A Short-term interest rates relating to long-lived assets have increased.
B The assets of the business are due for a major overhaul in the next reporting period.
C The budgeted cash outflows and cash inflows associated with an asset have both increased.
D An entity has discontinued an activity, which means that the assets involved will be idle until a different use can be found.

Question 7.4
The IAS 36 Impairment of Assets impairment test for an individual asset requires that the carrying amount of the asset be compared with its recoverable amount. According to IAS 36, ‘recoverable amount’ is described as the higher of two items.

Which of the following items are included in the definition of recoverable amount?

Select which one of the following options is correct.

A future cash flows from the asset and fair value of asset
B present value of future cash flows from the asset and fair value of the asset
C future cash flows from the asset and fair value of asset less costs of disposal
D present value of future cash flows from the asset and fair value of asset less costs of disposal
Question 7.5
Roller Ltd (Roller) is testing an asset for impairment. The carrying amount of the asset is $85,000. The following data has been obtained by Roller in relation to the asset.

- Future cash flows expected to be derived from the asset, $100,000.
- Estimated fair value of the asset, $80,000.
- Present value of future cash flows expected to be derived from the asset, $60,000.
- Costs of disposal for the asset, $2,000.

In accordance with IAS 36 Impairment of Assets, what is the recoverable amount of the asset?

Select which one of the following is correct.

A $60,000  
B $78,000  
C $80,000  
D $100,000

Question 7.6
The accountant for a manufacturing company is determining the value in use of an item of equipment. In accordance with IAS 36 Impairment of Assets, which one of the following items should be included in the determination of the equipment’s value in use?

A income tax payments  
B interest payments related to a loan obtained to fund capital expenditures  
C the cash inflow from the disposal of the equipment at the end of its useful life  
D cash inflows arising from planned improvements to the equipment to which the company is not yet committed
**Question 7.7**

Diva Ltd (Diva) has an item of equipment with a carrying amount of $110,000 (cost $150,000 less accumulated depreciation $40,000). The following data has been obtained by Diva in relation to the asset.

- Estimated fair value of the asset less costs of disposal, $90,000.
- Present value of future cash flows expected to be derived from the asset, $70,000.

To account for the impairment loss, the accountant for Diva is considering a number of accounting entries.

In accordance with IAS 16 *Property, Plant and Equipment* and IAS 36 *Impairment of Assets*, which one of the following entries would be appropriate to recognise the impairment loss?

<table>
<thead>
<tr>
<th>Debit $</th>
<th>Credit $</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>A</strong> Impairment loss</td>
<td>40,000</td>
</tr>
<tr>
<td>Accumulated depreciation and accumulated impairment losses</td>
<td>40,000</td>
</tr>
<tr>
<td><strong>B</strong> Accumulated depreciation</td>
<td>40,000</td>
</tr>
<tr>
<td>Impairment loss</td>
<td>20,000</td>
</tr>
<tr>
<td>Equipment</td>
<td>60,000</td>
</tr>
<tr>
<td><strong>C</strong> Impairment loss</td>
<td>20,000</td>
</tr>
<tr>
<td>Accumulated depreciation and accumulated impairment losses</td>
<td>20,000</td>
</tr>
<tr>
<td><strong>D</strong> Accumulated depreciation</td>
<td>40,000</td>
</tr>
<tr>
<td>Impairment loss</td>
<td>40,000</td>
</tr>
<tr>
<td>Equipment</td>
<td>80,000</td>
</tr>
</tbody>
</table>

(FR ID 7.7)
Question 7.8

At 30 June 20X5, Dome Ltd (Dome) had an item of machinery with a carrying amount of $140 000 (cost $200 000 less accumulated depreciation $60 000). The machinery was purchased on 3 July 20X2 and was depreciated at $20 000 per year based on a useful life of 10 years. On 30 June 20X5, it was determined that the recoverable amount of the machinery was $105 000. Therefore, an impairment loss of $35 000 was recognised.

After the depreciation entry for 30 June 20X6 had been processed, the recoverable amount of the machinery was reassessed. It was determined that the recoverable amount of the asset at 30 June 20X6 was $128 000.

To account for the reversal of the impairment loss, the accountant for Dome is considering a number of accounting entries.

In accordance with IAS 16 Property, Plant and Equipment and IAS 36 Impairment of Assets, which one of the following entries would be appropriate to recognise the reversal of the impairment loss?

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accumulated depreciation and</td>
<td>Income—reversal of impairment loss</td>
</tr>
<tr>
<td>accumulated impairment losses</td>
<td></td>
</tr>
<tr>
<td>A</td>
<td></td>
</tr>
<tr>
<td>B</td>
<td></td>
</tr>
<tr>
<td>C</td>
<td></td>
</tr>
<tr>
<td>D</td>
<td></td>
</tr>
</tbody>
</table>

(Rev ID 7.8)
Question 7.9

Hope Ltd has determined that one of its cash-generating units (CGUs) has sustained an impairment loss of $50,000. The carrying amounts of the assets within the CGU are as follows.

<table>
<thead>
<tr>
<th>Asset</th>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Asset 1</td>
<td>150,000</td>
</tr>
<tr>
<td>Asset 2</td>
<td>200,000</td>
</tr>
<tr>
<td>Asset 3</td>
<td>50,000</td>
</tr>
<tr>
<td>Total</td>
<td>400,000</td>
</tr>
</tbody>
</table>

The estimated fair value less costs of disposal of Asset 2 is $190,000, which is greater than its value in use.

A number of options are being considered as the amounts of impairment loss to be allocated to the three assets within the CGU.

In accordance with IAS 16 Property, Plant and Equipment and IAS 36 Impairment of Assets, which one of the following options would be the amount of impairment loss allocated to the three assets?

<table>
<thead>
<tr>
<th>Option</th>
<th>Asset 1</th>
<th>Asset 2</th>
<th>Asset 3</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>16,667</td>
<td>16,667</td>
<td>16,666</td>
<td>50,000</td>
</tr>
<tr>
<td>B</td>
<td>18,750</td>
<td>25,000</td>
<td>6,250</td>
<td>50,000</td>
</tr>
<tr>
<td>C</td>
<td>20,000</td>
<td>10,000</td>
<td>20,000</td>
<td>50,000</td>
</tr>
<tr>
<td>D</td>
<td>30,000</td>
<td>10,000</td>
<td>10,000</td>
<td>50,000</td>
</tr>
</tbody>
</table>

Question 7.10

The following information relates to three cash generating units.

<table>
<thead>
<tr>
<th>CGU A $000</th>
<th>CGU B $000</th>
<th>CGU C $000</th>
<th>Total $000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Carrying amount prior to allocation of corporate asset</td>
<td>1,000</td>
<td>2,000</td>
<td>4,000</td>
</tr>
<tr>
<td>Allocation of corporate asset (building)</td>
<td>150</td>
<td>200</td>
<td>350</td>
</tr>
<tr>
<td>Carrying amount after corporate asset allocation</td>
<td>1,150</td>
<td>2,200</td>
<td>4,350</td>
</tr>
<tr>
<td>Recoverable amount</td>
<td>1,500</td>
<td>1,800</td>
<td>3,850</td>
</tr>
</tbody>
</table>

In accordance with IAS 36 Impairment of Assets, what is the amount (to the nearest thousand) of the impairment loss that would be allocated to the corporate asset (building)?

Select which one of the following is correct.

<table>
<thead>
<tr>
<th>Option</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>Nil</td>
</tr>
<tr>
<td>B</td>
<td>$76,000</td>
</tr>
<tr>
<td>C</td>
<td>$82,000</td>
</tr>
<tr>
<td>D</td>
<td>$84,000</td>
</tr>
</tbody>
</table>
Question 7.11

In accordance with IAS 36 **Impairment of Assets**, how should an impairment loss for a cash generating unit (CGU) that includes goodwill be allocated?

Select which one of the following is correct.

A evenly over both the identifiable assets and goodwill of the CGU
B to both the identifiable assets and goodwill on a pro rata basis of the carrying amount of each asset
C to each of the identifiable assets in the CGU on a pro rata basis of the carrying amount of each identifiable asset
D first to reduce goodwill and then to the other identifiable assets on a pro rata basis of the carrying amount of each identifiable asset

Question 7.12

The carrying amount of a cash generating unit (CGU) is comprised of the following.

<table>
<thead>
<tr>
<th></th>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Machinery</td>
<td>400 000</td>
</tr>
<tr>
<td>Other plant</td>
<td>600 000</td>
</tr>
<tr>
<td>Land</td>
<td>1 000 000</td>
</tr>
<tr>
<td>Goodwill</td>
<td>400 000</td>
</tr>
</tbody>
</table>

2 400 000

It has been determined that the recoverable amount of the CGU is $1 800 000. It is not possible to estimate the recoverable amounts of the individual assets within the CGU.

A number of options are being considered as the carrying amounts of the assets in the cash generating unit after allocation of the impairment loss.

In accordance with IAS 16 **Property, Plant and Equipment** and IAS 36 **Impairment of Assets**, which one of the following options would be the carrying amounts of the assets after accounting for the impairment loss?

<table>
<thead>
<tr>
<th></th>
<th>Machinery</th>
<th>Other plant</th>
<th>Land</th>
<th>Goodwill</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$</td>
<td>$</td>
<td>$</td>
<td>$</td>
<td>$</td>
</tr>
<tr>
<td>A</td>
<td>250 000</td>
<td>450 000</td>
<td>850 000</td>
<td>250 000</td>
<td>1 800 000</td>
</tr>
<tr>
<td>B</td>
<td>300 000</td>
<td>450 000</td>
<td>750 000</td>
<td>300 000</td>
<td>1 800 000</td>
</tr>
<tr>
<td>C</td>
<td>333 333</td>
<td>533 333</td>
<td>933 334</td>
<td>—</td>
<td>1 800 000</td>
</tr>
<tr>
<td>D</td>
<td>360 000</td>
<td>540 000</td>
<td>900 000</td>
<td>—</td>
<td>1 800 000</td>
</tr>
</tbody>
</table>
**Question 7.13**

In accordance with IAS 36 *Impairment of Assets*, when determining the fair value of an asset less costs of disposal or its value in use, which **one** of the following statements is correct?

A. The costs of reorganising a business following the disposal of an asset should be deducted from its fair value.

B. An asset’s fair value less costs of disposal excludes legal costs that would be incurred in the course of disposing of the asset.

C. When determining the value in use, cash flow projections based on budgets or forecasts should not exceed a maximum of 10 years.

D. When determining value in use, risks specific to the asset should be incorporated in either the discount rate or the estimated future cash flows.

(FR ID 7.13)

**Question 7.14**

In accordance with IAS 36 *Impairment of Assets*, when identifying a cash-generating unit (CGU), which **one** of the following statements is correct?

A. Where a group of assets has an active market for its output, this group of assets would be considered to be a CGU.

B. A CGU is the smallest business unit that generates cash inflows independently of the cash inflows of other business units.

C. Even if an asset generates cash inflows independently of other assets, the recoverable amount of the CGU to which the asset belongs must still be estimated.

D. Where cash inflows can be identified with a particular asset but cannot be earned independently of other assets, the asset is still tested individually for impairment.

(FR ID 7.14)

**Question 7.15**

The following statements have been made in relation to the impairment of cash generating units (CGUs) and corporate assets. Select which **two** of the following are correct.

A. Corporate assets are assets that generate cash inflows separately from other assets or groups of assets.

B. The recoverable amount of an individual corporate asset cannot be determined unless management has decided to dispose of the asset.

C. The portion of a corporate asset that cannot be allocated on a reasonable and consistent basis to a CGU shall be treated as impaired and written off.

D. Where a portion of a corporate asset can be allocated on a reasonable and consistent basis to a CGU, the carrying amount of the CGU (including the allocated corporate asset) must be compared with the recoverable amount of the CGU to determine any impairment loss.

(FR ID 7.15)
Solutions

Module 1

Question 1.1
Correct answer: C

The correct answer is Option C. IAS 19 requires short-term employee benefits obligations to be measured at the undiscounted future sacrifice based on settlement amount. This would take account of salary rates at the date of payment for the benefits.

Option A is incorrect. Discounting of future payments to present value is not required for short-term employee obligations.

Option B is incorrect. The salary rate at the date of payment, not the reporting date, should be used to determine the amount of the liability.

Option D is incorrect. Discounting is not required for short-term employee benefits.

You can review this topic area in the study guide under the section titled ‘Application of measurement principles in IFRSs’—‘Employee benefits’.

Question 1.2
Correct answer: C

The correct answer is Option C. As discussed in paragraph 72 of IAS 19, the obligation (e.g. long-service leave) reflects both vested and non-vested benefits measured at future salaries. That is, each period of service gives rise to additional units of benefits regardless of whether they are vested or non-vested.

Option A is incorrect. It should include non-vested benefits.

Option B is incorrect. It should include non-vested benefits and should be based on future salaries.

Option D is incorrect. It should be based on future salary rates.

You can review this topic area in the study guide under the section titled ‘Application of measurement principles in IFRSs’—‘Employee benefits’.
**Question 1.3**
Correct answer: B and D

The correct answer is Options B and D. Financial statements are normally prepared under the assumption that the entity is a going concern (Conceptual Framework, para 4.1). Another assumption underpinning the preparation of general purpose financial statements is the application of the accrual basis of accounting (Conceptual Framework, para. OB17).

Option A is incorrect because relevance is a qualitative characteristic of useful financial information and not an assumption on which general purpose financial statements are based.

Option C is incorrect because general purpose financial statements are prepared on an accrual basis of accounting, and not on a cash basis, except for the statement of cash flows (paras. OB17 and OB20).

*You can review this topic area in the study guide under the section titled ‘Assumptions of general purpose financial statements’.*

**Question 1.4**
Correct answer: A

The correct answer is Option A. IFRS 13 *Fair Value Measurement* establishes a hierarchy for the measurement of fair value. The price of Blue Chip Ltd shares on the stock market is a Level 1 input because the share price is an observable quoted price and the shares traded on the market are identical to Sandy Ltd’s parcel of Blue Chip Ltd shares.

Option B is incorrect because the average share price for the month is not its fair value at 30 June 20X3.

Option C is incorrect because it is based on Level 2 inputs and should not be used if a quoted price for an identical asset is available.

Option D is incorrect because it is based on Level 3 inputs and should not be used if a measurement based on Level 1 inputs or Level 2 inputs is available.

*You can review this topic area in the study guide under the section titled ‘Measurement of elements of financial statements’—‘Cost-based and value-based measures used in IFRS’—‘Fair value’.*
**Question 1.5**

Correct answer: B

The correct answer is Option B. The distinction between operating leases and finance leases is used to determine whether a lease should be recognised on the statement of financial position. The resulting accounting treatment is not consistent with the recognition criteria for a liability because the obligations of the lessee are not recognised unless the lease transfers substantially all of the risks and rewards of ownership.

While Option A is a requirement of IAS 17, it is not a criticism, and Option A is therefore incorrect.

Option C is incorrect because finance leases, but not operating leases, are recognised in the statement of financial position.

Option D is incorrect because the rules-based approach (bright line definition) provides greater opportunity to structure leases so as to avoid the recognition of lease assets and liabilities.

*You can review this topic area in the study guide under the section titled ‘Definition and recognition criteria of elements of financial statements’—‘Applying the definitions and recognition criteria’—‘Accounting for leases’.*

**Question 1.6**

Correct answer: D

The correct answer is Option D. A criticism of the ‘risks and rewards approach’ is that leases with similar economic characteristics can be treated differently. For example, a lease that marginally satisfies the criteria for a finance lease would be recorded on the statement of financial position of a lessee, whereas a lease that marginally fails to meet the criteria would not.

Option A is incorrect. The approach can be applied using qualitative and/or quantitative criteria.

Option B is incorrect. The risks and rewards approach results in an ‘all-or-nothing’ approach to accounting for leases despite the diversity of lease arrangements.

Option C is incorrect because a lease liability is only recognised if the lease is classified as a finance lease.

*You can review this topic area in the study guide under the section titled ‘Definition and recognition criteria of elements of financial statements’—‘Applying the definitions and recognition criteria’—‘Accounting for leases’.*
Question 1.7
Correct answer: B and D

The correct answer is Options B and D. The transfer of legal ownership from the lessor to the lessee at the end of the lease term contributes to a finance lease classification (para. 10). Therefore, Option B would contribute to a finance lease classification.

The lessee is expected to recover substantially all of the fair value of the leased asset through the minimum lease payments it is to pay. This is an indicator that the risks and rewards incidental to ownership have passed from the lessor to the lessee (IAS 17 Leases, para. 10). Accordingly, Option D would also contribute to a finance lease classification.

The lease term is for other than the major part of the economic life of the leased asset. Accordingly, Option A does not contribute to a finance lease classification (see IAS 17, para. 10) and is therefore incorrect.

Under a finance lease the lessor will normally seek to obtain reimbursement from the party using the equipment (lessee) for substantially all of the fair value of the leased asset rather than only insurance, maintenance and operating expenses incurred by the lessor (IAS 17, para. 10). Accordingly, Option C does not contribute to a finance lease classification and is therefore incorrect.

You can review this topic area in the study guide under the section titled ‘Definition and recognition criteria of elements of financial statements’—‘Applying the definitions and recognition criteria’—‘Accounting for leases’.

Question 1.8
Correct answer: C

The correct answer is Option C. The internally generated software should be recognised in accordance with IAS 38 Intangible Assets.

Options A, B and D are incorrect because the recognition of the internally generated masthead, brand name and customer list are prohibited by paragraph 63 of the standard.

You can review this topic area in the study guide under the section titled ‘Qualitative characteristics of useful financial information’—‘Application of qualitative characteristics in IFRSs’.
**Question 1.9**

Correct answer: D

The correct answer is Option D. In an equity-settled share-based payment transaction, the goods or services, in this instance, the plant, are recognised when received and measured at the fair value of the goods or services acquired unless their fair value cannot be estimated reliably. In the present case, a reliable measurement of fair value of the goods received is available and should be used. (See IFRS 2, para. 10.)

Option A is incorrect. Liabilities for cash-settled share-based payments are remeasured but this does not apply to equity-settled share-based payments. (See IFRS 2, paras 7–10 and 30.)

Option B is incorrect. For equity-settled share-based payment transactions, the fair value of the recognised goods or services drives the measurement of the equity component of the transaction, subject to reliable estimation of fair value. (See IFRS 2, para. 10.)

Option C is incorrect. Goods or services acquired in a share-based payment transaction are recognised when the goods or services are received. (See IFRS 2, para. 7.)

You can review this topic area in the study guide under the section titled ‘Application of measurement principles in IFRSs’—‘Accounting for share-based payments’.

**Question 1.10**

Correct answer: D

The correct answer is Option D. As outlined in the module, IAS 19 Employment Benefits requires the discount rate to be based on high-quality corporate bonds, where a deep market exists for these bonds. This would reflect a market-determined, risk adjusted rate.

Options A and B are incorrect. The return on government bonds (i.e. the risk-free rate) is only used where there is no deep market for high-quality corporate bonds.

Option C is incorrect because the discount rate should be the rate that is applicable to high-quality corporate bonds not equity securities.

You can review this topic area in the study guide under the section titled ‘Application of measurement principles in IFRSs’—‘Employee benefits’.
Question 1.11
Correct answer: D

Option D is correct. Paragraph 35 of IAS 40 *Investment Properties* requires a gain or loss arising from a change in the fair value of investment property to be recognised in profit or loss in the period in which the gain or loss arises.

Option A is incorrect. Under this option, the carrying amount of the investment property remains at $100,000. However, as Hook's accounting policy is to carry investment properties at fair value, the carrying amount of the investment property must be adjusted to reflect its fair value at the reporting date.

Option B is incorrect. Under this option, the change in the investment property's fair value has been inappropriately recognised as rental revenue rather than as a gain on revaluation.

Option C is incorrect. Under this option, the gain on revaluation has been recognised in an asset revaluation reserve, consistent with the accounting for property, plant and equipment specified by IAS 16 *Property, Plant and Equipment*. However, as this is an investment property, IAS 40 *Investment Property* applies. Paragraph 35 of IAS 40 *Investment Properties* requires a gain or loss arising from a change in the fair value of investment property to be recognised in profit or loss in the period in which the gain or loss arises.

