Hong Kong Institute of Certified Public Accountants
香港會計師公會

Continuing Professional Development Programme

A Refresher Course on Current Financial Reporting Standards

(Programme Code: CFW120608)

Programme Dates: 8, 13, 17, 20, 28 June 2012
Facilitator: Ms Winnie Chan, Ms Eky Liu
Examination Date: 28 June 2012
Examination Time: 12:00 p.m. – 1:00 p.m.

Time Allowed	**1 hour**
No. of questions	16 MC Questions

Do not open this question paper until instructed by the lecturer.

You are required to use the appropriate answer sheet to answer all questions in the examination paper. Failure to do so may render your examination script invalid.

This question paper must not be removed from the examination hall.

Candidate Name: ____________________

Membership No.: ____________________

Question 1

Which one of the following independent statements about the concept of Control under HKFRS 10 is INCORRECT?

A An investor controls an investee when it is exposed or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.

B For the purpose of assessing power, the substantive rights held by the investor and other parties have to be considered.

C For potential voting rights to be substantive, it must be currently exercisable.

D When assessing control, an investor shall consider the nature of its relationship with other parties and whether those other parties are acting on the investor's behalf (ie they are 'de facto agents').

E None of the above statements A, B, C and D is INCORRECT.

Answer 1 **C**

A is correct because of paragraph 6 of HKFRS 10

B is correct because of paragraph B9 : To have power over an investee, an investor must have existing rights that give it the current ability to direct the relevant activities. For the purpose of assessing power, only substantive rights and rights that are not protective shall be considered

C is NOT correct because of paragraph: B24 To be substantive, rights also need to be exercisable when decisions about the direction of the relevant activities need to be made. Usually, to be substantive, the rights need to be currently exercisable. However, sometimes rights can be substantive, even though the rights are not currently exercisable.

D is correct because of paragraphB73.

Question 2

Entity M acquired 30% interest in entity N and obtained significant influence at 31 December 20X0. The cost of investment was $250,000 and entity N has net assets of $500,000 at date of acquisition. The fair values of those net assets are the same as that of the carrying amounts.

In 20X1, entity N recognised profit after tax of $100,000 and paid a dividend out of these profits of $9,000. It also recognised exchange losses of $20,000 directly in other comprehensive income.

Which one of the following independent statements is INCORRECT?

A Share of profit of entity N of $30,000 is recognised in the profit or loss of entity M's financial statements.

B Goodwill of $100,000 arising from this transaction is presented separately on the face of statement of financial position

C Share of exchange losses of entity N of $6,000 is recognised in the other comprehensive income of entity M's financial statements.

D None of the above statements A, B and C is INCORRECT.

E All of the above statements A, B and C are INCORRECT.

Answer 2 **B**

A is correct because of paragraph 11 of HKAS 28. The investor's share of the profit or loss of the investee is recognised in the investor's profit or loss. Distributions received from an investee reduce the carrying amount of the investment. Therefore, share of profit of associate is $30,000 ($100,000 x 30%)

B is NOT correct because of paragraph 23 of HKAS 28. Goodwill relating to an associate is included in the carrying amount of the investment.

C is correct because of paragraph 10 of HKAS 28. The investor's share of those changes (changes in other comprehensive income of the investee) is recognised in the investor's other comprehensive income.

Question 3

Which of the following independent statements about Joint Arrangement under HKFRS 11 are CORRECT?

1. There are two types of joint arrangements under HKFRS 11, namely joint operation and joint venture.
2. If the parties can demonstrate past experience of voting together in the absence of a contractual agreement, this can still satisfy the requirements of "joint control".
3. A joint arrangement structured through a separate vehicle must be a joint venture.
4. A guarantee to third parties provided by the parties to the arrangement, e.g. service provided or financing provided to the arrangement, does not in itself determine that the joint arrangement is a joint operation.
5. A joint venturer accounts for its investment using the equity method in accordance with HKAS 28 (2011) Investments in Associates and Joint Ventures unless the entity is exempted from applying the equity method as specified in that standard.

A. (1), (2) & (3)

B. (1), (3) & (4)

C. (1), (2) & (4)

D. (1), (2) & (5)

E. (1), (4) & (5)

Answer 3 **E**

1 is CORRECT According to paragraph 6 of HKFRS 11, a joint arrangement is either a *joint operation* or a *joint venture*.

2 Is NOT CORRECT. According to paragraph 7 of HKFRS 11, joint control is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control

3 is NOT CORRECT. According to B19 of HKFRS 11, a joint arrangement in which the assets and liabilities relating to the arrangement are held in a separate vehicle can be either a joint venture or a joint operation.

