59 Multiple choice questions – accounting for taxation

1 A company's trial balance shows a debit balance of $2.1 million brought forward on current tax and a credit balance of $5.4 million on deferred tax. The tax charge for the current year is estimated at $16.2 million and the carrying amounts of net assets are $13 million in excess of their tax base. The income tax rate is 30%

What amount will be shown as income tax in the statement of profit or loss for the year?

A $15.6 million
B $12.6 million
C $16.8 million
D $18.3 million **(2 marks)**

2 The statements of financial position of Nedburg include the following extracts:

Statements of financial position as at 30 September

	20X2	20X1
	$m	$m
Non-current liabilities		
Deferred tax	310	140
Current liabilities		
Taxation	130	160

The tax charge in the statement of profit or loss for the year ended 30 September 20X2 is $270 million.

What amount of tax was paid during the year to 30 September 20X2?

A $300 million
B $140 million
C $200 million
D $130 million **(2 marks)**

3 A company's trial balance at 31 December 20X3 shows a debit balance of $700,000 on current tax and a credit balance of $8,400,000 on deferred tax. The directors have estimated the provision for income tax for the year at $4.5 million and the required deferred tax provision is $5.6 million, $1.2 million of which relates to a property revaluation.

What is the profit or loss income tax charge for the year ended 31 December 20X3?

A $1 million
B $2.4 million
C $1.2 million
D $3.6 million **(2 marks**

4 The trial balance of Highwood at 31 March 20X6 showed credit balances of $800,000 on current tax and $2.6 million on deferred tax. A property was revalued during the year giving rise to deferred tax of $3.75 million. This has been included in the deferred tax provision of $6.75 million at 31 March 20X6.

The income tax charge for the year ended 31 March 20X6 is estimated at $19.4 million.

What will be shown as the income tax charge in the statement of profit or loss of Highwood at 31 March 20X6?

A $19 million
B $22 million
C $19.8 million
D $20.6 million **(2 marks)**

5 The statements of financial position of Pinto included the following.

Statements of financial position as at:

	31 March 20X8	*31 March 20X7*
	$'000	$'000
Current assets		
Income tax asset	-	50
Non-current liabilities		
Deferred tax	50	30
Current liabilities		
Income tax payable	150	-

The profit or loss income tax charge for the year ended 31 March 20X8 is estimated at $160,000.

What amount of income tax has been received or paid during the year ended 31 March 20X8?

A $60,000 paid
B $40,000 paid
C $60,000 received
D $40,000 received **(2 marks)**

60 Preparation question: Julian

Julian recognised a deferred tax liability for the year end 31 December 20X3 which related solely to accelerated tax depreciation on property, plant and equipment at a rate 30%. The net book value of the property, plant and equipment at that date was $310,000 and the tax written down value was $230,000.

The following data relates to the year ended 31 December 20X4:

(i) At the end of the year the carrying value of property, plant and equipment was $460,000 and their tax written down value was $270,000. During the year some items were revalued by $90,000. No items had previously required revaluation. In the tax jurisdiction in which Julian operates revaluations of assets do not affect the tax base of an asset or taxable profit. Gains due to revaluations are taxable on sale.

(ii) Julian began development of a new product during the year and capitalised $60,000 in accordance with IAS 38. The expenditure was deducted for tax purposes as it was incurred. None of the expenditure had been amortised by the year end.

(iii) Julian's statement of profit or loss showed interest income receivable of $55,000, but only $45,000 of this had been received by the year end. Interest income is taxed on a receipts basis.

(iv) During the year, Julian made a provision of $40,000 to cover an obligation to clean up some damage caused by an environmental accident. None of the provision had been used by the year end. The expenditure will be tax deductible when paid.

The corporate income tax rate recently enacted for the following year is 30% (unchanged from the previous year).

The current tax charge was calculated for the year as $45,000.

Current tax is settled on a net basis with the national tax authority.

Required

(a) Prepare a table showing the carrying values, tax bases and temporary differences for each for the items above at 31 December 20X4.

(b) Prepare the statement of profit or loss and statement of financial position notes to the financial statements relating to deferred tax for the year ended 31 December 20X4.

61 Preparation question: Bowtock

(a) IAS 12 *Income Taxes* details the requirements relating to the accounting treatment of deferred taxes.

Required

Explain why it is considered necessary to provide for deferred tax and briefly outline the principles of accounting for deferred tax contained in IAS 12 *Income taxes*.

(b) Bowtock purchased an item of plant for $2,000,000 on 1 October 20X0. It had an estimated life of eight years and an estimated residual value of $400,000. The plant is depreciated on a straight-line basis. The tax authorities do not allow depreciation as a deductible expense. Instead a tax expense of 40% of the cost of this type of asset can be claimed against income tax in the year of purchase and 20% per annum (on a reducing balance basis) of its tax base thereafter. The rate of income tax can be taken as 25%.