*You can review this topic area in the study guide under the section titled ‘Application of measurement principles in IFRSs’—‘Investment property’.*

Question 1.12
Correct answer: D

Option D is correct. Paragraph 35 of IAS 40 *Investment Properties* requires a gain or loss arising from a change in the fair value of investment property to be recognised in profit or loss in the period in which the gain or loss arises. The loss for the period is the decrease in the fair value of the property from 30 June 20X1 ($150,000) to 30 June 20X2 ($80,000).

Option A is incorrect. Under this option, the loss on revaluation has been recognised in an asset revaluation reserve. However, paragraph 35 of IAS 40 *Investment Properties* requires a gain or loss arising from a change in the fair value of investment property to be recognised in profit or loss in the period in which the gain or loss arises.

Option B is incorrect. Under this option, the loss on revaluation has been recognised in an asset revaluation reserve and profit or loss, consistent with the accounting for property, plant and equipment specified by IAS 16 *Property, Plant and Equipment*. However, as this is an investment property, IAS 40 *Investment Property* applies. Paragraph 35 of IAS 40 *Investment Properties* requires a gain or loss arising from a change in the fair value of investment property to be recognised in profit or loss in the period in which the gain or loss arises.

Option C is incorrect. This option assumes that decreases in fair value below the original cost of the property are not recognised.

*You can review this topic area in the study guide under the section titled ‘Application of measurement principles in IFRSs’—‘Investment property’.*
**Question 1.13**

Correct answer: B

Option B is correct. IFRS 2 *Share-based Payment* requires equity-settled share-based payment transactions to be measured at the fair value of the goods or services received, where the fair value can be estimated reliably (see IFRS 2, para. 10).

Option A is incorrect. This reflects the fair value of the property at the date of purchase by another entity, and not the fair value of the property at the time it was acquired by Snow.

Option C is incorrect. IFRS 2 *Share-based Payment* requires equity-settled share-based payment transactions to be measured at the fair value of the equity instruments granted only where the fair value of the goods or services acquired cannot be measured reliably (see IFRS 2, para. 10).

Option D is incorrect. Snow would reflect an increase in equity on recognition of the equity-settled share-based payment (see IFRS 2, para. 10).

*You can review this topic area in the study guide under the section titled ‘Application of measurement principles in IFRSs’—‘Accounting for share-based payments’.*

**Question 1.14**

Correct answer: B

The correct answer is Option B. Since entities have a free choice between cost and fair value, the choices made reduce the comparability of the performance and value of investment properties in the financial statements of different entities. However, the need for consistent information is addressed by the requirement for entities that choose to hold their investment properties at cost to disclose the fair value of the investment properties in the notes to the financial statements.

Investment properties are not unique and therefore the fair value can be obtained relatively easily, therefore Option A is incorrect.

The fair value movements recognised in profit and loss do not affect the reliability of the information—therefore Option C is incorrect. However, some critics of IAS 40 are of the view that recognising fair value movements in profit and loss affects the relevance of the information provided to users.

Entities hold investment properties and property, plant and equipment for different purposes. Investment properties are held for the purpose of earning of rentals/capital growth, whereas property, plant and equipment are held long term for the purpose of generating income. Therefore, classifying these assets separately on the statement of financial position faithfully represents the operations of the business—therefore Option D is incorrect.

*You can review this topic area in the study guide under the section titled ‘Application of measurement principles in IFRSs’—‘Investment property’.*
Question 1.15

Correct answer: A

Option A is correct. For cash-settled share-based payment transactions, IFRS 2 Share-based Payment requires the entity to measure the goods or services acquired and the liability incurred at the fair value of the liability.

Option B is incorrect as the plant is acquired in a cash-settled share-based payment transaction and not an equity-settled share-based payment transaction. For cash-settled share-based payment transactions, IFRS 2 Share-based Payment requires the entity to measure the goods or services acquired and the liability incurred at the fair value of the liability (see IFRS 2, para. 30). In contrast, IFRS 2 requires equity-settled share-based payment transactions to be measured at the fair value of the goods or services received, where the fair value can be estimated reliably (see IFRS 2, para. 10).

Option C is incorrect as the plant is acquired in a cash-settled share-based payment transaction and not an equity-settled share-based payment transaction. In a cash-settled share-based payment transaction, a liability incurred is recognised, rather than an increase in equity (see IFRS 2, para. 7).

Option D is incorrect. The goods received in a cash-settled share-based payment transaction are not remeasured after initial recognition. However, until the corresponding liability is settled, IFRS 2 requires the liability incurred to be remeasured to its fair value at the end of each reporting period and at the date of settlement, with any changes in fair value recognised in profit or loss for the period (see IFRS 2, para. 30).

You can review this topic area in the study guide under the section titled ‘Application of measurement principles in IFRSs’—‘Accounting for share-based payments’.
Question 1.16

Correct answer: B

The correct answer is Option B. In the absence of a specific accounting standard addressing the accounting for leases, the Conceptual Framework would require Beta to recognise an asset and liability because it has a right to use the equipment and an obligation for lease rentals arising from entering into the lease with Capital Finance Group. However, the accounting for leases, including recognition, is specified as part of IAS 17. There are two aspects to consider in this option. Under IAS 17, Beta would not recognise an asset and liability at the inception of the lease. However, the lease does meet the recognition criteria for an asset and liability under the Conceptual Framework.

The lease is not a finance lease under IAS 17 because it does not transfer substantially all of the risks and rewards of ownership to Beta. The lease is for only five years while the economic life of the equipment is eight years. Further, the present value of the lease rentals represents only half (rather than substantially all) of the fair value of the equipment at commencement of the lease, and Capital Finance Group retains the risk of loss of value of the equipment because the residual is not guaranteed. Beta would not recognise an asset and liability at inception of the lease under IAS 17 because the lease would not be classified as a finance lease. Accordingly, Options A and C are incorrect.

Option D is incorrect as while it correctly identifies that Beta would not recognise an asset and liability at the inception of the lease in accordance with IAS 17, it also incorrectly assumes that the asset and liability fail the recognition criteria in the Conceptual Framework.

You can review this topic area in the study guide under the section titled ‘Definition and recognition criteria of elements of financial statements’—‘Applying the definitions and recognition criteria’—‘Accounting for leases’.

Module 2

Question 2.1

Correct answer: A and D

The correct answer is Options A and D. IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors does not require the financial effects of a voluntary accounting policy change on subsequent reporting periods to be disclosed (para. 29). IAS 1 Presentation of Financial Statements requires the financial statements to be prepared on a going concern basis (para. 25). However, the fact that the financial statements have been prepared on a going concern basis does not have to be disclosed, except where this is not the case (para. 25). Paragraph 16 of IAS 1 requires a statement that the financial report has been prepared in accordance with IFRSs. Paragraph 29 of IAS 8 requires identification of the nature and reason for the accounting policy change if it might have an effect on the financial statements in future reporting periods.

Option B is incorrect. A statement concerning the going concern basis is required only where this basis has not been applied.

Option C is incorrect. The financial effects of the accounting policy change on subsequent reporting periods do not have to be disclosed.

You can review this topic area in the study guide under the sections titled ‘Fair Presentation and Compliance with IFRSs’ and ‘Accounting policies’.
**Question 2.2**

Correct answer: C

The correct answer is Option C. Refer to paragraph 29 of IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors.

Option A is incorrect. Paragraph 29 of IAS 8 requires disclosure of information about the accounting policy change where the accounting policy change might have an effect in subsequent reporting periods.

Option B is incorrect. Paragraph 29 of IAS 8 does not require an estimate of the financial effect in subsequent reporting periods to be disclosed.

Option D is incorrect. It does not indicate the nature of, or reason for, the change in accounting policy.

*You can review this topic area in the study guide under the section titled ‘Accounting policies’.*

**Question 2.3**

Correct answer: A, B and D

The correct answers are Options A, B and D. Option A is correct as even though the major fire is outside the ordinary operations of the entity, it will still impact on the profit after tax.

Option B is correct as the reassessment of the useful life of the entity’s plant and equipment should be recognised prospectively (IAS 8, para. 36). This would affect the depreciation charges for the 20X7 financial year, which in turn would affect the profit after tax.

Option D is correct as even though the change in accounting estimate relates to the 20X6 bad debt write-off, the change must be recognised in the reporting period in which the change in estimate is made (IAS 8, para. 37). Hence, the item will affect the profit after tax.

Option C is incorrect. The major currency realignment affects conditions after the end of the reporting period. Hence, in accordance with IAS 10 Events after the Reporting Period, it is a non-adjusting event and will not affect the profit. However, if the event is material, the nature of the event and an estimate of its financial effect should be included in the notes to the financial statements (IAS 10, para. 21).

*You can review this topic area in the study guide under the sections titled ‘Revisions of accounting estimates and correction of errors’ and ‘Events after the reporting period’.*
**Question 2.4**

Correct answer: C

The correct answer is Option C. Refer to paragraph 54(c) of IAS 1 *Presentation of Financial Statements*. This knowledge check refers to paragraph 54 of IAS 1, and requires you to apply this standard or have prior knowledge of the required categories of line items to be presented in a Balance Sheet. If you are unfamiliar with the 18 items set out in this paragraph, it is recommended that you refer to the Red Book. However, you will only be examined on content covered in the Study Guide.

Option A is incorrect. Refer to paragraph 60 of IAS 1. Assets and liabilities are to be presented in order of liquidity only where it provides information that is reliable and more relevant than the current/non-current presentation.

Option B is incorrect. Assets and liabilities cannot be offset, except if this is required or permitted by an International Financial Reporting Standard (IAS 1, para. 32).

Option D is incorrect. IAS 1 does not require the length of the operating cycle to be disclosed.

*You can review this topic area in the study guide under the section titled ‘IAS 1—disclosures in the statement of financial position or in the notes’.*

**Question 2.5**

Correct answer: D

The correct answer is Option D. Refer to paragraph 91 of IAS 1 *Presentation of Financial Statements*. This issue is discussed under ‘Other comprehensive income’ presentation and disclosures.

Option A is incorrect. Refer to paragraph 96 of IAS 1. Reclassification adjustments do not arise from the application of IAS 16 *Property, Plant and Equipment*.

Option B is incorrect. Other comprehensive income includes items of income and expense that are not recognised in profit or loss as required or permitted by other IFRSs. Refer to paragraph 7 of IAS 1. The definition of other comprehensive income does not refer to items of income and expense that are outside the ordinary operations.

Option C is incorrect. Refer to paragraphs 82(c) and 82A of IAS 1. The entity must disclose two items in the statement of profit or loss and other comprehensive income, share of profit of associates and share of other comprehensive income of associates. In addition, the investor's share of the other comprehensive income of associates cannot form part of the investor's profit for the reporting period.

*You can review this topic area in the study guide under the sections titled ‘Presentation of comprehensive income’ and ‘IAS 1—disclosures and classification’.*
**Question 2.6**

Correct answer: C

The correct answer is Option C. As the foreign operation was sold during the 20X4 reporting period, the total exchange difference gain net of tax over the life of the foreign operation would be included as a reclassification adjustment in the statement of profit or loss and other comprehensive income of Sandal Ltd for that financial year. The total exchange difference gain net of tax to be reclassified from other comprehensive income is $17,500. That is, the prior period after-tax exchange difference gain of $14,000 plus the current period after-tax exchange difference gain of $3,500.

Option A is incorrect. Other comprehensive income after tax would include an exchange difference loss of $14,000. That is, the after-tax exchange difference gain for the current period of $3,500 less a reclassification adjustment of $17,500.

Option B is incorrect. The reclassification adjustment included in other comprehensive income would be the total after-tax exchange difference gain over the life of the foreign operation ($17,500). The $14,000 after-tax exchange difference gain only relates to the prior period gains included in other comprehensive income.

Option D is incorrect. Paragraph 48 of IAS 21 requires the cumulative amount of the exchange differences relating to that foreign operation recognised in other comprehensive income to be reclassified from equity to profit or loss on disposal of the foreign operation.

*You can review this topic area under paragraph 90 to 96 of ‘IAS 1—Presentation of Financial Statements’ and ‘Question 2.7’ of the module in the study guide.*

**Question 2.7**

Correct answer: C

The correct answer is Option C. IAS 1 *Presentation of Financial Statements* does not require a subtotal for total expenses to be disclosed. Further, ‘ordinary activities’ is not a term used in IAS 1.

Option D is incorrect. Paragraph 81B(a)(i) of IAS 1 requires separate disclosure of the amount of profit or loss for the period attributable to non-controlling interests.

Option B is incorrect. Paragraph 82(c) of IAS 1 requires separate disclosure of the share of the profit or loss of associates accounted for using the equity method.

Option A is incorrect. Paragraph 82(b) of IAS 1 requires separate disclosure of finance costs incurred during the period.

*You can review this topic area in the study guide under the section titled ‘IAS 1—Disclosures and classification: Information to be presented in the statement of profit or loss and other comprehensive income’.*
Question 2.8
Correct answer: A

The correct answer is Option A. Refer to paragraphs 106 and 107 of IAS 1 Presentation of Financial Statements and Question 2.9 of the module. The closing retained earnings is equal to:

\[
\text{Opening retained earnings } \$220,000 + \text{Profit for the year } \$110,000 - \text{Dividends paid } \$35,000 = \$295,000
\]

Option B is incorrect. It includes total comprehensive income, rather than profit for the period, in the determination of closing retained earnings.

Option C is incorrect. Other comprehensive income of $20,000 has not been included in the asset revaluation surplus account (Total closing equity = Share capital $300,000 + Retained earnings $295,000 + Asset revaluation surplus $80,000 = $675,000).

Option D is incorrect. Other comprehensive income of $20,000 has been included in the determination of the asset revaluation surplus, but total comprehensive income (which includes the $20,000 other comprehensive income) has also been used to calculate the closing retained earnings.

You can review this topic area in the study guide under the section titled ‘IAS 1—Disclosures of changes in equity’.

Question 2.9
Correct answer: A

The correct answer is Option A. Paragraph 92 of IAS 1 requires an entity to disclose reclassification adjustments relating to components of other comprehensive income.

Option B is incorrect. The share of profit or loss of associates using the equity method is included in the determination of the profit or loss for the period (IAS 28 Investments in Associates), not other comprehensive income.

Option C is incorrect. Paragraph 96 of IAS 1 outlines that reclassification adjustments do not arise from revaluation surpluses made in accordance with IAS 16 Property, Plant and Equipment. Even though included in other comprehensive income, there is no reclassification to the profit or loss in subsequent reporting periods when the property, plant and equipment is sold.

Option D is incorrect. Paragraph 106(b) of IAS 1 requires retrospective adjustments in accordance with IAS 8 to be included in the statement of changes in equity.

You can review this topic area in the study guide under the sections titled ‘Determination of comprehensive income’, ‘IAS 1—disclosures and classification’ and ‘IAS 1—disclosure of changes in equity’.
Question 2.10

Correct answer: A

The correct answer is Option A. Other comprehensive income would include the following items:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share of other comprehensive income of associates*</td>
<td>$5,000</td>
</tr>
<tr>
<td>Exchange difference gain on foreign operation up to date of sale</td>
<td>$7,000</td>
</tr>
<tr>
<td>Reclassification adjustment for translation of foreign operation**</td>
<td>$(21,000)</td>
</tr>
<tr>
<td>Increase in asset revaluation surplus</td>
<td>$45,000</td>
</tr>
<tr>
<td><strong>Total other comprehensive income</strong></td>
<td>$36,000</td>
</tr>
</tbody>
</table>

* Share of total comprehensive income of associates less share of profit of associates ($20,000 – $15,000).

** This is the net of tax gain recognised in the profit or loss and represents the total gain over the life of the foreign operation (refer to Question 2.7 for example).

Option B is incorrect. The share of total comprehensive income of associate ($20,000) has been included and not the share of other comprehensive income of associate ($5,000).

Option C is incorrect. The reclassification adjustment (–$21,000) has not been included in other comprehensive income.

Option D is incorrect. The share of total comprehensive income of associate ($20,000) has been included and not the share of other comprehensive income of associate ($5,000). In addition, the reclassification adjustment (–$21,000) has not been included in other comprehensive income.

You can review this topic area in the study guide under the sections titled ‘Determination of comprehensive income’ and ‘IAS 1—disclosures and classification’, see ‘other comprehensive income presentation and disclosures’.

Question 2.11

Correct answer: D

The correct answer is Option D. Refer to paragraph 54(r) of IAS 1 Presentation of Financial Statements.

Option A is incorrect. Refer to paragraph 54 of IAS 1—it is not a required disclosure.

Option B is incorrect. Refer to paragraph 54 of IAS 1—it is not a required disclosure.

Option C is incorrect. Refer to paragraph 54 of IAS 1—reserves in aggregate only have to be disclosed on the face of the statement of financial position.

You can review this topic area in the study guide under the section titled ‘IAS 1—disclosures in the statement of financial position or in the notes’, see ‘Disclosures in the statement of financial position’.
Question 2.12

Correct answer: D

The correct answer is Option D. The amount may be obtained from reconstructing trade receivables and allowance for doubtful debts as shown below. Alternatively, the formula provided at the end of the accounts may be used. The formula can be derived from first principles or by examining the structure of the two ledger accounts.

<table>
<thead>
<tr>
<th>Trade receivables</th>
<th>Date</th>
<th>Particulars</th>
<th>$000</th>
<th>Date</th>
<th>Particulars</th>
<th>$000</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>20X2</td>
<td></td>
<td></td>
<td>20X2</td>
<td></td>
<td></td>
</tr>
<tr>
<td>30 June</td>
<td>Opening balance</td>
<td>150</td>
<td>(3)</td>
<td>Allowance for doubt.</td>
<td>11</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Various sales revenue</td>
<td>500</td>
<td></td>
<td>Debts (bad debts)†</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Cash</td>
<td>519</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>20X3</td>
<td></td>
</tr>
<tr>
<td></td>
<td>30 June</td>
<td>Closing balance</td>
<td>120</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>650</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>20X3</td>
<td>30 June</td>
<td>Balance c/d.</td>
<td>120</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

† This figure is derived from reconstructing the ‘Allowance for doubtful debts’ account below.

Note: The ‘Allowance for doubtful debts’ increases for doubtful debts expense and decreases as bad debts are written off. If you are unsure how to account for bad and doubtful debts, you should review a financial accounting text. In relation to the ‘Allowance for doubtful debts’ account, the question data provides the opening and closing balances plus the doubtful debts expense. Hence the missing variable ‘bad debt write-off’ can be determined from this data.
### Allowance for doubtful debts

<table>
<thead>
<tr>
<th>Date</th>
<th>Particulars</th>
<th>$000</th>
<th>Date</th>
<th>Particulars</th>
<th>$000</th>
</tr>
</thead>
<tbody>
<tr>
<td>20X2</td>
<td>30 June Opening balance</td>
<td>8</td>
<td>20X2</td>
<td>Profit &amp; loss</td>
<td>15</td>
</tr>
<tr>
<td></td>
<td>(3) Trade receivables</td>
<td>11</td>
<td>(2)</td>
<td>(Doubtful debts exp.)</td>
<td>15</td>
</tr>
<tr>
<td>20X3</td>
<td>30 June Closing balance</td>
<td>12</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Balance c/d.</td>
<td>12</td>
<td>20X3</td>
<td></td>
<td>23</td>
</tr>
</tbody>
</table>

Cash collected is:

- Sales revenue
- Decrease in gross receivables
- or
- Increase in gross receivables
- Bad debts

**Note:** The bad debt write-off must be determined from either reconstructing the ‘Allowance for doubtful debts’ account or by using the movement in the ‘Allowance for doubtful debts’ account and doubtful debts expense information.

\[
500000 + 30000 - 11000 = 519000
\]

Option A is incorrect as it uses:

\[
500000 - 30000 + 11000 = 481000
\]

Option B is incorrect as it uses:

\[
500000 - 30000 + 15000 = 485000
\]

Option C is incorrect as it uses:

\[
500000 + 30000 - 15000 = 515000
\]

*You can review this topic area in the study guide under the section titled ‘Statement of cash flows’.)*
Question 2.13
Correct answer: A

The correct answer is Option A. The following formula may then be used:

\[
\text{Sales revenue} + \frac{\text{Decrease in gross receivables}}{\text{or}} - \frac{\text{Increase in gross receivables}}{\text{Bad debts}}
\]

Bad debts written off are determined as follows:

Doubtful debts expense \(+ (-)\) Decrease (increase) in allowance for doubtful debts

\[
= \$5000 - \$2000
\]

\[
= \$3000
\]

Another way of viewing the above calculation is to consider what an increase in ‘Allowance for doubtful debt’ implies. That is, an allowance for doubtful debts is increased by doubtful debts expense and decreased as bad debts are written off. As the allowance increased by $2000, the doubtful debts expense must be $2000 greater than the bad debt write-off. The question data reveals a doubtful debts expense of $5000. Hence, the bad debt write-off must be $3000.