4 is CORRECT. According to B27 of HKFRS 11, the parties to joint arrangements are often required to provide guarantees to third parties that, for example, receive a service from, or provide financing to, the joint arrangement. The provision of such guarantees, or the commitment by the parties to provide them, does not, by itself, determine that the joint arrangement is a joint operation.

5 is CORRECT according to paragraph 24 of HKFRS 11.

Question 4

Entity A purchased a piece of land on 31 December 20X0 but there was no plan on what the land would be used for. On 10 February 20X1, management approved the plan to develop a 15-storey building which will then be leased out under operating leases to generate rental income. The construction was completed in March 20X2 and was then leased out to third parties.

On 10 May 20X5, management determined to use this building as the group head office as the lease term for the current office would soon be expired. On 1 April 20X6, after all the tenants had moved out, Entity A and its subsidiaries occupied the building and used it as office. Entity A occupied the first six floors as head office while the remaining floors were leased out to its subsidiaries.

Entity A elects to use fair value model to account for investment properties and cost model for own-use properties. The financial year end is 31 December.

Which of the following independent statements are CORRECT?

1. Entity A should account for the land under HKAS 16 Property, plant and equipment on 31 December 20X0.
2. Property under construction is stated at its fair value on 31 December 20X1 unless the fair value cannot be determined reliably.
3. The building is accounted for as property, plant and equipment under HKAS 16 in entity A's separate financial statements on 31 December 20X5.
4. For the transfer from investment property carried at fair value to property, plant and equipment, the fair value at the date of change in use will be the properties' deemed cost for subsequent accounting in accordance with HKAS 16.
5. Entity A should account for the whole building as property, plant and equipment under HKAS 16 in its consolidated financial statements on 31 December 20X6.

A (1), (2) & (3)

B (2), (3) & (4)

C (2) & (3)

D (2) & (4)

E (2), (4) & (5)

Answer 4 **E**

1. is NOT correct because of paragraph 8 of HKAS 40. Land held for undetermined future use is under the scope of HKAS 40.
2. is correct because of paragraph 8 of HKAS 40. Property that is being constructed or developed for future use as investment property is under the scope of HKAS 40.
3. is NOT correct because of paragraph 57(a) of HKAS 40, there should be

commencement of owner-occupation, for a transfer from investment property to owner-occupied property.

4. is correct because of paragraph 60 of HKAS 40.

5. is correct because of paragraph 15 of HKAS 40. The property does not qualify as investment property in the consolidated financial statements, because the property is owner-occupied from the perspective of the group.

Question 5

Which of the following independent statements about HKAS 36 impairment of assets are INCORRECT?

1. Goodwill acquired in a business combination should be tested for impairment only when there is any indication that it may be impaired.
2. When calculating the value in use, since the discount rate is determined on a pre-tax basis, future cash flows are estimated on a pre-tax basis (i.e. excluding income tax payments or receipts).
3. The impairment loss of a cash generating unit is allocated to reduce the carrying amount of goodwill and the other assets of the units pro rata on the basis.
4. The increased carrying amount due to reversal of impairment should not be more than what the depreciated historical cost would have been if no impairment loss had been recognised in prior years

A. (1) & (3)

B. (1) & (4)

C. (2) & (3)

D. (2) & (4)

E. (3) & (4)

Answer 5 **A**

1. is NOT correct because of paragraph 10 (b) of HKAS 36. "Irrespective of whether there is any indication of impairment, an entity shall also test goodwill acquired in a business combination for impairment annually in accordance with paragraphs 80-99.""
2. is correct because of paragraph 50 and 51 of HKAS 36. "Because the discount rate is determined on a pre-tax basis, future cash flows are also estimated on a pre-tax basis." "Estimates of future cash flows shall not include cash inflows or outflows from financing activities; or income tax receipts or payments."
3. is NOT correct because of paragraph 104 of HKAS 36.
4. Is correct because of paragraph 117 of HKAS 36. " The increased carrying amount of an asset other than goodwill attributable to a reversal of an impairment loss shall not exceed the carrying amount that would have been determined (net of amortisation or depreciation) had no impairment loss been recognised for the asset in prior years.

Question 6

Entity X is a retailer. It decides to sell one of its ten outlets while it will continue to run the remaining outlets in the territory. Management approves the plan and actively locates buyers with a reasonable price of $1.95 million on 30 June 20X1 and expects that the sale will be completed within 12 months. The cost to sell is expected to be negligible. Shareholders' approval is obtained on 3 August 20X1. Management does not consider this outlet as a separate major line of business.