Required

In respect of the above item of plant, calculate the deferred tax charge/credit in Bowtock's statement of profit or loss for the year to 30 September 20X3 and the deferred tax balance in the statement of financial position at that date.

Note. Work to the nearest $'000.

56 Multiple choice questions – leasing

1 On 1 January 20X6 Fellini hired a machine under a finance lease. The cash price of the machine was $3.5 million and the present value of the minimum lease payments was $3.3 million. Instalments of $700,000 are payable annually in advance with the first payment made on 1 January 20X6. The interest rate implicit in the lease is 6%.

What amount will appear under non-current liabilities in respect of this lease in the statement of financial position of Fellini at 31 December 20X7?

A $1,479,000
B $2,179,000
C $1,702,000
D $2,266,000 **(2 marks)**

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2 Which of the following situations does **not** suggest that a leasing arrangement constitutes a finance lease?

A The present value of the minimum lease payments is substantially less than the fair value of the asset.

B Ownership in the asset is transferred at the end of the lease term.

C The lease term is for a major part of the asset's useful life.

D The lease contains a purchase option at a price below fair value, which is reasonably certain to be exercised. **(2 marks)**

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3 A company acquired an item of plant under a finance lease on 1 April 20X7. The present value of the minimum lease payments was $15.6 million and the rentals are $6 million per annum paid in arrears for three years on 31 March each year.

The interest rate implicit in the lease is 8% per annum.

What amount will appear under current liabilities in respect of this lease in the statement of financial position at 31 March 20X8?

A $5,132,000
B $5,716,000
C $6,000,000
D $4,752,000 **(2 marks)**

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4 On 1 January 20X6 Platinum entered into a finance lease agreement. The cash price of the asset was $360,000 and the terms of the lease were a deposit of $120,000 payable on 1 January 20X6 and three further instalments of $100,000 payable on 31 December 20X6, 31 December 20X7 and 31 December 20X8. The rate of interest implicit in the lease is 12%.

What will be the amount of the finance charge arising from this lease which will be charged to profit or loss for the year ended 31 December 20X7?

A $28,800
B $20,256
C $16,800
D $14,400 **(2 marks)**

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5 At what amount does IAS 17 require a lessee to capitalise an asset acquired under a finance lease?

A Cash price of the asset
B Fair value of the asset
C Present value of minimum lease payments
D Lower of fair value and present value of minimum lease payments **(2 marks)**

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57 Preparation question: Branch

Branch acquired an item of plant and equipment on a finance lease on 1 January 20X1. The terms of the agreement were:

Deposit	:	$1,150 (non-refundable)
Instalments	:	$4,000 pa for seven years payable in arrears
Cash price	:	$20,000

The asset has useful life of four years and the interest rate implicit in the lease is 11%.

Required

Prepare extracts from the statement of profit or loss and statement of financial position for the year ending 31 December 20X1, using the following pro-forma.

Workings

STATEMENT OF PROFIT OR LOSS (EXTRACT)	$
Depreciation	
Finance costs	

STATEMENT OF FINANCIAL POSITION (EXTRACT)	$
Non-current assets	
Property, plant and equipment – assets held under finance leases	
Non-current liabilities	
Finance lease liabilities	
Current liabilities	
Finance lease liabilities	

58 Fino (12/07 amended) **27 mins**

(a) An important requirement of the IASB's *Conceptual Framework for Financial Reporting* is that an entity's financial statements should represent faithfully the transactions and events that it has undertaken.

Required

Explain what is meant by faithful representation and how it makes financial information useful. **(5 marks)**

(b) On 1 April 20X7, Fino increased the operating capacity of its plant. Due to a lack of liquid funds it was unable to buy the required plant which had a cost of $350,000. This was equal to both the fair value of the plant and the present value of the minimum lease payments under the lease. On the recommendation of the finance director, Fino entered into an agreement to lease the plant from the manufacturer. The lease required four annual payments in advance of $100,000 each commencing on 1 April 20X7. The plant would have a useful life of four years and would be scrapped at the end of this period. The finance director, believing the lease to be an operating lease, commented that the agreement would improve the company's return on capital employed (compared to outright purchase of the plant).

Required

(i) Discuss the validity of the finance director's comment and describe how IAS 17 *Leases* ensures that leases such as the above are faithfully represented in an entity's financial statements. **(4 marks)**

(ii) Prepare extracts of Fino's statement of profit or loss and statement of financial position for the year ended 30 September 20X7 in respect of the rental agreement assuming:

(1) It is an operating lease **(2 marks)**

(2) It is a finance lease (use an implicit interest rate of 10% per annum) **(4 marks)**

(Total = 15 marks)

21 Multiple choice questions – impairment of assets

1 A cash-generating unit comprises the following assets:

	$'000
Building	700
Plant and equipment	200
Goodwill	90
Current assets	20
	1,010

One of the machines, carried at $40,000, is damaged and will have to be scrapped. The recoverable amount of the cash-generating unit is estimated at $750,000.