The change in gross receivables can be determined using the change in net receivables adjusted for the change in the allowance for doubtful debts. The net receivables increased by $32 500 while the allowance for doubtful debts increased by $2000. The increase in allowance for doubtful debts would have reduced the change in net receivables by $2000 as it is deducted from gross receivables. Hence the change in gross receivables is $34 500.

Option A is correct as it uses:

\[
\$450 000 - \$34 500 - \$3000 = \$412 500
\]

Option B is incorrect as it uses:

\[
\$450 000 - \$34 500 + \$3000 = \$418 500
\]

Option C is incorrect as it uses:

\[
\$450 000 + \$34 500 - \$3000 = \$481 500
\]

Option D is incorrect as it uses:

\[
\$450 000 + \$34 500 + \$3000 = \$487 500
\]

You can review this topic area in the study guide under the section titled ‘Statement of cash flows’.
Question 2.14

Correct answer: C

The correct answer is Option C. This is found by reconstructing the tax payable account. To do this, first the credit (or debit) to tax payable resulting from the current year tax calculations is found. This amount, together with the change in the balance of tax payable, is the tax cash flow.

Any changes in the balances of the deferred tax accounts are the result of debits or credits to those accounts. Therefore, given that the tax expense is known, the debit or credit to tax payable can be found by reconstructing the current year tax journal entry as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax expense</td>
<td>$1,750</td>
</tr>
<tr>
<td>Deferred tax liability</td>
<td>$1,200</td>
</tr>
<tr>
<td>Deferred tax asset</td>
<td>$750</td>
</tr>
<tr>
<td>Tax payable</td>
<td>$2,200</td>
</tr>
</tbody>
</table>

The cash outflow is then simply the credit to tax payable plus the decrease in tax payable as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Credit to tax payable</td>
<td>$2,200</td>
</tr>
<tr>
<td>Plus: Decrease in tax payable</td>
<td>$200</td>
</tr>
<tr>
<td></td>
<td>$2,400</td>
</tr>
</tbody>
</table>

Options A, B and D are incorrect as the changes in the balances of the deferred tax accounts have not been appropriately reflected.

A is incorrect as it is based on:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax expense</td>
<td>$1,750</td>
</tr>
<tr>
<td>Tax payable</td>
<td>$200</td>
</tr>
<tr>
<td>Deferred tax liability</td>
<td>$1,200</td>
</tr>
<tr>
<td>Deferred tax asset</td>
<td>$750</td>
</tr>
<tr>
<td>Debit to tax payable</td>
<td>($200)</td>
</tr>
<tr>
<td>Plus: Decrease in tax payable</td>
<td>$200</td>
</tr>
</tbody>
</table>

B is incorrect as it is based on:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax expense</td>
<td>$1,750</td>
</tr>
<tr>
<td>Deferred tax asset</td>
<td>$750</td>
</tr>
<tr>
<td>Deferred tax liability</td>
<td>$1,200</td>
</tr>
<tr>
<td>Tax payable</td>
<td>$1,300</td>
</tr>
<tr>
<td>Credit to tax payable</td>
<td>$1,300</td>
</tr>
<tr>
<td>Plus: Decrease in tax payable</td>
<td>$200</td>
</tr>
<tr>
<td></td>
<td>$1,500</td>
</tr>
</tbody>
</table>
D is incorrect as it is based on:

\[
\begin{array}{c|c|c}
\text{Item} & \text{Amount} & \text{Amount} \\
\hline
\text{Tax expense} & 1,750 & \\
\text{Deferred tax liability} & 1,200 & \\
\text{Deferred tax asset} & 750 & \\
\text{Tax payable} & & 3,700 \\
\text{Credit to tax payable} & & 3,700 \\
\text{Plus: Decrease in tax payable} & & 200 \\
\hline
\text{Total} & & 3,900 \\
\end{array}
\]

You can review this topic area in the study guide under the section titled 'Statement of cash flows'.

**Question 2.15**

Correct answer: C

The correct answer is Option C. In this case, a reconciliation from operating cash flows to profit for the period is required. The reconciliation is as follows.

\[
\begin{array}{c|c}
\text{Item} & \text{Amount} \\
\hline
\text{Net cash inflows from operating activities} & 720,000 \\
\text{Plus: Decrease in trade payables} & 23,000 \\
\text{Less: Decrease in inventory} & (11,500) \\
\text{Plus: Increase in trade receivables} & 24,600 \\
\text{Less: Increase in allowance for doubtful debts} & (1,000) \\
\text{Less: Book loss on sale of plant} & (11,000) \\
\text{Profit for the period} & 744,100 \\
\hline
\end{array}
\]

Comments on individual adjustments are as follows.

- **Decrease in trade payables**: A decrease in trade payables occurs when cash paid to suppliers is greater than cash and credit purchases. The larger cash payments have been deducted in arriving at cash operating flows. Therefore, the decrease in trade payables should be added to cash operating flows in order to arrive at the lesser expense figure.

- **Decrease in inventory**: When inventory decreases, purchases of inventory are less than the cost of sales. For a given change in the balance of trade payables, the cash outlay for purchases is less than the cost of sales by the amount of the inventory run down. The inventory run down should be deducted from operating cash flows to arrive at the larger cost of sales.

- **Increase in trade receivables**: An increase in trade receivables occurs when cash collected from customers is less than sales revenue. The smaller cash collections have been included in the measurement of operating cash flows. Therefore, ignoring any bad debt write-off, the increase in trade receivables must be added to operating cash flows to allow for the larger sales revenue.

- **Increase in allowance for doubtful debts**: Deducting the net increase captures:
  - Doubtful debts expense which has not been deducted in arriving at operating cash flows. This amount should be deducted from the cash flow figure to allow for the expense.
  - Any bad debt write-off which is included in the change in trade receivables. This causes an understatement of sales revenue when the change in the receivables is added back to operating cash flows. Therefore, any bad debt write-off should be added back to operating cash flows when arriving at sales revenue.

- **Book loss of plant sold**: Sale proceeds of $14,000 have been included in the measurement of investing cash flows and are not included in operating cash flows. The loss on the sale of plant should be deducted from operating cash flows so as to include this expense item in the measurement of profit for the period.
The other alternatives Options A, B and D contain the following errors and are therefore incorrect:

Option A: The decrease in trade payables has been deducted.

Option B: The book value of plant sold has been deducted. This would correctly allow for a loss of $11 000 if the cash flow of $14 000 was included in operating cash flows rather than investing cash flows.

Option D: The decrease in inventory has been added.

You can review this topic area in the study guide under the section titled ‘Statement of cash flows’.

Module 3

Question 3.1

Correct answer: C

The correct answer is Option C. For a present obligation to exist, the entity must have no realistic alternative to settling the obligation created by the event (IAS 37, para. 17).

Option A is incorrect. This relates to the ability to measure the provision, not the existence of the obligation.

Option B is incorrect. A legal obligation does not have to exist before a provision can be recognised. An entity may also have a constructive obligation to the extent that there is a valid expectation that the obligation will be settled.

Option D is incorrect. This relates to the probability of the sacrifice occurring (a recognition criterion), not the existence of the obligation.

You can review this topic area in the study guide under the section titled ‘Recognition of provisions’. 
**Question 3.2**
Correct answer: B

The correct answer is Option B. As outlined in the module, where measurement uncertainty exists, the provision amount should be estimated based on its circumstance. Measurement uncertainty does not suggest that no provision is required.

Option A is incorrect. Paragraph 39 of IAS 37 states that where there is a continuous range of possible outcomes, and each point in that range is as likely as any other, the mid-point of the range is used.

Option C is incorrect. The minimum amount that an entity would rationally pay to settle or transfer the obligation may give the best estimate of the expenditure required to settle the present obligation at the end of the reporting period.

Option D is incorrect. Paragraph 40 of IAS 37 notes that where a single obligation is being measured, the individual most likely outcome may be the best estimate of the liability. However, even in such a case, the entity considers other possible outcomes. Where other possible outcomes are either mostly higher or mostly lower than the most likely outcome, the best estimate will be a higher or lower amount.

*You can review this topic area in the study guide under the section titled ‘Measurement of provisions’.*

**Question 3.3**
Correct answer: A

The correct answer is Option A. The present obligation as a result of a past event occurs when the product is sold. This gives rise to a legal obligation from the sale date to honour the warranty in the event of fault.

Option B is incorrect as at the end of the warranty period there would be no remaining present obligation arising in relation to the warranties.

Option C is incorrect as it assumes that the obligating event giving rise to the present obligation is the notification of a claim, and not the sale of the product.

Option D is incorrect as it assumes the present obligation arises only when the expenses to repair or replace the item occur.

*You can review this topic area in the study guide under the section titled ‘Recognition of provisions’.*
Question 3.4
Correct answer: B

Option B is correct. The expected value is the sum of probability-weighted amounts in a range of possible consideration amounts (see IFRS 15, para. 53). Accordingly, an entity would be required to identify the possible outcomes of a contract, the probability of each outcome occurring, and the consideration amount under each outcome to be able to determine the expected value.

Option A is incorrect. As the expected value is the sum of probability-weighted amounts in a range of possible consideration amounts, the expected value may be an appropriate estimate of the amount of variable consideration if an entity has a large number of contracts with similar characteristics. The ‘most likely amount’ method may better predict variable consideration if the contract has only two possible outcomes. (See IFRS 15, para. 53)

Option C is incorrect. Paragraph 53 of IFRS 15 requires the entity to apply the method that better predicts the amount of consideration to which it will be entitled to a contract. Accordingly, it is not appropriate for the expected value method to be applied to every contract as an accounting policy choice.

Option D is incorrect. Paragraph 59 of IFRS 15 requires an entity to update, at the end of each reporting period, the estimated transaction price (including updating its assessment of whether an estimate of variable consideration is constrained) to represent faithfully the circumstances present at the end of the reporting period and the changes in circumstances during the reporting period.

You can review this topic area in the study guide under the section titled ‘Recognition of revenue’—‘Step 3: Determine the transaction price of the contract’

Question 3.5
Correct answer: D

Option D is correct. Any distinct good or service promised to a customer as a result of a contract gives rise to a performance obligation. There are two distinct goods or services to be delivered to the customer in the phone package: the phone, and the phone service. Both the phone and the phone plan are considered as distinct as the customer can benefit from the good (the phone) or service (the phone service) either on its own or together with other readily available resources; and Zulu Ltd’s promise to transfer the phone to the customer can be separately identifiable from its promise to provide phone services under the contract (see IFRS 15, para. 27).

Option A is incorrect. This assumes that all performance obligations under the contract have been satisfied at contract inception. However, as Zulu is required to supply the customer with phone services for two years, there is an outstanding performance obligation at the contract inception (see IFRS 15, para. 35).

Option B is incorrect. This assumes that none of the performance obligations under the contract have been satisfied at contract inception. However, at contract inception Zulu has transferred control of the phone to the customer and accordingly, has satisfied some of its promises under the contract (see IFRS 15, para. 31).
Option C is incorrect. Any distinct good or service promised to a customer as a result of a contract gives rise to a performance obligation. There are two distinct goods or services to be delivered to the customer in the phone package: the phone, and the phone service. Both the phone and the phone plan are considered as distinct as the customer can benefit from the good (the phone) or service (the phone service) either on its own or together with other readily available resources; and Zulu's promise to transfer the phone to the customer can be separately identifiable from its promise to provide phone services under the contract (see IFRS 15, para. 27),

You can review this topic area in the study guide under the sections titled ‘Recognition of revenue’—‘Step 2: Identify the performance obligation(s) in the contract’ and ‘Step 5: Recognise revenue when each performance obligation is satisfied’.

Question 3.6
Correct answer: C

The correct answer is Option C. IAS 37 applies to the accounting for all provisions, contingent liabilities and contingent assets, except for those resulting from executory contracts (except where the contract is onerous) and those covered by another Australian Accounting Standard.

Paragraph 5 of IAS 37 scopes out provisions for employee benefits within the scope of IAS 19 and insurance contracts within the scope of IFRS 4 as they are addressed in another Australian Accounting Standard. Accordingly, Options A and D are incorrect.

Option B is incorrect as paragraph 2 of IAS 37 specifically scopes out financial instruments within the scope of IFRS 9.

You can review this topic area in the study guide under the section titled ‘Introduction’—‘Scope of IAS 37’.

Question 3.7
Correct answer: A

The correct answer is Option A. A provision should be recognised as the legislation has been enacted.

Option B is incorrect. A present obligation exists because an obligating event (previous transactions with the customers) has occurred.

Option C is incorrect. As the legislation is enacted, there will be a legal obligation for the future sacrifice of economic benefits, irrespective of any intention of the company to act illegally.

Option D is incorrect. On enactment of the legislation, the company will have a legal obligation, irrespective of its intention to lobby against it.

You can review this topic area in the study guide under the sections titled ‘Recognition of Provisions’ and ‘Contingent liabilities’.
Question 3.8
Correct answer: C and D

Both Options C and D are correct as they result in a contingent liability. They do not meet the Framework's definition of liabilities, but disclosure is required to explain the details in a contingent liability note.

Option A is incorrect, as it is not a liability nor contingent liability that requires disclosure because the sacrifice of economic benefits is remote.

Option B is incorrect, as it results in a liability, not a contingent liability.

You can review this topic area in the study guide under the section titled ‘Contingent liabilities’.

Question 3.9
Correct answer: B

The correct answer is Option B. Provisions to perform land rehabilitation activity are not addressed by another Standard. Accordingly, these provisions are within the scope of IAS 37 (refer para. 1 and 5 of IAS 37).

Option A is incorrect. Recognition means that an item is included in the financial statements.

Option C is incorrect. IAS 37 does not apply to such contingent liabilities and contingent assets (since they result from insurance contacts, they are covered by IFRS 4).

Option D is incorrect. For present obligations to exist, the entity must have no realistic alternative but to make the future sacrifice of economic benefit.

You can review this topic area in the study guide under the section titled ‘Scope of IAS 37’, ‘Recognition of Provisions’, ‘Contingent Assets’, and ‘Contingent Liabilities’.

Question 3.10
Correct answer: C

The correct answer is Option C. Paragraph 47 of IAS 37 specifies that the discount rate (or rates) is to be a pre-tax rate (or rates) that reflect(s) current market assessments of the time value of money and the risks specific to the liability.

Option A and Option B are incorrect as these are discount rates used to discount long-term employee benefit obligations, which are outside the scope of IAS 37 (see para. 5 of IAS 37 and IAS 19).

Option D is incorrect as it incorporates risks specific to the entity, rather than to the liability.

You can review this topic area in the study guide under the section titled ‘Measurement of provisions’.
**Question 3.11**

Correct answer: B and D

Option B is correct. The expected value is the sum of probability-weighted amounts in a range of possible consideration amounts (see IFRS 15, para. 53). This is calculated as $500 + $450 + $2550 + $600 + $175 = $4275.

Option D is correct. Under the most likely amount method, the transaction price is the consideration amount the entity is entitled to under the ‘most likely’ possible outcome of a contract (see IFRS 15, para. 53). The most likely outcome is that 15 widgets will be returned. Accordingly, the consideration amount the entity is entitled to under this method is 85 widgets × $50 = $4250.

Option A is incorrect. This option assumes that only the probability weighted consideration associated with the outcome with the highest probability of occurring is included in the transaction price. Under the expected value method, the transaction price is determined as the sum of probability-weighted amounts in a range of possible consideration amounts (see IFRS 15, para. 53).

Option C is incorrect. This option assumes that the probability weighted consideration associated with the outcome with the highest probability of occurring is included in the transaction price. Under the most likely amount method, the transaction price is the consideration amount the entity is entitled to under the ‘most likely’ possible outcome of a contract, without adjustment for the probability of that outcome (see IFRS 15, para. 53).

You can review this topic area in the study guide under the section titled ‘Recognition of revenue’—‘Step 3: Determine the transaction price of the contract’

**Question 3.12**

Correct answer: B

Option B is correct, as there is a possible obligation whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity. The possible liability must be disclosed as a contingent liability as the possibility of an outflow in settlement is more than remote. Option A is incorrect because disclosure of the contingent liability is required by IAS 37 as the possibility of the outflow in settlement is more than remote.

Option C incorrectly identifies the obligation as a provision rather than as a contingent liability. On the basis of the information available at year end 30 June 20X8, STU Ltd does not have a present obligation as a result of a past event.

Option D is incorrect as contingent liabilities are not recognised in general purpose financial statements.

You can review this topic area in the study guide under the section titled ‘Contingent liabilities’.
Module 4

Question 4.1

Correct answer: A

The correct answer is Option A. A reconciliation between accounting profit before tax and taxable profit is as follows.

Reconciliation between accounting profit before tax and taxable profit:

<table>
<thead>
<tr>
<th></th>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounting profit before tax</td>
<td>100,000</td>
</tr>
<tr>
<td>Adjustments for non-temporary differences</td>
<td></td>
</tr>
<tr>
<td>Impairment of goodwill</td>
<td>15,000</td>
</tr>
<tr>
<td>Accounting profit before tax adjusted for non-temporary differences</td>
<td>115,000</td>
</tr>
<tr>
<td>Adjustments for movements in temporary differences</td>
<td></td>
</tr>
<tr>
<td>Plus: Increase in unearned insurance premiums not recognised as revenue</td>
<td>4,000</td>
</tr>
<tr>
<td>Less: Excess of tax depreciation over accounting depreciation</td>
<td>(10,000)</td>
</tr>
<tr>
<td>Taxable profit</td>
<td>109,000</td>
</tr>
</tbody>
</table>

Tax payable = Taxable profit ($109,000) × Tax rate (0.30) = $32,700

Current tax expense

Current tax, the amount of income taxes payable in respect of taxable profit for the period (IAS 12, para. 5) is $32,700 ($109,000 × 0.30). According to the reconciliation given above, taxable profit is $109,000.

Current tax is the product of this amount and the tax rate of 30 per cent. The whole of the current tax is recognised as an expense (IAS 12, para. 58).

Deferred tax expense (income)

Deferred tax is to be recognised in the statement of profit or loss and other comprehensive income as an expense or as income, except to the extent that it was recognised in equity (IAS 12, para. 58). In our example, deferred tax for the period arose as a result of movements in temporary differences. None of these were associated with transactions that were recognised in equity.

Movements in temporary differences give rise to adjustments to the amounts of deferred tax assets and deferred tax liabilities, and to deferred tax. The total amount of deferred tax for the period is recognised in the statement of profit or loss and other comprehensive income as income or expense. Deferred tax expense for the period is comprised of the following:

Deferred tax expense (Table 1 below) $    
- Increase in deferred tax liability | 3,000 |
- Less: Deferred tax income (Table 2 below) |
  - Increase in deferred tax asset | (1,200) |
Net deferred tax expense | 1,800 |
Table 1: Deferred tax expense-depreciable asset

<table>
<thead>
<tr>
<th>Taxable temporary difference</th>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td>30 June 20Y0</td>
<td>10 000 †</td>
</tr>
<tr>
<td>30 June 20X9</td>
<td>0 ‡</td>
</tr>
</tbody>
</table>

Movement in temporary difference
(Excess of tax depreciation over accounting depreciation)

\[10 000 \times 0.30\]

Deferred tax expense/increase in deferred tax liability

\[3 000\]

† Taxable temporary difference 20Y0

<table>
<thead>
<tr>
<th>20Y0</th>
</tr>
</thead>
<tbody>
<tr>
<td>$</td>
</tr>
</tbody>
</table>

Carrying amount
Cost 100 000
Less: Accumulated depreciation (15 000) 85 000
Less: Tax base
Cost 100 000
Cumulative tax depreciation (25 000) (75 000)
Taxable temporary difference 10 000

‡ Taxable temporary difference 20Y9

As the depreciable asset was not acquired until the next reporting period, there was no temporary difference as at 30 June 20X9.