Details of the group of assets of the outlet to be sold (disposal group) are as follows:

	30 June 20X1	3 August 20X1
	Carrying value ($)	Carrying value ($)
Goodwill	200,000	200,000
Property, plant and equipment	2,100,000	2,000,000

The sales was not completed on 31 Dec 20X1 and the fair value less costs to sell of the outlet has risen to $2million at this date.

Which one of the following independent statement is CORRECT?

A Entity X classifies the disposal group as non-current assets held for sale on 30 June 20X1.

B Impairment loss recognises in relation to the disposal group is included in the line item - "profit/loss from discontinued operations" in the statement of comprehensive income.

C The carrying value of the disposal group is $2million (comprising $2 million of property, plant and equipment) at 31 Dec 20X1.

D None of the above statements A, B and C is CORRECT.

E All of the above statements A, B and C are CORRECT.

Answer 6 **C**

A is NOT correct because of paragraph 8 of HKFRS 5. The probability of shareholders' approval (if required in the jurisdiction) should be considered as part of the assessment of whether the sale is highly probable.

B is NOT correct because of paragraphs 32 (a) and 37 of HKFRS 5. The outlet is not a separate major line of business and is not classified as discontinued operations.

C is correct because of paragraph 23 of HKFRS 5. Goodwill impairment is not reversed.

Question 7

Entity Yellow has three subsidiaries, B, C and D. Entities B and C are wholly owned subsidiaries while entity D is 80% owned by Yellow. When Yellow acquired D, goodwill of HK$800,000 was recognised in Yellow's consolidated financial statements.

The functional currency of Yellow and B is HKD. C and D are foreign operations and their functional currency is RMB.

On 30 August 20X1, B granted a loan of HK$2 million to C and the settlement of this loan is neither planned nor likely to occur in the foreseeable future. On 25 October 20X1, Yellow disposed D in its entirety. Exchange differences of HK$500,000 relating to D have been accumulated in Yellow's foreign currency translation reserve in equity up to this date.

Which of the following independent statements are INCORRECT?

1. B's loan receivable from C forms part of Yellow's net investment in C and hence the related exchange differences recognised in C's accounts will also be recognised in the consolidated profit or loss.
2. The goodwill arising on the acquisition of D is translated using the exchange rate at the date of the transaction at each subsequent reporting date.
3. Before disposal of D, accumulated exchange differences of HK$125,000 have been allocated to and recognised as part of the non-controlling interests of D in the consolidated statement of financial position.
4. Upon disposal of D, accumulated exchange differences of HK$500,000 in Yellow's reserve are reclassified from reserve to consolidated profit or loss and included in the calculation of profit or loss on disposal.

A (1) & (2)

B (2) & (3)

C (1) & (3)

D (2) & (4)

E (3) & (4)

Answer 7 **A**

1. is incorrect because of paragraph 15, 15A and 32 of HKAS 21.
2. is incorrect because of paragraph 47 of HKAS 21.
3. is correct because of paragraph 41 of HKAS 21.
4. is correct because of paragraph 48 of HKAS 21.

Question 8

Under which of the following situations can an entity classify its financial liabilities under non-current liabilities in the statement of financial position at the reporting date?

A An entity breaches a provision of a long-term loan arrangement at the reporting date. The entity rectifies the breach after the reporting date but before the financial statements are authorised for issue.

B The entity obtains a comfort letter from the lender signed after the reporting date. The lender indicates in the letter that the loan that contains an overriding repayment on demand clause will not be called within the next twelve months from the date of the letter.

C The entity has the discretion to roll over an obligation for at least twelve months after the reporting period under an existing loan facility.

D None of the above

E All of the above

Answer 8 **C**

A is NOT correct because of paragraph 74 of HKAS 1 (Revised)

B is NOT correct because of paragraph 75 of HKAS 1 (Revised)

C is correct because of paragraph 73 of HKAS 1 (Revised)

Question 9

Entity P owns a property with a carrying value of $1.6 million and a 40% equity interest in entity Q. The carrying value of the equity interest is $200,000 under the equity method. Entity P acquires the remaining 60% interest in entity Q by selling its property to the remaining shareholders of entity Q.

The fair value of the property is $3 million. The fair value of the 40% previously held equity interest is $2 million. The net aggregate value of the identifiable assets and liabilities of entity Q measured in accordance with HKFRS 3 (revised) is $4.4 million.

Which one of the following independent statements about the accounting treatment for this business combination is CORRECT?

A Goodwill arising from this transaction is $600,000.

B Entity P recognises a gain on the previously 40% equity interest in entity Q as $1.8 million in the profit or loss.

C Entity P recognises a gain on the disposal of the property as $1.4 million in the profit or loss.

D None of the above statements A, B and C is correct.