What will be the carrying amount of the building when the impairment loss has been recognised? (to the nearest $'000)

A $597,000
B $577,000
C $594,000
D $548,000 **(2 marks)**

2 What is the **recoverable amount** of an asset?

A Its current market value less costs of disposal
B The lower of carrying amount and value in use
C The higher of fair value less costs of disposal and value in use
D The higher of carrying amount and market value **(2 marks)**

3 A machine has a carrying amount of $85,000 at the year end of 31 March 20X9. Its market value is $78,000 and costs of disposal are estimated at $2,500. A new machine would cost $150,000. The company which owns the machine expects it to produce net cash flows of $30,000 per annum for the next three years. The company has a cost of capital of 8%.

What is the impairment loss on the machine to be recognised in the financial statements at 31 March 20X9?

A $7,687
B $9,500
C $1,667
D $2,200 **(2 marks)**

4 IAS 36 *Impairment of Assets* suggests how indications of impairment might be recognised.

Which one of the following would **not** be an external indicator that one or more of an entity's assets may be impaired?

A An unusually significant fall in the market value of an asset
B Significant change in the technological environment of the business in which the assets are employed
C The carrying amount of the entity's net assets being less than its market capitalisation
D An increase in market interest rates used to calculate value in use **(2 marks)**

5 The following information relates to an item of plant.

- Its carrying amount in the statement of the financial position is $3 million.
- The company has received an offer of $2.7 million from a company in Japan interested in buying the plant.
- The present value of the estimated cash flows from continued use of the plant is $2.6 million.
- The estimated cost of shipping the plant to Japan is $50,000.

What is the amount of the impairment loss that should be recognised on the plant?

A $350,000
B $300,000
C $400,000
D $450,000 **(2 marks)**

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6 A business which comprises a single cash-generating unit has the following assets.

	$m
Goodwill	3
Patent	5
Property	10
Plant and equipment	15
Net current assets	2
	35

Following an impairment review it is estimated that the value of the patent is $2 million and the recoverable amount of the business is $24 million.

At what amount should the property be measured following the impairment review?

A $8 million
B $10 million
C $7 million
D $5 million **(2 marks)**

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22 Telepath (6/12) 27 mins

(a) The objective of IAS 36 *Impairment of assets* is to prescribe the procedures that an entity applies to ensure that its assets are not impaired.

Required

Explain what is meant by an impairment review. Your answer should include reference to assets that may form a cash generating unit.

Note. You are **not** required to describe the indicators of an impairment or how impairment losses are allocated against assets. **(4 marks)**

(b) (i) Telepath acquired an item of plant at a cost of $800,000 on 1 April 20X0 that is used to produce and package pharmaceutical pills. The plant had an estimated residual value of $50,000 and an estimated life of five years, neither of which has changed. Telepath uses straight-line depreciation. On 31 March 20X2, Telepath was informed by a major customer (who buys products produced by the plant) that it would no longer be placing orders with Telepath. Even before this information was known, Telepath had been having difficulty finding work for this plant. It now estimates that net cash inflows earned from the plant for the next three years will be:

		$'000
Year ended:	31 March 20X3	220
	31 March 20X4	180
	31 March 20X5	170

On 31 March 20X5, the plant is still expected to be sold for its estimated realisable value.

Telepath has confirmed that there is no market in which to sell the plant at 31 March 20X2.

Telepath's cost of capital is 10% and the following values should be used:

Value of $1 at	$
End of year 1	0.91
End of year 2	0.83
End of year 3	0.75

(ii) Telepath owned a 100% subsidiary, Tilda, that is treated as a cash generating unit. On 31 March 20X2, there was an industrial accident (a gas explosion) that caused damage to some of Tilda's plant. The assets of Tilda immediately before the accident were:

	$'000
Goodwill	1,800
Patent	1,200
Factory building	4,000
Plant	3,500
Receivables and cash	1,500
	12,000

As a result of the accident, the recoverable amount of Tilda is $6.7 million.

The explosion destroyed (to the point of no further use) an item of plant that had a carrying amount of $500,000.

Tilda has an open offer from a competitor of $1 million for its patent. The receivables and cash are already stated at their fair values less costs to sell (net realisable values).

Required

Calculate the carrying amounts of the assets in (i) and (ii) above at 31 March 20X2 after applying any impairment losses.

Calculations should be to the nearest $1,000.

The following mark allocation is provided as guidance for this requirement.

(i) **4 marks**

(ii) **7 marks** **(11 marks)**

(Total = 15 marks)