Table 2: Deferred tax income-unearned insurance premiums

<table>
<thead>
<tr>
<th>Deductible temporary difference</th>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td>30 June 20Y0</td>
<td>31 000 †</td>
</tr>
<tr>
<td>Less; 30 June 20X9</td>
<td>(27 000) ‡</td>
</tr>
</tbody>
</table>

Movement in temporary difference
(Insurance premiums received not recognised in accounting profit before tax)

\[4 000 \times 0.30\]

Deferred tax income/increase in deferred tax asset

\[1 200\]

† Deductible temporary differences

<table>
<thead>
<tr>
<th>20X9</th>
<th>20Y0</th>
</tr>
</thead>
<tbody>
<tr>
<td>$</td>
<td>$</td>
</tr>
</tbody>
</table>

Carrying amount insurance premiums 27 000 31 000
Tax base 0 0
Deductible temporary difference 27 000 31 000

Increase in deferred tax asset: Table 2

The increase in the deferred tax asset is the product of the movement (increase) in the deductible temporary difference and the tax rate = $4000 × 0.30 = $1200.
Increase in deferred tax liability: Table 1

The increase in the deferred tax liability is the product of the movement in the taxable temporary difference and the tax rate = $10,000 × 0.30 = $3,000.

Option B is incorrect. Under this alternative taxable profit has been wrongly calculated as $121,000, arising from treating the depreciable asset as giving rise to a deferred tax asset and the unearned insurance premiums as giving rise to a deferred tax liability.

Option C is incorrect. It is based on the following reconciliation:

Reconciliation between accounting profit before tax and taxable profit

<table>
<thead>
<tr>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounting profit before tax</td>
</tr>
<tr>
<td>Adjustments for movements in temporary differences</td>
</tr>
<tr>
<td>Plus:</td>
</tr>
<tr>
<td>Insurance premiums received not recognised in accounting profit before tax</td>
</tr>
<tr>
<td>Impairment of goodwill</td>
</tr>
<tr>
<td>Less: Excess of tax depreciation over accounting depreciation</td>
</tr>
<tr>
<td>Taxable profit</td>
</tr>
</tbody>
</table>

This reconciliation implies:

Tax payable $109,000 × 0.3 $32,700

Deferred tax asset:

- Excess tax insurance premiums $4,000 × 0.3 = $1,200
- Impairment of goodwill $15,000 × 0.3 = $4,500 $5,700

Deferred tax liability:

- Excess tax depreciation $10,000 × 0.3 = $3,000

Option D is incorrect. This alternative uses the reconciliation in C above, but treats the insurance premiums and impairment of goodwill as giving rise to a deferred tax liability and excess depreciation as giving rise to a deferred tax asset.

You can review this topic area in the study guide under the section titled ‘Deferred tax assets and deferred tax liabilities’.

Question 4.2

Correct answer: B

The correct answer is Option B.

The correct answer is Option B. Paragraph 5 of IAS 12 defines tax expense as the aggregate amount included in the determination of profit or loss for the period in respect of current tax and deferred tax.

Option C is incorrect. Deferred tax liabilities do not arise from deductible temporary differences but from taxable temporary differences.

Option D is incorrect. The movements in deferred tax assets and liabilities could be included directly in equity (see para. 61A of IAS 12).

You can review this topic area in the study guide under the section titled ‘Calculating tax expense’.
**Question 4.3**

**Correct answer: D**

The correct answer is Option D. Refer to the discussion relating to ‘Determining the tax base’. As this liability does not relate to revenue received in advance, the tax base for the employee benefit liability would be:

\[
\text{Carrying amount of liability} - \text{Future deductible amounts} + \text{Future assessable amounts}
\]

Option A is incorrect. Formula has not allowed for future deductible amounts.

Option B is incorrect. The formula is for a liability involving revenue received in advance.

Option C is incorrect. The formula is for the tax base of an asset.

You can review this topic area in the study guide under the section titled ‘Deferred tax assets and deferred tax liabilities’.

**Question 4.4**

**Correct answer: B**

The correct answer is Option B. The carrying amount of the asset is greater than the tax base. In the future, the entity will recover $100,000 from the asset (assessable income) but will only be able to deduct $80,000 against this income. Hence, at 30 June 20X3 there is a taxable temporary difference of $20,000, which results in a deferred tax liability of $6000 ($20 000 × 0.30). See also relationships in Table 4.1.

Option A is incorrect. The asset does not lead to a deductible temporary difference and, therefore, a deferred tax asset does not result.

Option C is incorrect. It is not a deductible temporary difference and the amount is not based on the tax base.

Option D is incorrect. The amount of the deferred tax liability is based on the taxable temporary difference, not the tax base of the asset.

You can review this topic area in the study guide under the section titled ‘Deferred tax assets and deferred tax liabilities’.
**Question 4.5**

Correct answer: B

The correct answer is Option B. Deferred tax expense is based on the movements in deferred tax assets and deferred tax liabilities.

The deferred tax asset has increased by $14 000—this will result in a decrease in deferred tax expense, that is, debit deferred tax asset for $14 000 and credit deferred tax expense for $14 000.

The deferred tax liability has decreased by $6000—this will result in a decrease in deferred tax expense, that is, debit deferred tax liability for $6000 and credit deferred tax expense for $6000.

Therefore, there is a total credit to deferred tax expense of $20 000 and the amount of tax expense is therefore:

\[ (230 000 \times 0.3) - 20 000 = 69 000 - 20 000 = 49 000. \]

Option A is incorrect. It reflects only the amount of deferred tax and has been treated as a debit and not as a credit.

Option C is incorrect. The increase in deferred tax liability has been treated as resulting in a debit to deferred tax expense. Therefore, we have deducted $8000 ($14 000 − $6000) from the current tax expense of $69 000.

Option D is incorrect. This amount represents current tax expense with no adjustment for the deferred tax expense.

*You can review this topic area in the study guide under the section titled ‘Deferred tax assets and deferred tax liabilities’.*
**Question 4.6**

Correct answer: B

The correct answer is Option B.

Tax expense = Current tax expense + Deferred tax expense. The current tax expense for the year ended 30 June 20X7 is $51 000 (taxable profit $170 000 × 30%). Tax expense is given as $60 000. Therefore, the deferred tax expense = Tax expense ($60 000) − Current tax expense ($51 000) = $9000.

The increase in the deferred tax expense would be reflected in the closing deferred tax liability. Hence, the opening deferred tax liability is the closing deferred tax liability ($27 000) less deferred tax expense for the period ($9000), which is equal to $18 000.

Option A is incorrect. The deferred tax liability at 30 June 20X6 was $18 000 (see correct answer above). This answer assumes a deferred tax expense for the year ended 30 June 20X7 of $27 000.

Option C is incorrect. The current tax expense is $51 000 (taxable profit $170 000 × 30%). This answer is calculated as tax expense ($60 000) less amount of deferred tax liability ($27 000). The opening amount of the deferred tax liability has not been taken into account.

Option D is incorrect. The opening deferred tax liability has not been taken into account.

*You can review this topic area in the study guide under the section titled 'Deferred tax assets and deferred tax liabilities'.*

**Question 4.7**

Correct answer: A

The correct answer is Option A.

The tax base of an asset = Carrying amount + Future deductible amounts − Future assessable amounts.

Tax base of accounts receivable = $9500 + $500 − $0 = $10 000.

As the tax base ($10 000) is greater than the carrying amount of the asset ($9500), there is a deductible temporary difference of $500. This would result in the recognition of a deferred tax asset of $150 ($500 × 0.30).

Option B is incorrect. The temporary difference has been treated as taxable, not as deductible.

Options C and D are incorrect. The tax base for both C and D has been calculated based on the assumption that the receivables will be assessable in the future: that is, Tax base of the receivables = Carrying amount ($9500) + Future deductible amounts ($500) − Future assessable amounts ($10 000) = $0. This incorrect calculation gives rise to a taxable temporary difference of $9500 (carrying amount $9500 > tax base $0), which would result in the recognition of a deferred tax liability of $2850 ($9500 × 0.30). For C, not only is the amount of the temporary difference incorrect, but it has also been treated as a deductible temporary difference.

*You can review this topic area in the study guide under the section titled 'Deferred tax assets and deferred tax liabilities'.*
**Question 4.8**

Correct answer: A

The correct answer is Option A.

The tax base of a liability = Carrying amount − Future deductible amounts + Future assessable amounts

Tax base of provision for employee benefits = $1,200,000 − $1,200,000 + $0 = $0

Tax base of foreign currency loan = $180,000 − $0 + $20,000 = $200,000

As the carrying amount of the provision for employee benefits ($1,200,000) is greater than its tax base ($0), this gives rise to a deferred tax asset of $360,000 ($1,200,000 × 0.30). That is, in the future when employee benefits are paid, a tax deduction will be received and a smaller amount of tax would be paid than if settlement of the liability did not have any tax consequences. As the carrying amount of the foreign currency loan ($180,000) is less than its tax base ($200,000), this gives rise to a deferred tax liability of $60,000 ($20,000 × 0.30). That is, in the future when the foreign currency loan is settled, a $20,000 foreign currency gain will be included in taxable profit and an additional $60,000 of tax would be paid than if settlement of the liability did not have any tax consequences. Hence, there is a net deferred tax asset of $354,000 ($360,000 DTA − $60,000 DTL).

Option B is incorrect. The foreign currency loan has been treated as giving rise to a deferred tax asset.

Option C is incorrect. This answer treats the provision for employee benefits as giving rise to a deferred tax liability and the foreign currency loan as giving rise to a deferred tax asset.

Option D is incorrect. The provision for employee benefits has been treated as giving rise to a deferred tax liability.

*You can review this topic area in the study guide under the section titled ‘Deferred tax assets and deferred tax liabilities’.*
Question 4.9

Correct answer: B

The correct answer is Option B. The current tax expense for the year ended 30 June 20X8 was $30 000 (taxable profit of $100 000 × tax rate of 30%).

Deferred tax expense/income is determined by the movement in the deferred tax assets and deferred tax liabilities of Alpha Ltd. This can be calculated as follows.

<table>
<thead>
<tr>
<th></th>
<th>20X7</th>
<th>20X8</th>
<th>Movement</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$22 500</td>
<td>$28 500</td>
<td>$6 000 increase in deferred tax assets</td>
</tr>
<tr>
<td></td>
<td>$6 000</td>
<td>$9 000</td>
<td>$3 000 increase in deferred tax liabilities</td>
</tr>
<tr>
<td></td>
<td>$16 500</td>
<td>$19 500</td>
<td>$3 000 increase in net deferred tax assets</td>
</tr>
</tbody>
</table>

† Total of deductible temporary differences × Tax rate = $75 000 × 0.30
‡ Total of deductible temporary differences × Tax rate = $95 000 × 0.30
§ Taxable temporary difference × Tax rate = $20 000 × 0.30
‖ Taxable temporary difference × Tax rate = $30 000 × 0.30

As there is increase in the net deferred tax asset for the year ended 30 June 20X8 of $3000, there will be deferred tax income of $3000. Tax expense = current tax expense $30 000 less deferred tax income $3000 = $27 000.

Option A is incorrect. The movement in the taxable temporary difference has been ignored. Only the change in the deferred tax asset has been included in the calculation.

Option C is incorrect. The answer does not take into account the deferred tax expense.

Option D is incorrect. The increase in the deferred tax asset has been treated as a deferred tax expense and the increase in the deferred tax liability treated as deferred tax income, hence, the net movement in the deferred tax balances of $3000 has been added to the current tax expense of $30 000.

You can review this topic area in the study guide under the section titled ‘Deferred tax assets and deferred tax liabilities’.
**Question 4.10**

Correct answer: D

The correct answer is Option D.

**Deferred tax liability**

As at the date of sale, there was a taxable temporary difference of $30,000, the difference between the book-carrying amount of the asset $90,000 and the tax base of the asset (the tax written-down amount): $60,000.

This taxable temporary difference and the related deferred tax liability of $9,000 ($30,000 × 0.30) reverses on the sale of the asset. The analysis of the reversal of the taxable temporary difference and of the related deferred tax liability is as follows.

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deferred tax liability after sale</td>
<td>0</td>
</tr>
<tr>
<td>Less: Opening deferred tax liability ($30,000 × 0.30)</td>
<td>(9,000)</td>
</tr>
<tr>
<td>Reduction in deferred tax liability relating to the reversal of temporary differences/deferred tax income</td>
<td>9,000</td>
</tr>
</tbody>
</table>

**Tax payable and current tax expense**

Taxable profit for the period was $75,000, calculated as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Proceeds from sale of asset</td>
<td>160,000</td>
</tr>
<tr>
<td>Less: Tax written-down carrying amount</td>
<td>(60,000)</td>
</tr>
<tr>
<td>Less: Exempt capital gain‡</td>
<td>(25,000)</td>
</tr>
<tr>
<td>Taxable profit</td>
<td>75,000</td>
</tr>
</tbody>
</table>

† Comprises:

- Taxable capital gain                                                       | 35,000 |
- Depreciation recouped                                                      | 40,000 |

‡ Exempt taxable gain

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sale proceeds</td>
<td>160,000</td>
</tr>
<tr>
<td>Less: Purchase price</td>
<td>(100,000)</td>
</tr>
<tr>
<td>Capital gain</td>
<td>60,000</td>
</tr>
<tr>
<td>Less: Taxable capital gain</td>
<td></td>
</tr>
<tr>
<td>Sale proceeds</td>
<td>160,000</td>
</tr>
<tr>
<td>Less: Capital gains tax cost base</td>
<td>(125,000)</td>
</tr>
<tr>
<td>Exempt capital gain</td>
<td>(35,000)</td>
</tr>
<tr>
<td>Exempt capital gains tax cost base</td>
<td>25,000</td>
</tr>
</tbody>
</table>

§ Tax depreciation recouped

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost of asset</td>
<td>100,000</td>
</tr>
<tr>
<td>Less: Tax written-down amount</td>
<td>(60,000)</td>
</tr>
<tr>
<td>Depreciation recouped</td>
<td>40,000</td>
</tr>
</tbody>
</table>
Tax payable is $22 500 (30% of taxable profit of $75 000) and, by definition (IAS 12, para. 5), current tax expense is equal to this amount.

We can also use a reconciliation between accounting profit before tax and taxable profit to analyse the tax consequences. All of the transactions that have tax consequences for the period affect either taxable profit or accounting profit before tax. The reconciliation is as follows.

**Reconciliation between accounting profit before tax and taxable profit**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Proceeds of sale of depreciable asset</td>
<td>160 000</td>
</tr>
<tr>
<td>Less: Book carrying amount</td>
<td>(90 000)</td>
</tr>
<tr>
<td>Accounting profit before tax</td>
<td>70 000</td>
</tr>
<tr>
<td>Adjustments for non-temporary differences and excluded temporary differences:</td>
<td></td>
</tr>
<tr>
<td>Exempt capital gain</td>
<td>(25 000)</td>
</tr>
<tr>
<td>Adjustments for movements in temporary differences</td>
<td>45 000</td>
</tr>
<tr>
<td>Plus: Excess of tax depreciation recouped over accounting depreciation recouped</td>
<td>30 000</td>
</tr>
<tr>
<td>Taxable profit</td>
<td>75 000</td>
</tr>
</tbody>
</table>

*† Note that this amount is equal to: *

- Taxable capital gain: $35 000
- Accounting depreciation recouped: $(100 000 − $90 000) = $10 000
- Total: $45 000

Looking at the reconciliation we note that:

- Tax payable and current tax expense, based on taxable profit, is $22 500 ($75 000 × 0.30).
- The movement in the temporary difference is a reversal of the deductible temporary difference, which gives rise to a reduction in the deferred tax liability of $9000 ($30 000 × 0.30) and to deferred tax income of an equal amount.

As there are no recoupments of tax losses reducing tax expense, tax expense is numerically equal to the product of the tax rate and accounting profit before tax, adjusted for non-temporary differences and excluded temporary differences.

Option A is incorrect. This alternative confuses the exempt and taxable portions of the capital gains. The reconciliation for this alternative is as follows.
Reconciliation between accounting profit before tax and taxable profit

$  
Proceeds of sale of depreciable asset  160 000  
Less: Book carrying amount  (90 000)  
Accounting profit before tax  70 000  

Adjustments for non-temporary differences and excluded temporary differences:  
   Exempt capital gain  (35 000)  
Accounting profit before tax, adjusted for non-temporary differences and excluded temporary differences  35 000  

Adjustments for movements in temporary differences  
   Plus: Excess of tax depreciation recouped over accounting depreciation recouped  30 000  
Taxable profit  65 000  

Looking at the reconciliation we note that the following.  
   • Tax payable and current tax expense, based on taxable profit, is $19 500 ($65 000 × 0.30).  
   • The movement in the temporary difference is a reversal of the deductible temporary difference, which gives rise to a reduction in the deferred tax liability of $9000 ($30 000 × 0.30) and to deferred tax income of an equal amount.  

Option B is incorrect. This alternative confuses the exempt and taxable portions of the capital gain and adds, instead of subtracts, the supposed exempt capital gain, and treats the reversal of the taxable temporary difference as if it is an originating taxable temporary difference. The reconciliation for this alternative is as follows.

Reconciliation between accounting profit before tax and taxable profit

$  
Proceeds of sale of depreciable asset  160 000  
Less: Book carrying amount  (90 000)  
Accounting profit before tax  70 000  

Adjustments for non-temporary differences and excluded temporary differences:  
   Exempt capital gain  35 000  
Accounting profit before tax, adjusted for non-temporary differences and excluded temporary differences  105 000  

Adjustments for movements in temporary differences  
   Less: Excess of tax depreciation recouped over accounting depreciation recouped  (30 000)  
Taxable profit  75 000  

Looking at the reconciliation we note the following.  
   • Tax payable and current tax expense, based on taxable profit, is $22 500 ($75 000 × 0.30).  
   • The movement in the temporary difference is treated as an originating deductible temporary difference which gives rise to an increase in the deferred tax liability of $9000 ($30 000 × 0.30) and to deferred tax expense of an equal amount.  

Option C is incorrect. This alternative treats the reversing temporary difference as if it is an originating temporary difference. The reconciliation for this alternative is as follows.
### Reconciliation between accounting profit before tax and taxable profit

<table>
<thead>
<tr>
<th></th>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Proceeds of sale</td>
<td>160 000</td>
</tr>
<tr>
<td>of depreciable asset</td>
<td></td>
</tr>
<tr>
<td>Less: Book carrying</td>
<td>(90 000)</td>
</tr>
<tr>
<td>amount</td>
<td></td>
</tr>
<tr>
<td>Accounting profit</td>
<td>70 000</td>
</tr>
<tr>
<td>before tax</td>
<td></td>
</tr>
</tbody>
</table>

#### Adjustments for non-temporary differences and excluding temporary differences:

- Exempt capital gain: (25 000)

#### Accounting profit before tax, adjusted for non-temporary differences and excluded temporary differences

45 000

#### Adjustments for movements in temporary differences

- Less: Excess of tax depreciation recouped over accounting depreciation recouped: (30 000)

#### Taxable profit

15 000

Looking at the reconciliation we note the following.

- Tax payable and current tax expense, based on taxable profit, is $4500 ($15 000 × 0.30).
- The movement in the temporary difference is regarded as an originating temporary difference, which gives rise to an increase in the deferred tax liability of $9000 ($30 000 × 0.30) and to deferred tax expense of an equal amount.

You can review this topic area in the study guide under the section titled ‘Deferred tax assets and deferred tax liabilities’ and ‘Recognition of deferred tax on revaluation’—‘Recovery of assets through use or through sale’.
Question 4.11

Correct answer: C

The correct answer is Option C. If the carrying amount of the asset is recovered by use, the tax written-down amount of the asset is deductible for tax purposes against the taxable economic benefits recovered. Therefore, as indicated in the figure below, after the revaluation, the total taxable temporary difference is $85,000. Of this amount, $15,000 relates to the temporary difference in existence prior to the revaluation, and $70,000 is the additional taxable temporary difference attributable to the revaluation increment. Therefore, the additional deferred tax that is to be recognised as a consequence of recognising the revaluation is $21,000 ($70,000 × 0.30). This is reflected in the following figure.

An alternative way of presenting these data is set out in the following table.