E All of the above statements A, B and C are correct.

Answer 9 **E**

A is correct because goodwill is calculated as the fair value of consideration transferred plus fair value of previously held equity interest less net identifiable assets of entity Q. ($3million + $2 million - $4.4 million)

B is correct because gain on disposal of 40% equity interest is calculated as fair value of equity interest less its carrying amount ($2 million - $200,000).

C is correct because gain on disposal of property is calculated as fair value of property given up less its book value. ($3 million - $1.6 million)

The correct entries are as follows:

Dr. Net identifiable assets	4.4 M
Dr. Goodwill	0.6 M
Cr. Property's carrying value	1.6M
Cr. Associate	0.2M
Cr. Gain on disposal of property	1.4M
Cr. Gain on disposal of associate	1.8M

Question 10

During the year, CEF Ltd incurred general borrowings on 1 January 2010 for a general loan of $50,000 at 4% per annum. It also issued a debenture of $200,000 on 1 April 2010 at 5% per annum. CEF Ltd. is constructing numerous qualifying assets and had capitalized $9,000 borrowing costs on other qualifying assets, excluding the qualifying asset A, for the year ended 31 December 2010. Expenses incurred as from 1 May 2010 on this qualifying asset A was $45,000.

Which of the following independent statement is CORRECT?

A The amount of borrowing costs that an entity capitalizes during a period shall not exceed the amount of borrowing costs it incurred during that period

B Borrowing costs to the amount of $500 would be capitalized on the qualifying asset A.

C The weighted average capitalization rate used for capitalization of borrowing costs should be 4.75%.

D All the above statements A, B and C are correct.

Answer 10 **D**

A is CORRECT because paragraph 14 of HKAS 23 continues to state that "….The amount of borrowing costs that an entity capitalizes during a period shall not exceed the amount of borrowing costs it incurred during that period."

B Expenses incurred on qualifying assetA was $45,000. Interest capitalized at the capitalization rate of 4.75% should be $1,425 ($45,000 X 4.75% X 8/12). Total interest incurred was $9,500. The company has already capitalized $9,000 of the borrowing costs on other qualifying assets. Therefore, only $500 can be capitalized to qualifying assetA

C is CORRECT because paragraph 14 of HKAS 23 states that "To the extent that an entity borrows funds generally and uses them for the purpose of obtaining a qualifying asset, the entity shall determine the amount of borrowing costs eligible for capitalization by applying a capitalization rate to the expenditures on that asset. The capitalization rate shall be the weighted average of the borrowing costs applicable to the borrowings of the entity that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset….."

Question 11

DEF Construction Company is currently constructing a new office block. The construction site is located in a summer rainfall area, and construction was held up for two months due to the annual heavy rainfall and flooding. The foundations could not be built in such wet conditions, so construction was resumed in the autumn.

Which of the following statements is/are CORRECT?

(1) Interest and other costs incurred by an enterprise in connection with borrowing of funds are borrowing costs according to HKAS 23.

(2) Finance charges in respect of finance leases recognised in accordance with HKAS 17 "Leases" are borrowing costs according to HKAS 23.

(3) Capitalisation of borrowing costs should not be suspended for the two months where no construction took place.

(4) Capitalisation of borrowing costs should be suspended for the two months where no construction took place.

A. (1) only

B. (1) and (2) only

C. (1), (2) and (3) only

D. (1), (2) and (4) only

Answer 11 **C**

(1) is CORRECT because paragraph 5 of HKAS 23 defines "Borrowing costs are interest and other costs that an entity incurs in connection with the borrowing of funds."

(2) is CORRECT because paragraph 6(d) states that borrowing costs may include "finance charges in respect of finance leases recognised in accordance with HKAS 17 Leases"

(3) is CORRECT because of paragraph 21 of HKAS 23 states that "…..An entity also does not suspend capitalizing borrowing costs when a temporary delay is a necessary part of the process of getting an asset ready for its intended use or sale. For example, capitalization continues during the extended period that high water levels delay construction of a bridge, if such high water levels are common during the construction period in the geographical region involved."

(4) is NOT correct because of paragraph 21 of HKAS 23 states that "An entity may incur borrowing costs during an extended period in which it suspends the activities necessary to prepare an asset for its intended use or sale. Such costs are costs of holding partially completed assets and do not qualify for capitalization. However, an entity does not normally suspend capitalizing borrowing costs during a period when it carries out substantial technical and administrative work. An entity also does not suspend capitalizing borrowing costs when a temporary delay is a necessary part of the process of getting an asset ready for its intended use or sale.