<table>
<thead>
<tr>
<th>Before revaluation</th>
<th>After revaluation</th>
<th>Attributable to revaluation</th>
</tr>
</thead>
<tbody>
<tr>
<td>$</td>
<td>$</td>
<td>$</td>
</tr>
<tr>
<td>(1)</td>
<td>(2)</td>
<td>(3)</td>
</tr>
<tr>
<td>Carrying amount</td>
<td>90,000</td>
<td>160,000</td>
</tr>
<tr>
<td>Tax base</td>
<td>75,000</td>
<td>75,000</td>
</tr>
<tr>
<td>Taxable temporary difference</td>
<td>15,000</td>
<td>85,000</td>
</tr>
<tr>
<td>Deferred tax liability (row 3 × 0.30)</td>
<td>4,500</td>
<td>25,500</td>
</tr>
</tbody>
</table>

The entity should recognise an increase in the deferred tax liability of $21,000 ($70,000 × 0.30). Since the additional deferred tax relates to an item that was recognised in other comprehensive income (and accumulated in the revaluation surplus), the deferred tax should be recognised in other comprehensive income (and reduce the revaluation surplus (IAS 12, para. 61A)).
Option A is incorrect. This alternative arrives at the taxable amount by comparing the cost of the asset with the pre-revaluation carrying amount, as follows.

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost</td>
<td>101,250</td>
</tr>
<tr>
<td>Carrying amount before revaluation</td>
<td>(90,000)</td>
</tr>
<tr>
<td>Taxable temporary difference</td>
<td>11,250</td>
</tr>
</tbody>
</table>

This alternative also incorrectly recognises the deferred tax in the statement of profit or loss and other comprehensive income as tax expense.

Option B is incorrect. This alternative incorrectly presumes that, since capital gains are non-taxable, any amount in excess of cost that is recovered is not taxable, regardless of whether or not recovery is by means of using the asset. The calculation of the taxable temporary difference was:

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost</td>
<td>101,250</td>
</tr>
<tr>
<td>Tax base</td>
<td>(75,000)</td>
</tr>
<tr>
<td>Taxable temporary difference</td>
<td>26,250</td>
</tr>
</tbody>
</table>

Option D is incorrect. This alternative incorrectly attributes the whole of the post-revaluation deferred tax liability to the revaluation increment. This alternative also incorrectly recognises the deferred tax in the statement of profit or loss and other comprehensive income as tax expense.

*You can review this topic area in the study guide under the section titled ‘Assets carried at fair value or revalued amounts’.*
Question 4.12

Correct answer: D

Option D is the correct answer based on the following table of calculations.

<table>
<thead>
<tr>
<th>Statement of financial position item</th>
<th>Carrying amount</th>
<th>Taxable temporary differences</th>
<th>Deductible temporary differences</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$ (1)</td>
<td>$ (2)</td>
<td>$ (3)</td>
</tr>
<tr>
<td>1 Rental revenue received in advance</td>
<td>80 000</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>2 Provision for employee benefits</td>
<td>20 000</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>3 Interest revenue receivable</td>
<td>50 000</td>
<td>0</td>
<td>50 000</td>
</tr>
<tr>
<td>4 Development costs carried forward</td>
<td>40 000</td>
<td>0</td>
<td>40 000</td>
</tr>
<tr>
<td>5 Plant and equipment less accumulated depreciation</td>
<td>100 000</td>
<td>40 000</td>
<td>60 000</td>
</tr>
<tr>
<td>6 Temporary differences</td>
<td></td>
<td>150 000</td>
<td>100 000</td>
</tr>
<tr>
<td>7 Unused tax losses</td>
<td></td>
<td>120 000</td>
<td></td>
</tr>
<tr>
<td>8</td>
<td></td>
<td>220 000</td>
<td></td>
</tr>
<tr>
<td>9 Deferred tax liability before change in tax rate (row 6, col. 3 × 0.30)</td>
<td></td>
<td>45 000</td>
<td></td>
</tr>
<tr>
<td>10 Deferred tax asset before change in tax rate (row 8, col. 4 × 0.30)</td>
<td></td>
<td>66 000</td>
<td></td>
</tr>
<tr>
<td>11 Deferred tax liability after change in tax rate (row 6, col. 3 × 0.35)</td>
<td></td>
<td>52 500</td>
<td></td>
</tr>
<tr>
<td>12 Deferred tax asset after change in tax rate (row 8, col. 4 × 0.35)</td>
<td></td>
<td>77 000</td>
<td></td>
</tr>
<tr>
<td>13 Increase in deferred tax balance</td>
<td>7 500</td>
<td>11 000</td>
<td></td>
</tr>
<tr>
<td>14 Debit/(Credit) tax expense (income)</td>
<td>7 500</td>
<td>11 000</td>
<td>(11 000)</td>
</tr>
</tbody>
</table>

Option A is incorrect. The answer treats the temporary differences as deductible differences and vice versa.

Option B is incorrect. This answer excludes the consequences of the unused tax losses from the entry. Therefore, the deferred tax asset after and before the change in the tax rate are assumed to be:

\[
\begin{align*}
\text{Deferred tax asset after} & \quad $100 000 \times 0.35 = 35 000 \\
\text{Deferred tax asset before} & \quad $100 000 \times 0.30 = 30 000 \\
\text{Change in deferred tax asset} & \quad 5 000
\end{align*}
\]

Option C is incorrect. The rental revenue received in advance is regarded as giving rise to a taxable temporary difference. Therefore, the totals of the deductible and taxable amounts, and the resulting changes in the deferred tax asset and deferred tax liability, are treated as being:

\[
\begin{align*}
\text{Change in deferred tax asset:} & \quad $ \\
\text{total deductible amount } \times (0.35 - 0.30) & = $140 000 \times 0.05 = 7 000 \\
\text{Change in deferred tax liability:} & \quad $ \\
\text{total taxable amount } \times (0.35 - 0.30) & = $230 000 \times 0.05 = 11 500 \\
\text{Tax expense} & = 4 500
\end{align*}
\]

You can review this topic area in the study guide under the section titled ‘Recognition of deferred tax assets and deferred tax liabilities’.
**Question 4.13**

Correct answer: B

The correct answer is Option B. The tax base of an asset as at the end of 20X1 is the amount that will be deductible for tax purposes against the taxable benefits that will flow to the entity when the carrying amount of the asset is recovered (IAS 12, para. 7, first sentence). This amount is the tax written-down amount of the asset. The difference between accounting profit before tax and taxable profit for 20X1 implies that the tax written-down amount of the asset, the tax base, is $1000 less than the carrying amount of the asset. This means that the amount deductible from the taxable benefits recovered is $1000 less than those benefits, giving rise to a taxable temporary difference of $1000. Therefore, a deferred tax liability of $300 ($1000 \times 0.30) is recognised.

Options A and C are incorrect. They interpret the question as requiring the recognition of a deferred tax asset. A deferred tax asset would be recognised if the transaction gave rise to a deductible temporary difference. Option C also assumes the difference between the taxable profit and accounting profit is the amount of the deferred tax balance.

Option D is incorrect. It assumes the difference between the taxable profit and accounting profit is the amount of the deferred tax balance.

*You can review this topic area in the study guide under the section titled ‘Deferred tax assets and deferred tax liabilities’.*

**Question 4.14**

Correct answer: D

Option D is correct because:

- A deferred tax liability is initially recognised with respect to the taxable temporary difference of $1000.
- The tax consequences of all subsequent reversals of the temporary difference are recognised as reductions in the deferred tax liability. The tax written-down amount is always less than the carrying amount of the asset up until the final reversal.

Options A, B and C are incorrect. From above, a deferred tax asset is never recognised or affected.

*You can review this topic area in the study guide under the section titled ‘Deferred tax assets and deferred tax liabilities’.*
Question 4.15
Correct answer: B

The correct answer is Option B. In general, the amount of tax expense for a period may differ from the tax that is prima facie payable on accounting profit before tax as a consequence of any, or all, of the following factors.

a. Non-temporary differences:
   i. items that are included in the measurement of either accounting profit before tax or taxable profit, but never both, and which arise on the initial recognition of an asset or liability, and
   ii. allowable deductions that do not affect the measurement of an asset or liability; and

b. Temporary differences for which IAS 12 precludes recognition of a deferred tax asset or deferred tax liability; and

c. Reductions in current tax expense or deferred tax expense arising from previously unrecognised tax losses, tax credits or temporary differences.

Examples of these items that are included in the data for this question are non-temporary differences—statutory fines payable and dividends receivable.

A is incorrect. These items do not cause tax expense to differ from the amount of tax that is prima facie payable with respect to accounting profit before tax.

C is incorrect. The effect attributable to the items that cause tax expense to differ from prima facie tax is in the opposite direction to the actual effect.

D is incorrect. None of the items included in this reconciliation as causes of the difference between tax expense and prima facie tax should have been taken into account. Note particularly that, as a deferred tax asset has previously been recognised for the unused tax losses, the benefit of the recoupment is a reduction in the deferred tax asset, not a reduction in tax expense.

The following reconciliation between accounting profit before tax and taxable profit shows how the case data affects (or is excluded from) the determination of tax expense for the period.

<table>
<thead>
<tr>
<th>Reconciliation between accounting profit before tax and taxable profit</th>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounting profit before tax</td>
<td>100 000</td>
</tr>
<tr>
<td>Adjustments for non-temporary differences and excluded temporary differences</td>
<td></td>
</tr>
<tr>
<td>Statutory fines</td>
<td>5 000†</td>
</tr>
<tr>
<td>Dividends</td>
<td>(8 000)‡</td>
</tr>
<tr>
<td>Adjustments for non-temporary differences and excluded temporary differences</td>
<td>97 000§</td>
</tr>
<tr>
<td>Adjustments for movements in temporary differences</td>
<td></td>
</tr>
<tr>
<td>Plus: Inventory write-down</td>
<td>4 000</td>
</tr>
<tr>
<td>Less: Foreign currency exchange gain</td>
<td>(10 000)</td>
</tr>
<tr>
<td>Taxable profit before utilising unused tax losses</td>
<td>91 000</td>
</tr>
<tr>
<td>Less: Tax losses recouped this period</td>
<td>(60 000)</td>
</tr>
<tr>
<td>Taxable profit after utilising tax losses</td>
<td>31 000</td>
</tr>
</tbody>
</table>

† 5 000 × 0.3 = 1 500
‡ (8 000) × 0.3 = (2 400)
§ 97 000 × 0.3 = 29 100
You can review this topic area in the study guide under the sections titled ‘Calculating tax expense’ and ‘Relationship between tax expense (income) and accounting profit’.

**Question 4.16**

Correct answer: C

Option C, the correct answer, is based on the following worksheet.

<table>
<thead>
<tr>
<th>Item</th>
<th>Taxable profit</th>
<th>Current tax expense/ (income) $</th>
<th>Deferred tax expense/ (income) $</th>
<th>Deferred tax asset $</th>
<th>Deferred tax liability $</th>
<th>Tax payable $</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Pre-tax operating profit (loss)</td>
<td>100 000</td>
<td>30 000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2</td>
<td><strong>Movements in non-temporary differences and excluded temporary differences</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Statutory fines</td>
<td>5 000</td>
<td>1 500</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Exempt dividends</td>
<td>(8 000)</td>
<td>(2 400)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>Pre-tax operating profit (loss) adjusted for non-temporary differences and excluded temporary differences</td>
<td>97 000</td>
<td>29 100</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4</td>
<td><strong>Movements in temporary differences</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Inventory write-down</td>
<td>4 000</td>
<td>1 200 Credit</td>
<td>1 200 Debit</td>
<td>1 200</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Foreign currency exchange gain</td>
<td>(10 000)</td>
<td>3 000 Debit</td>
<td>3 000 Credit</td>
<td>(3 000)</td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>Taxable profit (loss) before utilising tax losses</td>
<td>91 000</td>
<td>27 300</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>Tax losses recouped—deferred tax asset not previously recognised</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>Tax losses recouped—utilisation of deferred tax asset previously recognised</td>
<td>(60 000)</td>
<td>18 000 Debit</td>
<td>18 000 Credit</td>
<td>(18 000)</td>
<td></td>
</tr>
<tr>
<td>8</td>
<td>Previously unrecognised tax losses benefit, recognised as deferred tax asset this period</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>9</td>
<td>Taxable profit (loss) after utilising tax losses</td>
<td>31 000</td>
<td>9 300 Debit</td>
<td>19 800 Debit</td>
<td>16 800 Credit</td>
<td>3 000 Credit</td>
</tr>
<tr>
<td>10</td>
<td>Totals</td>
<td>9 300 Debit</td>
<td>19 800 Debit</td>
<td>16 800 Credit</td>
<td>3 000 Credit</td>
<td>9 300 Credit</td>
</tr>
</tbody>
</table>

Option A is incorrect. This alternative incorrectly deals with the benefit of the tax losses recouped.

Option B is incorrect. This alternative is based on the following reconciliation between accounting profit before tax and taxable profit. The reconciliation incorrectly deducts the inventory write-down and incorrectly adds the foreign currency exchange gain.
Reconciliation between accounting profit before tax and taxable profit

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounting profit before tax</td>
<td>$100,000</td>
</tr>
<tr>
<td>Adjustments for non-temporary differences and excluded</td>
<td></td>
</tr>
<tr>
<td>temporary differences</td>
<td></td>
</tr>
<tr>
<td>Statutory fines</td>
<td>$5,000</td>
</tr>
<tr>
<td>Dividends</td>
<td>$(8,000)</td>
</tr>
<tr>
<td>Accounting profit before tax adjusted for non-temporary</td>
<td>$97,000</td>
</tr>
<tr>
<td>differences and excluded temporary differences</td>
<td></td>
</tr>
<tr>
<td>Less: Inventory write-down</td>
<td>$(4,000)</td>
</tr>
<tr>
<td>Plus: Foreign currency gain</td>
<td>$10,000</td>
</tr>
<tr>
<td>Taxable profit before utilising unused tax losses</td>
<td>$103,000</td>
</tr>
<tr>
<td>Less: Tax losses recouped this period</td>
<td>$(60,000)</td>
</tr>
<tr>
<td>Taxable profit</td>
<td>$43,000</td>
</tr>
</tbody>
</table>

Option D is incorrect. This alternative is based on the following reconciliation, which excludes movements in temporary differences.

Reconciliation between accounting profit before tax and taxable profit

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounting profit before tax</td>
<td>$100,000</td>
</tr>
<tr>
<td>Adjustments for non-temporary differences and excluded</td>
<td></td>
</tr>
<tr>
<td>temporary differences</td>
<td></td>
</tr>
<tr>
<td>Statutory fines</td>
<td>$5,000</td>
</tr>
<tr>
<td>Dividends</td>
<td>$(8,000)</td>
</tr>
<tr>
<td>Taxable profit before utilising unused tax losses</td>
<td>$97,000</td>
</tr>
<tr>
<td>Less: Tax losses recouped this period</td>
<td>$(60,000)</td>
</tr>
<tr>
<td>Taxable profit</td>
<td>$37,000</td>
</tr>
</tbody>
</table>

You can review this topic area in the study guide under the sections titled ‘Calculating tax expense’, ‘Deferred tax assets and deferred tax liabilities’ and ‘Recognition of deferred tax assets and deferred tax liabilities’.
**Question 4.17**

Correct answer: A

The correct answer is Option A.

**Reconciliation between accounting profit before tax and taxable profit**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loss on sale of non-depreciable asset</td>
<td>(100,000)</td>
</tr>
<tr>
<td>Royalty revenue earned</td>
<td>70,000</td>
</tr>
<tr>
<td><strong>Accounting loss before tax</strong></td>
<td>(30,000)</td>
</tr>
<tr>
<td>Adjustments for movements in temporary differences</td>
<td></td>
</tr>
<tr>
<td>Increase in unearned royalty revenue (excess of royalties received over royalty revenue recognised in accounting profit)</td>
<td>80,000</td>
</tr>
<tr>
<td><strong>Taxable profit</strong></td>
<td>50,000</td>
</tr>
</tbody>
</table>

**Deferred tax asset—$24,000**

Epsilon Ltd has recognised $70,000 of royalty revenue and a liability of $80,000 for unearned royalty revenue. The tax base of the liability for unearned royalties is nil (IAS 12, para. 8) giving rise to a deductible temporary difference of $80,000 and a deferred tax asset of $24,000 ($80,000 × 0.30). Alternatively, as the revenue will not be taxed when the liability is settled, future tax payments will be smaller than in the absence of this tax consequence. Therefore, a deferred tax asset is recognised. This transaction also gives rise to deferred tax income of $24,000.

**Tax payable—$15,000**

According to the above reconciliation, taxable profit for the year is $50,000. The related tax payable is $15,000 ($50,000 × 0.30).

**Current tax expense—$15,000**

Current tax is equal to tax payable on taxable profit for the period (IAS 12, para. 5). The whole of the current tax of $15,000 is recognised as an expense in the statement of profit or loss and other comprehensive income for the current period.

**Deferred tax income**

Deferred tax income is equal to the $24,000 increase in the deferred tax asset.

Option B is incorrect. It was based on the following calculations.

**Reconciliation between accounting profit before tax and taxable profit**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loss on sale of non-depreciable asset</td>
<td>(100,000)</td>
</tr>
<tr>
<td>Accounting loss before tax</td>
<td>(100,000)</td>
</tr>
<tr>
<td>Adjustments for movements in temporary differences</td>
<td></td>
</tr>
<tr>
<td>Excess of royalties received over royalty revenue recognised in accounting profit</td>
<td>(80,000)</td>
</tr>
<tr>
<td><strong>Taxable profit</strong></td>
<td>(180,000)</td>
</tr>
</tbody>
</table>
This option ignores royalty revenue and treats excess royalties incorrectly. The deferred tax asset was calculated as follows:

\[
\text{Deferred tax asset relating to tax losses} = 180,000 \times 0.30 = 54,000
\]

Option C is incorrect. It was based on the following calculations.

**Reconciliation between accounting profit before tax and taxable profit**

\[
\begin{align*}
\text{Loss on sale of non-depreciable asset} & : -100,000 \\
\text{Royalty revenue} & : 70,000 \\
\text{Accounting loss before tax} & : -30,000 \\
\text{Excess of royalties received over royalty revenue recognised in accounting profit} & : -80,000 \\
\text{Taxable profit} & : -110,000
\end{align*}
\]

This option treats excess royalties incorrectly. The deferred tax asset was calculated as follows:

\[
\text{Deferred tax asset relating to tax losses} = 110,000 \times 0.30 = 33,000
\]

Option D is incorrect. It was based on the following calculations.

**Reconciliation between accounting profit before tax and taxable profit**

\[
\begin{align*}
\text{Loss on sale of non-depreciable asset} & : -100,000 \\
\text{Royalty revenue} & : 70,000 \\
\text{Accounting loss before tax} & : -30,000 \\
\text{Loss on sale of non-depreciable asset} & : 100,000 \\
\text{Accounting profit before tax adjusted for non-temporary differences and excluded temporary differences} & : 70,000 \\
\text{Excess of royalties received over royalty revenue recognised in accounting profit} & : 80,000 \\
\text{Taxable profit} & : 150,000
\end{align*}
\]

This option incorrectly treats the loss on equipment as a non-temporary difference.

*You can review this topic area in the study guide under the sections titled ‘Calculating tax expense’ and ‘Deferred tax assets and deferred tax liabilities’.*
Question 4.18

Correct answer: C

The correct answer is Option C. Looking at the reconciliations in the question data for each year, and focusing on the prominent figures, we have the following.

Year ended 30 June 20X8

Decrease in liability for product warranties $20,000—this leads to a decrease of an equivalent amount in a deductible temporary difference, causing a reduction of $6,000 ($20,000 × 0.30) in a deferred tax asset. The journal entry is:

$  
Deferred tax expense  6,000  
Deferred tax asset  6,000

Tax loss $50,000—as the probability recognition criterion is satisfied, a deferred tax asset of $15,000 should be recognised. The journal entry is:

$  
Deferred tax asset  15,000  
Current tax income  15,000

Combining these entries gives:

$  
Deferred tax asset  9,000  
Deferred tax expense  6,000  
Current tax income  15,000

Year ended 30 June 20X9

Increase in liability for product warranties $10,000—this leads to an increase of an equivalent amount in a deductible temporary difference, causing an increment of $3,000 ($10,000 × 0.30) in a deferred tax asset. The journal entry is:

$  
Deferred tax asset  3,000  
Deferred tax income  3,000

Taxable profit before utilising tax losses $35,000—the journal entry to recognise the benefit of this recoupment of $35,000 of the previous period tax losses is:

$  
Deferred tax expense ($35,000 × 0.30)  10,500  
Deferred tax asset  10,500

Taxable profit after utilising tax losses is nil; accordingly, there is no current tax expense/liability to recognise.

Combining these entries gives:

$  
Deferred tax expense  7,500  
Deferred tax asset  7,500
Year ended 30 June 20Y0

Increase in liability for product warranties $20 000—this leads to an increase of an equivalent amount in a deductible temporary difference, causing an increment of $6000 ($20 000 × 0.30) in a deferred tax asset. The journal entry is:

\[
\begin{array}{c|c|c}
\text{Deferred tax asset} & 6 000 \\
\text{Deferred tax income} & 6 000 \\
\end{array}
\]

Taxable profit before utilising tax losses $60 000—this amount is sufficient to absorb the $15 000 balance of the unused tax losses. The journal entry to recognise the benefit of the recoupment of the remaining unused tax losses is:

\[
\begin{array}{c|c|c}
\text{Deferred tax expense ($15 000 × 0.30)} & 4 500 \\
\text{Deferred tax asset} & 4 500 \\
\end{array}
\]

Taxable profit after utilising tax losses $45 000 ($60 000 − $15 000)—this gives rise to a liability for tax currently payable and to a current tax expense of $13 500. The journal entry is:

\[
\begin{array}{c|c|c}
\text{Current tax expense} & 13 500 \\
\text{Tax payable} & 13 500 \\
\end{array}
\]

Combining these entries gives:

\[
\begin{array}{c|c|c}
\text{Deferred tax asset} & 1 500 \\
\text{Deferred tax income} & 1 500 \\
\text{Current tax expense} & 13 500 \\
\text{Tax payable} & 13 500 \\
\end{array}
\]

Options A, B and D are incorrect.

The entry for the year ended 30 June 20X8 is incorrect for Options B and D. This entry has taken into account only the deferred tax asset and the current tax income of $15 000 relating to the tax loss. The deferred tax expense and reduction in the deferred tax asset of $6000 relating to the reversal of the deductible temporary difference has been ignored.

The entry for the year ended 30 June 20X9 is incorrect in Options A and D. The increase in the liability for product warranties was treated as a decrease.

The entry for the year ended 30 June 20Y0 is incorrect in Options A and B. The net increase in the deferred tax asset was treated as a net decrease.

You can review this topic area in the study guide under the section titled ‘Recoupment of tax losses’.
Module 5

Question 5.1
Correct answer: B and C

The correct answers are Options B and C. Paragraph B5.2.4 of IFRS 9 lists a number of circumstances where cost would not be a good estimate of fair value and includes Options B and C. Paragraph B5.2.4 also notes that internal matters of the investee such as fraud or change in management may also be indicators that cost is not representative of fair value—in this instance, Options A and D are less likely to be indicators (compared to the other two options) as the fraud is of a low-level and not considered to be either significant nor widespread, and the retirement of the CEO is planned. Options A and D are therefore incorrect.

You can review this topic area in the study guide under the section titled ‘Measurement’—‘Investments in equity securities’.

Question 5.2
Correct answer: C

The correct answer is Option C. The objective with portfolio A is to buy and sell securities to gain from movements in fair value and hence the fair value method is required as the requirements in paragraph 4.1.2 of IFRS 9 to achieve amortised cost measurement are not met. With portfolio B, the objective is not to buy and sell based on movements in fair value but to benefit from the contractual cash flows, and paragraph 4.1.2 of IFRS 9 requires its measurement at amortised cost (except where the portfolio is designated as measured at fair value through profit or loss).

Option A is correct only where the company designates portfolio B as measured at fair value through profit or loss on initial recognition, which it is only able to do if doing so eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases (see para. 4.1.5 of IFRS 9).

Options B and D are incorrect as Portfolio A does not meet the conditions to achieve measurement at amortised cost (see para. 4.1.2 of IFRS 9).

You can review this topic area in the study guide under the section titled ‘Classification of financial assets and financial liabilities’—‘Classification of financial assets’.
**Question 5.3**

Correct answer: C

The correct answer is Option C because the instrument in Option C fails the test as the premium for early repayment exceeds what paragraph B4.1.11 of IFRS 9 describes as a ‘reasonable additional compensation for the early termination of the contract’.

The instrument in Option A meets the test as the rate varies only for changes in LIBOR up to a capped upper limit. The cap reduces cash flow variability by setting a limit on the variable interest rate, but this does not of itself cause the instrument to not have cash flows that are solely payments of principal and interest. (See B4.1.13 of IFRS 9.) Option A is therefore incorrect.

Option B is incorrect because the instrument in Option B meets the test as the rate varies only for changes in LIBOR and credit risk, which is discussed in B4.1.11 of IFRS 9.

Option D is incorrect because the instrument in Option D meets the test as the amount to be repaid under the extension terms represents payments of principal and interest only as no penalties are involved (See B4.1.11 of IFRS 9.)

*You can review this topic area in the study guide under the section titled ‘Classification of financial assets and financial liabilities’— ‘Contractual cash flows that are solely payments of principal and interest on the principal amount outstanding’.*

**Question 5.4**

Correct answer: C

The correct answer is Option C. A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity. Prepaid insurance would not meet the definition because it involves a right (obligation) to receive (deliver) a service rather than cash or an equity instrument.

Option A is incorrect because cash at bank is clearly a financial asset, and is identified as such in the definition of financial asset.

Option B is incorrect because a bill of exchange involves one party having the right to receive cash in exchange for the bill and the other party having the converse right and obligation. Therefore, it meets the definition of a financial instrument.

Option D is incorrect because a forward exchange contract gives both parties the right and obligation to exchange different currencies in the future and is therefore a financial instrument.

*You can review this topic area in the study guide under the section titled ‘Part A: What are financial instruments?’—‘Definition of a financial instrument’.*
Question 5.5
Correct answer: B

The correct answer is Option B. Under IAS 32, the redeemable preference shares are classified as a liability from the date of issue because the holder has the right to demand redemption. Therefore, the instruments are a liability and the payment for the year is classified as interest. The probability of conversion makes no difference to the classification of the instruments.

Option A is incorrect, as it assumes that the shares are equity.

Options D and C are incorrect, as they assume that the shares are reclassified during the year, but this is not permitted according to paragraph 30 of IAS 32 Financial Instruments: Presentation.

You can review this topic area in the study guide under the section titled ‘Presentation issues’—‘Classification of interest, dividends, gains and losses’ and ‘Classification as liabilities or equity’.

Question 5.6
Correct answer: A

The correct answer is Option A. The fair value declines from $100,000 to $85,000. Thus, a loss of $15,000 should be recognised. In year 1, a gain of $10,000 would be recognised, and the financial assets carrying amount at the start of year 2 would be $100,000.

Option B is incorrect as it reflects the difference between the fair value of the derivative financial asset at the end of year 2 and its cost ($85,000 – $90,000), and not the movement in the fair value of the derivative between the start of year 2 and the end of year 2.

Option C is incorrect as it assumes that the fair value of the instrument has not changed since year 0.

Option D is incorrect as it reflects the difference between the fair value of the derivative financial asset at the end of year 1 and its fair value at year 0 ($100,000 – $90,000), and not the movement in the fair value of the derivative between the start of year 2 and the end of year 2.

You can review this topic area in the study guide under the section titled ‘Impairment of financial assets and hedge accounting’—‘Hedging’.

Question 5.7
Correct answer: B and D

Market risk is defined in Appendix A in IFRS 7 as the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risk: currency risk, interest rate risk and other price risk. Therefore Options B and D are correct.

Options A and C are incorrect because credit risk and liquidity risk are other risks that arise from financial instruments, but are not part of market risk.

You can review this topic area in the study guide under the section titled ‘Disclosure issues’—‘Collateral and other credit enhancements’.
**Question 5.8**
Correct answer: B

The correct answer is Option B. The issuer does not currently have a present obligation to transfer financial assets (cash) to the shareholders as the redemption of the shares is solely at the discretion of the issuer, and the issuer has not exercised its option to redeem those shares (see para. AG 25 of IAS 32).

Option A is incorrect as a preference share that provides for redemption on a specific date contains a financial liability because the issuer has an obligation to transfer financial assets (cash) to the holder of the share at the redemption date (see para. AG25 of IAS 32).

Option C is incorrect as a preference share that provides for redemption at the option of the holder contains a financial liability because the issuer has an obligation to transfer financial assets (cash) to the holder of the share when requested by the holder (see para. AG25 of IAS 32).

Option D is incorrect as the issuer has a present obligation to transfer financial assets (cash) to the shareholders as the issuer of the shares has formally notified shareholders of its intention to redeem the shares (see para. AG25 of IAS 32). Therefore, the redeemable preference shares should be classified as a financial liability.

*You can review this topic area in the study guide under the section titled ‘Presentation issues’—‘Classification as liabilities or equity’.*

**Question 5.9**
Correct answer: D

The correct answer is Option D. With all of the information already contained in the financial statements, a user can determine that the maximum credit risk is $74m. Paragraph 36(a) of IFRS 7 states that disclosure of the amount that best represents the maximum exposure to credit risk at the end of the reporting period without taking account of any collateral held or other credit enhancements is not required for financial instruments whose carrying amount best represents the maximum exposure to credit risk.

Options A and C are incorrect. The maximum credit risk is $74m, not $80m. Moreover, further disclosure in the notes to comply with paragraph 36(a) of IFRS 7 is not required as the maximum credit risk is already recognised in the financial statements (net carrying amount of receivables).

Option B is incorrect. Paragraph 36(a) of IFRS 7 (which requires disclosure of the maximum credit risk exposure by class of financial instrument) does not apply to financial instruments whose carrying amount best represents the maximum exposure to credit risk.

*You can review this topic area in the study guide under the section titled ‘Disclosure issues’—‘Statement of profit and loss and other comprehensive income’.*
Question 5.10
Correct answer: A

The correct answer is Option A. The note does not meet the definition of a financial liability. The issuer does not have a contractual obligation to deliver cash or another financial asset to the noteholder, nor is the issuer obliged to deliver a variable number of its own equity instruments to the noteholder. In general, a contract that will be settled by the entity (receiving or) delivering a fixed number of its own equity instruments in exchange for a fixed amount of cash or another financial is an equity instrument (see IAS 32, para. 22).

Options B and D are incorrect as the instrument does not meet the definition of a financial liability. The issuer does not have a contractual obligation to deliver cash or another financial asset to the noteholder, nor is the issuer obliged to deliver a variable number of its shares in settlement.

Option C is incorrect. The holder is exposed to changes in the fair value of the issuer’s shares as the note can only be settled by the holder for a fixed number of shares.

You can review this topic area in the study guide under the section titled ‘Presentation issues’—‘Classification as liabilities or equity’.

Question 5.11
Correct answer: A

The correct answer is Option A. Paragraph 4.4.2 states that the reclassification of financial liabilities is not permitted.

Option B is incorrect. Paragraph B4.4.1 states that such reclassifications are expected to be very infrequent.

Options C and D are incorrect. Paragraph 4.4.1 of IFRS 9 permits the reclassification of financial assets but only when there is a change in the business model.

You can review this topic area in the study guide under the section titled ‘Classification of financial assets and financial liabilities’—‘Reclassification’.

Question 5.12
Correct answer: B

The correct answer is Option B. The holder has the option to demand repayment of the principal in the first 10 years; accordingly the instrument meets the definition of a financial liability.

Option A is incorrect as during the first 10 years, the issuer has a contractual obligation to deliver cash to the holder; accordingly the instrument should be classified as a financial liability.

Option C is incorrect as IAS 32 does not permit a choice in classification.

Option D is incorrect as during the first 10 years, the instrument does not contain any features of an equity instrument in addition to the financial liability component.

You can review this topic area in the study guide under the section titled ‘Presentation issues’—‘Classification as liabilities or equity’.
**Question 5.13**
Correct answer: A

The correct answer is Option A. The interest payments and principal are now payable at the discretion of the issuer and, therefore, represent equity (IAS 32, para. AG 25). The holder has the option to convert to ordinary shares and will receive a fixed number of ordinary shares. There is no obligation on the issuer to redeem the instruments.

Option B is incorrect as after 10 years the issuer has no contractual obligation to deliver cash to the holder of the instrument, nor obliged to settle the instrument for a variable number of the issuer’s shares.

Option C is incorrect as IAS 32 does not permit entities a choice in classification.

Option D is incorrect as the instrument does not contain features of both an equity component and a financial liability component. For example, the instrument would be classified as a compound instrument if after 10 years the issuer was still obliged to make a 5 per cent dividend payment to the holder each year while the instrument remained outstanding.

You can review this topic area in the study guide under the section titled ‘Presentation issues’—‘Classification as liabilities or equity’.

**Question 5.14**
Correct answer: B

The correct answer is Option B. Once the issuer formally notifies the holder of the intention to redeem the notes, a financial liability is created (IAS 32, para. AG 25). Accordingly, Option A is incorrect.

Option C is incorrect as IAS 32 does not permit entities a choice in classification.

Option D is incorrect as the instrument will no longer contain any features of an equity instrument.

You can review this topic area in the study guide under the section titled ‘Presentation issues’—‘Classification as liabilities or equity’.
Question 5.15
Correct answer: D

The correct answer is Option D. The issuer has issued a compound financial instrument as it has created both a financial liability (to repay the bonds on maturity and to pay interest) and an equity instrument (the grant of the option to convert the obligation into equity instruments of the issuer) (see para. 28 of IAS 32). The component parts are classified as financial liability and equity separately in accordance with paragraph 29 of IAS 32.

Option A is incorrect, as it ignores the contractual obligation of the issuer to make payments under the bond terms (financial liability).

Option B is incorrect, as it ignores the option granted to the holder of the bonds to convert it into equity instruments of the entity (equity instrument).

Option C is incorrect, as IAS 32 does not permit a choice in classification.

You can review this topic area in the study guide under the section titled ‘Compound financial instruments’.

Question 5.16
Correct answer: B

The correct answer is Option B. The issuer has issued a compound financial instrument as it has created both a financial liability (to repay the notes on maturity) and an equity instrument (the grant of the option to convert the obligation into equity instruments of the issuer on a fixed future date). (See para. 28 of IAS 32.) The component parts are classified as financial liability and equity separately in accordance with paragraph 27 of IAS 32. The value of the financial liability is $90,000, being the fair value of the note without the conversion option. The residual of $10,000 is attributed to the equity instrument.

Note: Classification of the financial liability and equity components is not revised as a result of a change in likelihood that the conversion option is exercised (see para. 30 of IAS 32).

Options A and D are not correct as they do not attribute any value to the equity instrument on initial recognition.

Option C is not correct as it has included the greater amount in equity on assumption that the notes will be converted into shares in the future.

You can review this topic area in the study guide under the section titled ‘Compound financial instruments’.
Question 5.17
Correct answer: B

The correct answer is Option B. Paragraphs 4.1.4 and 4.2.1 of IFRS 9 require the derivative to be measured at fair value through profit or loss. Accordingly, Options A, C and D are incorrect.

Note, as the derivative is designated as the hedging item in a fair value hedge of a receivable, gains and losses on changes in the fair value of the derivative are recognised in profit or loss in accordance with paragraph 6.5.8 of IFRS 9.

You can review this topic area in the study guide under the sections titled ‘Measurement’ and ‘Hedging’.

Question 5.18
Correct answer: C

The correct answer is Option C. XYZ is still exposed to substantially all the risks and rewards of ownership as it has agreed to repurchase the financial asset in three months’ time for a price that resembles a lender’s return (para. 3.2.7 of IFRS 9). Accordingly, in accordance with paragraph 3.2.6 of IFRS 9, XYZ continues to recognise the financial asset as the criteria for derecognition is not met. The transaction is treated as a borrowing and not a sale in accordance with paragraph 3.2.15 in IFRS 9. XYZ will record a $15,000 interest expense when it repays the loan in three months.

Options A and D are incorrect because the transaction is not a sale.

Option B is incorrect because it treats only part of the transaction as a borrowing and derecognises the financial asset. The criteria for derecognition is not met as XYZ is still exposed to substantially all the risks and rewards of ownership. Paragraph 3.2.15 requires the entire amount to be treated as a borrowing.

You can review this topic area in the study guide under the section titled ‘Derecognition of financial assets and financial liabilities’.

Question 5.19
Correct answer: B

The correct answer is Option B. The increase in value of the forward FX contract is a gain. Paragraph 6.5.8 of IFRS 9 requires the gain or loss on remeasurement of the forward FX contract designated as part of a fair value hedge to be recognised in profit or loss.

Option A is incorrect, as the forward contract has increased in value and so, there is no loss on the forward contract.

Option C is incorrect, as the gains on the forward FX contract are recognised in profit or loss and not in comprehensive income in accordance with paragraph 6.5.8 of IFRS 9. Gains and losses on a hedging instrument designated as part of a fair value hedge are recognised in profit or loss, except where the hedging instrument hedges an equity instrument for which the entity has elected to present changes in fair value in other comprehensive income.

Option D is incorrect, as the forward contract has increased and not decreased in value, and as the gain should be recognised in profit or loss.

You can review this topic area in the study guide under the section titled ‘Hedging’.
Module 6

Question 6.1
Correct answer: B

The correct answer is Option B. Refer to the calculation below.

Consideration transferred has to be calculated by deduction.

\[
\begin{align*}
\text{Fair value of investee’s net assets} & = 180,000 + 20,000 - 6,000 \\
\text{Fair value of the investee’s net assets} & = 194,000 \\
\text{Add: Goodwill (given)} & = 10,000 \\
\text{Consideration transferred} & = 204,000
\end{align*}
\]

Option A is incorrect. This answer has adjusted for the costs directly attributable to the combination. Acquisition costs are expensed in accordance with paragraph 53 of IFRS 3, with the exception of costs to issue debt or equity securities, which are recognised in accordance with IAS 32 and IFRS 9.

Option C is incorrect. This answer has not adjusted for the deferred tax liability relating to the revaluation.

Option D is incorrect. This answer has not taken into account the deferred tax liability relating to the revaluation and has included the costs directly attributable to the combination.

You can review this topic area in the study guide under the sections titled ‘The acquisition method: Recognising and measuring goodwill or a gain from a bargain purchase’ and ‘Deferred tax arising from a business combination’.

Question 6.2
Correct answer: A

The correct answer is Option A. It is the group that has acquired the net assets and goodwill. The parent has acquired a single asset, an investment in the subsidiary.

Option B is incorrect. The investor would only record the investment in the subsidiary.

Options C and D are incorrect. Goodwill must be recorded in the financial statements of the group.

You can review this topic area in the study guide under the sections titled ‘Identifying a business combination’ and ‘The acquisition method: Recognising and measuring goodwill or a gain from a bargain purchase.’
**Question 6.3**

Correct answer: B

The correct answer is Option B. IFRS 3, paragraph 37, requires the consideration transferred in a business combination to be measured at fair value, which shall be calculated as the sum of:

- the acquisition-date fair values of the assets transferred by the acquirer;
- the liabilities incurred by the acquirer to former owners of the acquiree; and
- the equity interests issued by the acquirer.

The consideration transferred is equal to the fair value of the shares issued by Alpha.

\[
\text{S} \begin{align*}
10,000 \text{ shares in Alpha} & \times 2.70 \\
& = 27,000
\end{align*}
\]

Option A is incorrect. This answer is based on the fair value of Beta’s shares.

Option C is incorrect. This answer is based on the fair value of Beta’s shares, plus the acquisition costs. Acquisition costs are expensed in accordance with paragraph 53 of IFRS 3, with the exception of costs to issue debt or equity securities, which are recognised in accordance with IAS 32 and IFRS 9.

Option D is incorrect. This answer takes into account the acquisition costs. Acquisition costs are expensed in accordance with paragraph 53 of IFRS 3, with the exception of costs to issue debt or equity securities, which are recognised in accordance with IAS 32 and IFRS 9.

*You can review this topic area in the study guide under the section titled ‘The acquisition method: Recognising and measuring goodwill or a gain from a bargain purchase’.*

**Question 6.4**

Correct answer: C

The correct answer is Option C. Paragraph B63(a) of IFRS 3 Business Combinations notes that AASB 138 Intangible Assets requires the acquirer to measure goodwill at the amount recognised at the acquisition date less any accumulated impairment losses.

Options A and B are incorrect, as amortisation is not permitted by IFRS 3.

Option D is incorrect. Goodwill must be tested for impairment annually, not just when circumstances indicate that impairment may have occurred.

*You can review this topic area in the study guide under the section titled ‘The acquisition method: Recognising and measuring goodwill or a gain from a bargain purchase’.*
**Question 6.5**
Correct answer: C

The correct answer is Option C. The cost of the combination is measured primarily by reference to the consideration transferred, which reflects what was given, not what was received.

Option A is incorrect—to apply the acquisition method, one of the combining entities must be identified as the acquirer (see para. 6 of IFRS 3).

Option B is incorrect—paragraph 18 of IFRS 3 requires the acquirer to measure the identifiable assets acquired and the liabilities assumed at acquisition-date fair values.

Option D is incorrect—paragraph 32 of IFRS 3 require goodwill to be measured as the excess between the aggregate of the consideration transferred, the amount of any non-controlling interest in the acquire and the fair value of any previously held equity interest in the acquire, less the fair value of the net assets acquired.

You can review this topic area in the study guide under the section titled ‘The acquisition method’.

**Question 6.6**
Correct answer: A

The correct answer is Option A.

Fair value of consideration transferred ($400 000 cash + 1 million shares @ $1.20) = $1 600 000.

Goodwill = Consideration transferred – Fair value of identifiable net assets acquired

= $1 600 000 – $1 390 000

= $210 000

Option B is incorrect. This answer has included the costs attributable to the combination in the determination of the consideration transferred and, hence, the goodwill.

Option C is incorrect. This answer has used the book value of the net assets acquired.

Option D is incorrect. This answer has used the book value of the assets acquired and included the acquisition costs in measuring the consideration transferred.

You can review this topic area in the study guide under the section titled ‘The acquisition method: Recognising and measuring goodwill or a gain from a bargain purchase’.
Question 6.7
Correct answer: A

The correct answer is Option A. The owner’s equity of Sub after the revaluation of the non-current assets was $850 000.

If Parent acquired 70 per cent of the shares in Sub, 70 per cent of the fair value of the identifiable net assets, $595 000, plus the goodwill of $100 000, must be equal to the consideration transferred by Parent, by deduction, $695 00.

In accordance with paragraph B86(b) of IFRS 10, the investment in the subsidiary must be eliminated along with the parent’s share of the equity of the subsidiary. The entry reflects the following calculation.

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount ($000)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Issued capital</td>
<td>350 DR</td>
</tr>
<tr>
<td>General reserve</td>
<td>70 DR</td>
</tr>
<tr>
<td>Retained earnings</td>
<td>35 DR</td>
</tr>
<tr>
<td>Asset revaluation reserve</td>
<td>140 DR</td>
</tr>
<tr>
<td>Owner’s equity</td>
<td>595</td>
</tr>
<tr>
<td>Goodwill</td>
<td>100 DR</td>
</tr>
<tr>
<td>Cost of investment</td>
<td>695 CR</td>
</tr>
</tbody>
</table>

Option B is incorrect. It has not taken into account the fact that Parent acquired 70 per cent of Sub (not 100%). In addition, it has ignored the revaluation of the identifiable assets of the Sub, which reflects pre-acquisition equity.

Option C is incorrect. It has ignored the revaluation of the identifiable assets of Sub.

Option D is incorrect. It has not taken into account the fact that Parent acquired 70 per cent of Sub.

You can review this topic area in the study guide under the section titled ‘Preparation of consolidated financial statements’—‘Parent with an interest in a subsidiary’ and ‘Non-controlling interest’.

Question 6.8
Correct answer: B

The correct answer is Option B. As the dividends are between entities within the group, all the effects of these dividends must be eliminated (para. B86(c) of IFRS 10). This requires eliminations in: the statement of comprehensive income (dividend income $30 000); retained earnings (interim and final dividend appropriations); and statement of financial position (dividend receivable and payable).

Option A is incorrect. It ignores the inter-company debt and receivable for the final dividend.

Option C is incorrect. It has ignored the effect of the interim dividend.

Option D is incorrect. It has ignored the fact that an interim dividend was paid.

You can review this topic area in the study guide under the section titled ‘Preparation of consolidated financial statements’—‘Transactions within the group’.
**Question 6.9**

Correct answer: A

The correct answer is Option A. Paragraph B86(b) of IFRS 10 requires the carrying amount of the parent’s investment to be eliminated in the consolidated financial statements.

Option B is incorrect as the consolidated financial statements should reflect business combinations by applying the provisions of IFRS 3 Business Combinations. In applying the acquisition method to accounting for a business combination, goodwill arising from the purchase of a group entity is recognised in the consolidated financial statements.

Option C is incorrect as only intra-group loans are eliminated from the consolidated financial statements (see para. B86(c) of IFRS 10).

Option D is incorrect as the non-controlling interests’ share of consolidated net assets are not eliminated from the consolidated financial statements, but are separately presented in the consolidated financial statements.

*You can review this topic area in the study guide under the section titled ‘Disclosures—Consolidated financial statements’.*

**Question 6.10**

Correct answer: C

The correct answer is Option C. The dividend income and retained earnings effects must be eliminated because this is an intra-group transaction. Parent Ltd will only receive 60 per cent of the dividend; the remainder is paid to the non-controlling interests. There are no tax effects—Parent Ltd would have treated the dividend as a tax-exempt difference. Inter-company dividend debt must be eliminated.

Option A is incorrect. There is no allowance for the share of dividends received by the non-controlling interests.

Option B is incorrect. There is no allowance for the share of dividends received by the non-controlling interests, and no tax-effect entry is required.

Option D is incorrect. The tax-effect entry is not required. Further, the tax-effect entry is wrong.

*You can review this topic area in the study guide under the section titled ‘Preparation of consolidated financial statements’—‘Non-controlling interest’.*
Question 6.11
Correct answer: C

The correct answer is Option C. Refer to paragraph B14 of IFRS 10—the investor must have power over an investee and this must stem from existing rights that give the investor the current ability to direct relevant activities.

Option A is incorrect. Paragraph 16 of IFRS 10 indicates that only one investor can have control but other parties can share in the variable returns of the investee (e.g. non-controlling interests).

Option B is incorrect. A majority of voting rights would be an indicator of rights that give the investor power over the investee, but an investor can have control with less than 50 per cent of the voting rights (or no voting rights).

Option D is incorrect. Representation on the board of directors or governing body is an indicator of rights that give the investor power over the investee, but an investor can have control without such representation.

You can review this topic area in the study guide under the section titled ‘The group’—‘Concept of control’.

Question 6.12
Correct answer: B

The correct answer is Option B. In accordance with the requirements of paragraph B86(b) of IFRS 10, the entry is eliminating the investment account together with the parent’s share of the subsidiary’s equity balances. In the process of doing this, assets have to be measured at fair value, and goodwill has to be measured.

As discussed in the study materials, the revaluation of assets upwards to fair value will give rise to a deferred tax liability. The equipment has to be remeasured from a book value of $40,000 to a fair value of $60,000 (debit ‘Accumulated depreciation’ $40,000, credit ‘Equipment’ $20,000), and this gives rise to a deferred tax liability of $6000 (30% of $20,000). Goodwill is measured as the difference between the consideration transferred ($400,000) and the fair value of the identifiable net assets acquired ($310,000 + $20,000 – $6000 = $324,000), which equals $76,000.

Option A is incorrect—a deferred tax asset has been recognised, not a deferred tax liability. This changes the amount of goodwill.

Option C is incorrect—no deferred tax liability has been raised.

Option D is incorrect—the equipment has not been revalued and a deferred tax liability has not been recognised.

You can review this topic area in the study guide under the section titled ‘Preparation of consolidated financial statements’—‘Parent with an interest in a subsidiary’.
**Question 6.13**

Correct answer: B

The correct answer is Option B. Paragraph 7(c) of IFRS 10 requires the investor to have the ability to use its power over the investee to affect the investor’s returns from the investee.

Option A is incorrect—the investor must be exposed to variable returns from the investee. A return from an investor could be a fixed return.

Option C is incorrect—paragraph 10 indicates that power arises when the investor has existing rights that give it the current ability to direct the relevant activities of the investee. They do not have to have the ability to determine the amount of returns received.

Option D is incorrect—paragraph 14 indicates that the investor who has the current ability to direct the activities that most significantly affect the returns of the investee is regarded as having power over the investee.

*You can review this topic area in the study guide under the section titled ‘The group’.*

**Question 6.14**

Correct answer: C

The correct answer is Option C. Paragraph 5 of IAS 28 states that if an investor holds 20 per cent or more of the voting power of the investee, it is presumed that the investor has significant influence, unless it can be demonstrated that this is not the case.

Option A is incorrect. IAS 28 does not require board representation as a prerequisite for significant influence.

Option B is incorrect. The focus of IAS 28 is on voting power, not ownership interest, and the standard does not require board representation as a prerequisite for significant influence.

Option D is incorrect. To determine whether significant influence exists, IAS 28 focuses on voting power, not ownership rights.

*You can review this topic area in the study guide under the section titled ‘Identifying associates’.*
Question 6.15

Correct answer: C

The correct answer is Option C. Paragraph 32 of IAS 28 requires that on the acquisition of an investment in an associate, the difference between the cost of the investment and the fair values of the identifiable net assets of the associate should be accounted for as goodwill (this is consistent with the requirements specified in IFRS 3). Paragraph 32(a) of IAS 28 notes that the goodwill is included in the amount of the investment and, hence, is not separately recorded.

Option A is incorrect. Goodwill is not recorded separately in the books of Investor but is included as part of the amount of Investor’s investment in Investee (refer to para. 32(a) of IAS 28).

Option B is incorrect. Purchased goodwill not recognised by the acquiree.

Option D is incorrect. Goodwill is not recorded separately in the consolidated financial statements of Investor but is included as part of the amount of Investor’s investment in Investee (refer to para. 32(a) of IAS 28).

You can review this topic area in the study guide under the section titled ‘Application of the equity method: Accounting for the initial investment’.

Question 6.16

Correct answer: B

The correct answer is Option B. Where the sale of inventory from the investor to the associate results in unrealised profits, paragraph 28 of IAS 28 requires the unrealised profit to be eliminated to the extent of the investor’s ownership interest in the associate. As discussed in the module, this would require adjustments to ‘Investment in Associates’ and ‘Share of profit of associates’.

Option A is incorrect—the bonus issue would not change the post-acquisition reserves of the associate and, therefore, no adjustment is required.

Option C is incorrect—revaluation is already reflected in the initial cost of the investment and no adjustment should be undertaken.

Option D is incorrect—the transfer would not change the post-acquisition reserves of the associate and, therefore, no adjustment is required.

You can review this topic area in the study guide under the section titled ‘Application of the equity method’.
Question 6.17

Correct answer: A

The correct answer is Option A. Paragraph 10 of IAS 28 requires the investment to be initially recognised at cost.

Option B is incorrect. The investment is initially recognised at cost and not at the fair value of the net assets of the associate.

Option C is incorrect. Goodwill is notionally measured, but not separately accounted for.

Option D is incorrect. Paragraph 10 of IAS 28 requires the investment to be initially recognised at cost to the investor, not the fair value of the investee’s assets.

You can review this topic area in the study guide under the section titled ‘Application of the equity method: Accounting for the initial investment’.

Question 6.18

Correct answer: D

The correct answer is Option D. Paragraph 32(b) of IAS 28 requires any excess of the entity’s share of the net fair value of the investee’s identifiable assets and liabilities over the cost of the investment to be included in the investor’s share of the associate’s profit or loss in the period in which the investment is acquired.

Option A is incorrect. Paragraph 32(a) of IAS 28 requires any goodwill arising on acquisition of an associate to be included in the carrying amount of the investment. However, a different accounting treatment is recognised in respect of any gain arising on acquisition—see paragraph 32(b) of IAS 28.

Option B is incorrect. Paragraph 32(b) of IAS 28 requires the gain to be included in the investor’s share of the associate’s profit or loss in the period in which the investment is acquired.

Option C is incorrect. Paragraph 32(b) of IAS 28 requires the gain to be wholly recognised as income in the period of acquisition.

You can review this topic area in the study guide under the section titled ‘Application of the equity method’.
Question 6.19
Correct answer: C

The correct answer is Option C. The sales within the group should be eliminated. The credit to the cost of goods sold is made up of two components: the original cost of goods sold within the group ($6000), and the overstatement of cost of goods sold when sold by Parent to external parties ($1000—half the inventory cost the group $3000; Parent would have recorded a cost of goods sold of $4000). The credit to inventory restates the inventory on hand at cost to the group ($3000), not the cost to Parent ($4000). From the group’s point of view, there is a remaining unrealised profit of $1000. As this has been eliminated in the financial statements of the group, the profit of the group is $1000 less than the profit of Parent plus Subsidiary. Hence, the income tax expense of the group has to be reduced (credited) by $300. The sale of inventory within the group at a profit has resulted, from the group’s perspective, in the tax base of the inventory being higher (by $1000) than its carrying amount in the consolidated statement of financial position. Hence, in 20X2 the group has a deductible temporary difference because when the cost of the inventory to the group is recovered, the group will receive a deduction greater than this amount (the tax base). Hence, the group has recognised a deferred tax asset.

Option A is incorrect. A deferred tax liability, instead of a deferred tax asset, has been recognised.

Option B is incorrect. It ignores the fact that half of the inventory has been sold. The correct accounts have been used, but it has been assumed that all the inventory is still on hand (unrealised profit is $2000). This assumption also means that the amount for the tax entry is incorrect.

Option D is incorrect. It assumes that all of the inventory sold within the group is still on hand. The amount of income tax expense is incorrect and has been increased, not reduced. In addition, a deferred tax liability, instead of a deferred tax asset, has been recognised.

You can review this topic area in the study guide under the section titled ‘Preparation of consolidated financial statements’—‘Transactions within the group’.

Question 6.20
Correct answer: A

The correct answer is Option A. In 20X1, the profit of the group was reduced by $700 ($1000 unrealised profit less income tax expense of $300). This would have reduced the retained earnings of the group, as compared with the sum of the retained earnings of Parent and Subsidiary. Hence, the opening balance of the retained earnings for the group has to be reduced by $700. When the inventory is sold in 20X2, the other half of the profit on the inventory ($1000) is realised by the group. Therefore, the income tax expense of the group will have to be increased (debited) by $300. The credit entry adjusts cost of goods sold to reflect the costs of the inventory sold at the original cost to the group ($3000), so as to capture the realisation of the other half of the profit on the inventory ($1000). The adjustment is necessary as consolidated cost of goods sold would otherwise include the cost recorded by Parent ($4000) when it sold the inventory in 20X2.

Option B is incorrect. The effect on the retained earnings of the group via the reduction in the tax expense of the group in 20X1 has not been allowed for. The deferred tax asset has been realised in 20X2. However, as this account has not been reinstated in the consolidation worksheet, no credit entry to this account is required.
Option C is incorrect. It assumes all of inventory remained on hand as at 30 June 20X1.

Option D is incorrect. It assumes the tax expense of the group was increased in 20X1.

You can review this topic area in the study guide under the section titled ‘Preparation of consolidated financial statements’—‘Transactions within the group’.

Question 6.21

Correct answer: B

The correct answer is Option B.

- The depreciation expense recorded in the financial statements of Big is overstated by $1000 annually from the group’s perspective. Consequently, the depreciation expense for 20X5 needs to be reduced (credited) and the accumulated depreciation reduced (debited) to allow for 20X4 and 20X5 ($2000).
- Reducing the depreciation expense of the group, as compared with the sum of Big and Little, reflects the group’s realisation in 20X5 of a further $1000 of the profit previously considered unrealised on the transfer of the equipment within the group. Hence, the income tax expense of the group has to be increased (debited) by $300 (30 per cent of $1000).
- In 20X4, when the equipment was sold ‘internally’, a deferred tax asset of $3000 was raised on consolidation (30% of $10 000). The 20X4 consolidation entries would also have reflected a reduced depreciation expense of $1000 and a consequent realised profit of $1000 and related decrease in deferred tax asset of $300. In 20X5, a further $1000 of profit has been realised and, as a result, an additional $300 of the tax asset has been realised. Therefore, a net debit of $2400 ($3000 – $300 – $300) to deferred tax asset is required.
- In 20X4, the profit of the group was reduced by the unrealised profit on the ‘internal’ sale of the equipment ($7000 net of tax). During 20X4, $700 of the profit net of tax was realised. The effect of the 20X4 consolidation entries reflecting these events ‘flowed through’ to reduce the closing group’s retained earnings by $6300. Therefore, a debit entry to reduce the opening retained earnings must be processed.
- The equipment is overstated from the point of view of the group. The cost to the group is $30 000, not $40 000 as recorded in the financial statements of Big, hence the credit entry to equipment for $10 000.

Option A is incorrect. Only one year of depreciation has been taken into account, and the tax effect of the unrealised profit in 20X4 has been ignored.

Option C is incorrect. The realisation of $1000 of profit (including the tax effect) by the group in 20X4 has been ignored.

Option D is incorrect. The depreciation expense is incorrect—both years have been allowed for as an adjustment to the current year’s profit.

You can review this topic area in the study guide under the section titled ‘Preparation of consolidated financial statements’—‘Transactions within the group’.
Question 6.22
Correct answer: C

The correct answer is Option C. Twenty per cent of: Profit for the year of subsidiary – (+) any unrealised (realised) after-tax profits made by the subsidiary.

\[ \begin{align*}
= & \quad 20\% \text{ of } ($20\,000 + ($1000 - $300)) \\
= & \quad 20\% \text{ of } $20\,700 \\
= & \quad $4140
\end{align*} \]

Notes:
† The unrealised profit on the sale of the land was recorded in the financial statements of Big Ltd. Hence, no non-controlling interest is involved.
‡ $700 of the profit (net of tax) relating to the equipment has been realised by the group. This sale of equipment was originally recorded by Little Ltd and, therefore, the non-controlling interest is affected.

Option A is incorrect. The unrealised profit after tax on the land has been included in the calculation.

Option B is incorrect. Twenty per cent of the book profit of the subsidiary with no adjustments for profits, realised or unrealised.

Option D is incorrect. No allowance for the tax effect of the $1000 of profit realised.

You can review this topic area in the study guide under the section titled ‘Preparation of consolidated financial statements’—‘Non-controlling interest’.

Question 6.23
Correct answer: C

The correct answer is Option C. Twenty per cent of: Closing retained earnings in the financial statements of the subsidiary +(–) any realised (unrealised) profit net of tax made by the subsidiary over preceding periods and the current period

\[ \begin{align*}
= & \quad 20\% \text{ of } ($10\,000 - ($10\,000 - $3000) + ($2000 - $600)) \\
= & \quad 20\% \text{ of } $4400 \\
= & \quad $880
\end{align*} \]

Option A is incorrect. Unrealised profit on the sale of land has been included in the calculation: relates to the parent entity and not the subsidiary.

Option B is incorrect. It has not allowed for the tax effect of unrealised and realised profits.

Option D is incorrect. No adjustments are made for unrealised or realised profits.

You can review this topic area in the study guide under the section titled ‘Preparation of consolidated financial statements’—‘Non-controlling interest’.
Question 6.24
Correct answer: A, B and C

The correct answer is Options A, B and C. The realisation of loss via depreciation charges (transaction 1), the elimination of intra-group dividend revenue included in the statement of profit or loss and other comprehensive income of Parent (transaction 2), and the elimination of the unrealised profit on sale of inventory (transaction 3) will all decrease consolidated profits for the year as compared with the sum of the profits for the year of Parent and Sub.

Option D is incorrect. The elimination of the intra-group borrowing (transaction 4) will have no impact on the consolidated profit, as compared with the sum of the profits of Parent and Sub, as no unrealised profit or loss arises on the transaction.

You can review this topic area in the study guide under the section titled ‘Preparation of consolidated financial statements’—‘Transactions within the group’.

Question 6.25
Correct answer: A and C

The correct answer is Options A and C. A tax effect relates to the situation where there is unrealised or realised profit (or loss). Even though the plant was sold in a prior reporting period, the consolidated profit will be affected via depreciation adjustments and the related tax effects (Option A, transaction 1). The intra-group sale of inventory will give rise to a tax effect as the inventory has been sold for a profit and the inventory is still held by the group at the period end (Option C, transaction 3).

Option B (transaction 2) is incorrect as Parent treats the dividends as tax free in their own tax-effect entries; accordingly, there are no tax-effect adjustments required in the consolidation worksheet.

Option D (transaction 4) is incorrect because no unrealised profit or loss arises in relation to the intra-group interest; accordingly, there are no associated net tax effects from elimination of the intra-group interest.

You can review this topic area in the study guide under the section titled ‘Preparation of consolidated financial statements’—‘Transactions within the group’.

Question 6.26
Correct answer: A

The correct answer is Option A. To affect the non-controlling interest in the consolidated profit, the transaction must involve a sale of inventory or non-current asset (as transactions involving unrealised or realisation of profit or loss) from Sub to Parent.

Option B is incorrect as transaction 2 does not give rise to any unrealised profits or losses.

Option C is incorrect as transaction 3 relates to an intra-group sale from Parent to Sub.

Option D is incorrect as the intra-group loan between Sub and Parent does not result in any unrealised profit or loss and, therefore, has no non-controlling interest implications.

You can review this topic area in the study guide under the section titled ‘Preparation of consolidated financial statements’—‘Non-controlling interests’—‘3. Measurement of non-controlling interest’.
**Question 6.27**

Correct answer: C

The correct answer is Option C. Share of associate’s profit is calculated as follows.

<table>
<thead>
<tr>
<th>$</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Share of book value of profit</strong></td>
<td>33,600†</td>
</tr>
<tr>
<td><strong>Add:</strong> Gain</td>
<td>5,000‡</td>
</tr>
<tr>
<td><strong>Less:</strong> Share of unrealised profit after tax</td>
<td>(1,400)§</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>37,200</td>
</tr>
</tbody>
</table>

† 40% of $84,000.
‡ 40% of fair value of net assets = 40% of $200,000 ($180,000 + $20,000 revaluation) = $80,000.

Cost of investment = $75,000. Resulting gain of $5,000 is included in the share of profit of associate in the period in which the investment is acquired (para. 32(b) of IAS 28).

§ Half of unrealised profit after tax = $3,500; 40% of $3,500 = $1,400.

Option A is incorrect. The entity’s share of dividends from the associate does not affect the determination of its share of associate’s profit.

Option B is incorrect. Gain on the bargain purchase has not been included in the share of associate’s profit.

Option D is incorrect. The investor’s share of unrealised profits of the associate has not been eliminated.

*You can review this topic area in the study guide under the section titled ‘Application of the equity method’.*

**Question 6.28**

Correct answer: B

The correct answer is Option B. Equity-accounted amount of investment in consolidated financial statements is calculated as follows.

<table>
<thead>
<tr>
<th>$</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Original investment</strong></td>
<td>75,000</td>
</tr>
<tr>
<td><strong>Add:</strong> Share of prima facie profit of associate</td>
<td>33,600†</td>
</tr>
<tr>
<td>Gain*</td>
<td>5,000‡</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>38,600</td>
</tr>
<tr>
<td><strong>Less:</strong> Share of unrealised profit after tax</td>
<td>(1,400)§</td>
</tr>
<tr>
<td>Share of interim dividend</td>
<td>(8,000)¶</td>
</tr>
<tr>
<td>Share of declared dividend</td>
<td>(12,000)‖</td>
</tr>
<tr>
<td><strong>Equity amount of investment</strong></td>
<td>92,200</td>
</tr>
</tbody>
</table>

† 40% of $84,000.
‡ 40% of fair value of net assets = 40% of $200,000 ($180,000 + $20,000 revaluation) = $80,000.

*You can review this topic area in the study guide under the section titled ‘Application of the equity method’.*
† 40% of $84,000.
‡ Paragraph 32(b) of IAS 28 requires gain to be excluded from the original cost of the investment and included in income (via share of associate’s profit) in the period the investment is acquired. The gain arises because the investor’s share of the net fair value of the associate’s identifiable assets ($80,000) exceeds the cost of the investment ($75,000). After the gain is added back to the ‘investment in the associate’, the investment now reflects the investor’s share of the net value of the associate’s identifiable assets ($80,000).
§ Half of unrealised profit after tax = $3,500; 40% of $3,500 = $1,400.
¶ 40% of $20,000.
‖ 40% of $30,000.

Option A is incorrect. The gain on acquisition has been ignored.

Option C is incorrect. The share of unrealised profit after tax has been excluded from Investor Ltd’s share of Investee Ltd’s profit.

Option D is incorrect. It has not deducted share of dividends.

You can review this topic area in the study guide under the section titled ‘Application of the equity method’.

Question 6.29

Correct answer: C

The correct answer is Option C. Paragraph 28 of IAS 28 requires that unrealised profits or losses on both ‘upstream’ and ‘downstream’ transactions should be eliminated to the extent of the investor’s ownership interest in the associate.

As discussed in the module notes, adjustments to eliminate unrealised profits or losses on transactions with an associate must be made on a net basis to the ‘Investment in associates’ and ‘Share of profit or loss of associates’. As the transaction from Investor to Investee is an unrealised profit, both the ‘Share of profit and associates’ and ‘Investment in associates’ accounts would be reduced.

Option A is incorrect. Adjustments to eliminate unrealised profits and losses are made to the ‘Investment in associates’ and ‘Share of profit or loss of associates’ accounts. Hence, in accordance with IAS 28, adjustments to the individual accounts are not made.

Option B is incorrect. There is no increase in ‘Investment in associates’, unless an unrealised loss is involved.

Option D is incorrect. There is no increase in ‘Share of profit of associates’, unless an unrealised loss is involved.

You can review this topic area in the study guide under the section titled ‘Application of the equity method’.
Module 7

Question 7.1
Correct answer: C

The correct answer is Option C. Paragraph 10(a) of IAS 36 requires an intangible asset with an indefinite useful life to be tested annually for impairment by comparing its carrying amount with its recoverable amount.

Option A is incorrect. Investment properties carried at fair value do not fall within the scope of IAS 36 (para. 2(f)).

Option B is incorrect. Goodwill must be tested annually for impairment (para. 10(b)).

Option D is incorrect. Inventories do not fall within the scope of IAS 36 (para. 2(a)).

You can review this topic area in the study guide under the section titled ‘Impairment of assets—an overview’.

Question 7.2
Correct answer: A

The correct answer is Option A. Evidence that the asset is obsolete or physically damaged is an indicator of impairment (IAS 36, para. 12(e)).

Option B is incorrect. Interest rates would have to rise to increase the discount rate which would, in turn, reduce the recoverable amount of the asset (para. 12(c)).

Option C is incorrect. The market value would have to have declined by significantly more than expected, given the lapse of time or normal use (para. 12(a)).

Option D is incorrect. The indicator is the reverse—where the carrying amount of the entity’s net assets is more than the entity’s market capitalisation (para. 12(d)).

You can review this topic area in the study guide under the section titled ‘Identifying assets that may be impaired under IAS 36’.
Question 7.3
Correct answer: D

The correct answer is Option D. Refer to paragraph 12(f) of IAS 36. The restructuring has had an adverse impact on the way in which the assets are used. The assets will be idle and, presumably, will have to be sold if an alternative use cannot be found.

Option A is incorrect. An increase in interest rates is important if it will have a significant impact on the discount rate. Paragraph 16(a) of IAS 36 indicates that increases in short-term interest rates ‘may not have a material effect on the discount rate used for an asset that has a long remaining life’.

Option B is incorrect. A major overhaul is part of the normal maintenance program of an asset and, hence, would not be indicative of a change in the asset's value in use or fair value less costs of disposal.

Option C is incorrect. Both the cash inflows and outflows have increased, which would offset the impact. Hence, it is unlikely that the economic performance of the asset will be worse than expected.

You can review this topic area in the study guide under the section titled ‘Identifying assets that may be impaired under IAS 36’.

Question 7.4
Correct answer: D

The correct answer is Option D. Refer to definitions of recoverable amount, value in use and fair value less costs of disposal (IAS 36, para. 6).

Option A is incorrect. The future cash flows must be discounted to present value to determine the value in use. In addition, the costs of disposal of the asset must be deducted from its fair value.

Option B is incorrect. The costs of disposal of the asset must be deducted from its fair value.

Option C is incorrect. The future cash flows must be discounted to present value to determine the value in use.

You can review this topic area in the study guide under the section titled ‘Impairment of individual assets’.
**Question 7.5**

Correct answer: B

The correct answer is Option B. The recoverable amount of an asset is the ‘higher of its fair value less costs of disposal and its value in use’ (IAS 36, para. 6). The value in use is the ‘present value of the future cash flows expected to be derived from an asset’ (para. 6). In this case, the fair value less costs of disposal is $78,000 ($80,000 less $2,000) and the present value of the future cash flows is $60,000. Therefore, the higher amount is the fair value less costs of disposal, $78,000.

Option A is incorrect. This calculation has taken the lower of the value in use and fair value less costs of disposal.

Option C is incorrect. The costs of disposal of the asset have not been deducted from its fair value.

Option D is incorrect. The future value of the cash flows has been used instead of their present value.

*You can review this topic area in the study guide under the section titled ‘Impairment of individual assets’.*

**Question 7.6**

Correct answer: C

The correct answer is Option C. The cash inflow from the disposal of the asset (IAS 36, para. 39(c)) should be included in the determination of the value in use.

Option A is incorrect because the cash flows should not include income tax payments (refer IAS 36, para. 50(b)).

Option B is incorrect because the cash flows should not include cash outflows associated with financing activities (refer IAS 36, para. 50(a)).

Option D is incorrect because the cash flows should not include cash inflows from planned improvements to which an entity has not yet committed—this has to be cash flows from the asset in its existing condition (refer IAS 36, para. 44).

*You can review this topic area in the study guide under the section titled ‘Value in use’.*
**Question 7.7**

Correct answer: C

The correct answer is Option C. The recoverable amount of an asset is the ‘higher of its fair value less costs of disposal and its value in use’ (IAS 36, para. 6). For Diva’s equipment, the fair value less costs of disposal of $90,000 is greater than the present value of the future cash flows, $70,000. Therefore, there is an impairment loss in relation to the equipment of $20,000 (carrying amount of $110,000 less recoverable amount of $90,000). Paragraph 30 of IAS 16 Property, Plant and Equipment requires an item of property, plant and equipment measured using the cost model to be ‘carried at its cost less any accumulated depreciation and any accumulated impairment losses’. Hence, ‘accumulated depreciation and accumulated impairment losses’ must be credited for $20,000, and an impairment loss debited.

Option A is incorrect. The impairment loss is incorrect because it is based on a recoverable amount of $70,000 (the value in use).

Option B is incorrect. The amount of the impairment loss is correct, but it has not been accounted for in accordance with the cost model requirements of IAS 16.

Option D is incorrect. The impairment loss is incorrect because it is based on a recoverable amount of $70,000 (the value in use), and the impairment loss has not been accounted for in accordance with the cost model requirements of IAS 16.

*You can review this topic area in the study guide under the section titled ‘Recognising and measuring an impairment loss’.*

**Question 7.8**

Correct answer: A

The correct answer is Option A. At 30 June 20X5, the machinery has been written down to its recoverable amount of $105,000. The machinery has a remaining useful life of seven years and, therefore, the asset will be depreciated at $15,000 per year ($105,000 / 7). After the asset is depreciated for the year ended 30 June 20X6, the machinery will have a carrying amount of $90,000 ($105,000 less $15,000). The recoverable amount of the machinery has been reassessed as being $128,000. Hence, the carrying amount of the machinery can be increased, but the increase must not exceed the carrying amount that would have been determined if no impairment loss had been recognised (IAS 36, para. 117). If no impairment loss had been recognised, the carrying amount of the asset at 30 June 20X6 would have been $120,000 ($200,000 less four year’s depreciation at $20,000 per year). Hence, the carrying value of the machinery can be increased by $30,000 ($120,000 less $90,000), and a gain for the same amount can be recognised in the profit or loss (IAS 36, para. 119).

Option B is incorrect. This entry assumes the asset was still depreciated by $20,000 during the year ended 30 June 20X6 and, hence, has a carrying amount of $85,000 ($105,000 less $20,000). Hence, the reversal is calculated as $120,000 less $85,000.

Option C is incorrect. The machinery has been increased to its recoverable amount ($128,000), which exceeds the carrying amount that the asset would have been carried at if no impairment loss had been recognised.
Option D is incorrect. The entry assumes the asset was still depreciated by $20,000 during year ended 30 June 20X6 and, hence, has a carrying amount of $85,000 ($105,000 less $20,000). In addition, it has increased the machinery to the new recoverable amount ($128,000).

You can review this topic area in the study guide under the section titled ‘Reversals of impairment losses’.

Question 7.9
Correct answer: D

The correct answer is Option D. In the first instance, the impairment loss would be allocated in proportion to the carrying amount of each asset.

\[
\begin{align*}
150,000 / 400,000 \times 50,000 &= 18,750 \\
200,000 / 400,000 \times 50,000 &= 25,000 \\
50,000 / 400,000 \times 50,000 &= 6,250
\end{align*}
\]

The carrying amount of the assets after this allocation would be as follows.

- Asset 1 = $150,000 – $18,750 = $131,250
- Asset 2 = $200,000 – $25,000 = $175,000
- Asset 3 = $50,000 – $6,250 = $43,750

However, Asset 2 has a fair value less costs of disposal of $190,000, which is greater than its value in use. Therefore, the impairment loss for Asset 2 is limited to $10,000 ($200,000 – $190,000) (IAS 36, para. 105). The remaining impairment loss of $15,000 attributable to Asset 2 must be allocated to the remaining assets in the CGU in proportion to their carrying amounts after the impairment loss.

\[
\begin{align*}
131,250 / 175,000 \times 15,000 &= 11,250 \\
43,750 / 175,000 \times 15,000 &= 3,750
\end{align*}
\]

Therefore, the impairment loss for each asset would be as follows.

- Asset 1 = $18,750 + $11,250 = $30,000
- Asset 2 = $10,000
- Asset 3 = $6,250 + $3,750 = $10,000

Option A is incorrect. The impairment loss has been allocated evenly over the three assets.

Option B is incorrect. The impairment loss has been allocated in proportion to the carrying amount of the assets within the cash generating unit. The impairment loss in relation to Asset 2 has not been limited to $10,000.

Option C is incorrect. The impairment loss for Asset 2 has been limited to $10,000, but the remaining $40,000 has been allocated evenly to Asset 1 and Asset 3.

You can review this topic area in the study guide under the section titled ‘Recoverable amount and carrying amount of a CGU’.
Question 7.10
Correct answer: B

The correct answer is Option B. CGU B has an impairment loss of $400 000 ($2 200 000 – $1 800 000) and CGU C has an impairment loss of $500 000 ($4 350 000 – $3 850 000). These impairment losses would be allocated as follows.

CGU B
- Building: \( \frac{200}{2 200} \times 400 000 = 36 000 \)
- Assets in CGU: \( \frac{2 000}{2 200} \times 400 000 = 364 000 \)

CGU C
- Building: \( \frac{350}{4 350} \times 500 000 = 40 000 \)
- Assets in CGU: \( \frac{4 000}{4 350} \times 500 000 = 460 000 \)

Hence, the impairment loss allocated to the building (corporate asset) = $36 000 + $40 000 = $76 000.

Option A is incorrect. This assumes that the impairment losses are not allocated to the corporate asset.

Option C is incorrect. The total impairment loss has been allocated in proportion to the total amount of all CGUs. That is, \( \frac{700}{7 700} \times 900 000 = 82 000 \)

Option D is incorrect. The impairment loss has been allocated using the original carrying amount. That is,

CGU B
- Building: \( \frac{200}{2 000} \times 400 000 = 40 000 \)

CGU C
- Building: \( \frac{350}{4 000} \times 500 000 = 44 000 \)

You can review this topic area in the study guide under the section titled ‘Recoverable amount and carrying amount of a CGU’.

Question 7.11
Correct answer: D

The correct answer is Option D. Paragraph 104 of IAS 36 requires the impairment loss to first be allocated against goodwill and then to the other assets of the CGU pro rata on the basis of the carrying amount of each asset in that CGU.

Option A is incorrect. The impairment loss must be used to first reduce goodwill and then is attributed on a pro rata basis to the other identifiable assets in the CGU.

Option B is incorrect. The impairment loss must first be allocated to goodwill, not on a pro rata basis across all assets.

Option C is incorrect. The impairment loss must first be allocated to goodwill.

You can review this topic area in the study guide under the section titled ‘Recoverable amount and carrying amount of a CGU’.
**Question 7.12**

Correct answer: D

The correct answer is Option D. There is an impairment loss of $600,000 ($2,400,000 – $1,800,000). In accordance with paragraph 104 of IAS 36, the impairment loss is first allocated to goodwill ($400,000). The remaining $200,000 is then allocated to the identifiable assets on a pro rata basis, using the carrying amount of each identifiable asset as follows.

\[
\begin{align*}
\text{Machinery} & \quad (400,000 / 2,000,000) \times 200,000 = 40,000 \\
\text{Other plant} & \quad (600,000 / 2,000,000) \times 200,000 = 60,000 \\
\text{Land} & \quad (1,000,000 / 2,000,000) \times 200,000 = 100,000
\end{align*}
\]

The carrying amounts of the assets after this allocation would be as follows.

\[
\begin{align*}
\text{Machinery} & \quad 400,000 - 40,000 = 360,000 \\
\text{Other plant} & \quad 600,000 - 60,000 = 540,000 \\
\text{Land} & \quad 1,000,000 - 100,000 = 900,000
\end{align*}
\]

Option A is incorrect. The $600,000 impairment loss is allocated evenly over the identifiable assets and goodwill ($600,000 / 4 = $150,000 per asset).

Option B is incorrect. The $600,000 impairment loss is allocated over the identifiable assets and goodwill pro rata. For example, the impairment loss allocated to the machinery would be as follows.

\[
(400,000 / 2,400,000) \times 600,000 = 100,000.
\]

Therefore, the carrying amount of the machinery would be $300,000 ($400,000 – $100,000).

Option C is incorrect. After allocating $400,000 of the impairment loss to goodwill, the remaining $200,000 is allocated evenly over the identifiable assets ($200,000 / 3 = $66,666).

*You can review this topic area in the study guide under the section titled ‘Recoverable amount and carrying amount of a CGU’.*

**Question 7.13**

Correct answer: D

The correct answer is Option D. Paragraph 56 of IAS 36 notes that the discount rate(s) used to measure an asset's value in use should not reflect risks for which the future cash flow estimates have been adjusted as the effect of some assumptions would otherwise be double-counted.

Option A is incorrect. The cost of reorganising a business following the disposal of an asset is not regarded by IAS 36 as a cost of disposal (para. 28).

Option B is incorrect. Paragraph 28 of IAS 36 identifies legal costs as an example of a cost of disposal included in measuring fair value less costs of disposal.

Option C is incorrect. Cash flow projections should cover a maximum of five years, unless a longer period can be justified (IAS 36, para. 33(b)).

*You can review this topic area in the study guide under the section titled ‘Impairment of individual assets’.*
Question 7.14
Correct answer: A

The correct answer is Option A. Paragraph 70 of IAS 36 requires a group of assets to be identified as a cash-generating unit where an active market exists for the output produced by that group of assets. This applies even if some or all of the output is used internally by the entity.

Option B is incorrect. See the definition of 'cash-generating unit', which is the smallest group of assets that generate cash inflows largely independently of the cash inflows of other assets or groups of assets. A CGU is not necessarily a business unit.

Option C is incorrect. If the recoverable amount of an asset can be determined, the impairment test would be applied to the asset. If the cash inflows are not largely independent of those from other assets, the impairment test is applied to the CGU to which the asset belongs (IAS 36, paras 66 and 67).

Option D is incorrect. The cash inflows are not largely independent of the cash inflows of other assets and, hence, the impairment test is applied to the CGU (IAS 36, para. 67).

You can review this topic area in the study guide under the section titled 'Impairment of CGUs'.

Question 7.15
Correct answer: B and D

Option B is correct. Paragraph 101 of IAS 36 notes that the recoverable amount of an individual corporate asset cannot be determined unless management has decided to dispose of the asset, because corporate assets do not otherwise generate separate cash inflows.

Option D is correct. Paragraph 102(a) of IAS 36 requires an entity to, if a portion of the carrying amount of a corporate asset can be allocated on a reasonable and consistent basis to a cash-generating unit, compare the carrying amount of the unit (including the portion of the carrying amount of the corporate asset allocated to the unit) with its recoverable amount to determine any impairment loss.

Option A is incorrect. A distinctive characteristic of a corporate asset is that it does not generate cash inflows largely independently of other assets (refer IAS 36, para. 100).

Option C is incorrect. If a portion of a corporate asset cannot be allocated on a reasonable and consistent basis to a CGU, for the purposes of impairment testing, it is necessary to identify the smallest group of CGUs to which a portion of the carrying amount of the corporate asset can be allocated on a reasonable and consistent basis (refer to para. 102(b)(ii)).

You can review this topic area in the study guide under the section titled 'Impairment of CGUs'. 