Question 12

IT Company has entered into a finance lease during the year. The finance manager of IT Company has prepared the accounting entries for the transactions and is seeking your advice as to how the transactions should be disclosed in the statement of cash flows and the classification of them. IT Company is the lessee and details of the lease entries are as follows:

		$'000	$'000
Dr.	Capitalised lease equipment	500,000	
Cr.	Finance lease liability		500,000
Recognition of asset and liability at commencement of lease term			
Dr.	Finance lease liability	100,000	
Dr.	Interest paid	10,000	
Cr.	Bank		110,000
Payments made during the year to the lessor			
Dr.	Depreciation	100,000	
Cr.	Accumulated depreciation		100,000
Depreciation of the equipment for the year @20% on a straight-line basis			

Having examined the spreadsheet, you need to classify the amounts into different cash flow activities and then decide what amounts need to be included in the statement of cash flows. Which of the following is CORRECT for your response to the finance manager of IT Company so that he can ensure that his statement of cash flows is correct?

A The purchase of the asset (originally worth of $500M) through the finance lease will be classified under non-cash transaction – not disclosed on face, disclosed in note; The liability incurred at the acquisition of the asset is disclosed as non-cash transaction – not disclosed on face, disclosed in note

B The payments made to the lessor during the year totaling $110M will be broken down as $100M – Capital portion classified as financing activities; and $10M – the interest portion classified as a separate line item in financing activities

C Depreciation of $100M would be disclosed as financing activities

D The purchase of the asset (originally worth of $500M) through the finance lease will be classified under non-cash transaction – not disclosed on face, disclosed in note; the liability incurred at the acquisition of the asset is disclosed as investing activities

E None of the above statement is correct.

Answer 12 **A**

A is CORRECT because paragraph 43 of HKAS 7 states "Investing and financing transactions that do not require the use of cash or cash equivalents shall be excluded from a statement of cash flows. Such transactions shall be disclosed elsewhere in the financial statements in a way that provides all the relevant information about these investing and financing activities.

In this case, the only amounts with cash effects are those which affect the bank, i.e. the payment of capital and interest on the loan. On initial recognition of the asset and liability, there were no cash inflows/outflows, so there is no impact on the statement of cash flows and hence, the transaction will instead be reflected in a separate note. As depreciation was included in operating profit and has no effect on the cash flows of the entity, it needs to be excluded.

Question 13

Which of the following statements is CORRECT relating to the cash flows in the cash flows statements?

A Cash payment to owners to redeem the entity's shares is classified under investing activities

B Cash receipts from repayment of an advance made to a party other than a finance institution is classified under investing activities

C Cash flows arising from changes in ownership interests in a subsidiary that do not result in a loss of control shall be classified as cash flows from investing activities.

D None of the above statement is correct

E All of the above statements are correct

Answer 13 **B**

A is NOT correct because paragraph 17(b) of HKAS 7 states that "Cash payments to owners to acquire or redeem the entity's shares are disclosed as cash flows arising from financing activities."

B is CORRECT because of paragraph 16(f) of HKAS 7 states that "Cash receipts from the repayment of advances and loans made to other parties (other than advances and loans of a financial institution)" are cash flows arising from investing activities. Paragraph 16 of HKAS 7 states that only expenditures that result in a recognised asset in the statement of financial position are eligible for classification as investing activities.

C is NOT correct because paragraph 42A of HKAS 7 states that "Cash flows arising from changes in ownership interests in a subsidiary that do not result in a loss of control shall be classified as cash flows from financing activities". Paragraph 39 of HKAS 27 states that the aggregate cash flows arising from obtaining or losing control of subsidiaries or other business shall be presented separately and classified as investing activities.

Question 14

During the year, the following business activities were undertaken by different entities and revenue was recognised accordingly:

(1) JAP, an evening school, has received the full amount of tuition fees from participants for an elementary Japanese language course. The course has ten lessons running once per week. JAP recognised revenue over the period of instruction, that is, one-tenth per week.

(2) X sold a property to Y at market value for cash. There is a call and put option in place under which Y could require X to buy back (put option) and X could require Y to sell back (call option) the property one year later. The repurchase price is based on the market value as at the date of exercise of the option. X recognized revenue from the sale of the property to Y at initial recognition.

(3) FBC Ltd. entered into a franchise agreement with a franchisee and charges fees that comprises an initial franchise fee of $5M and continuing franchise fee of 3% on gross sales. Costs to provide continuing franchise services are estimated to be $1M per year. FBC Ltd. considers the separate fee of 3% of gross sale is sufficient to cover the cost of continuing services together with a reasonable profit. Hence, FBC Ltd. recognized the whole amount of $5M as revenue when performance of all the initial services and other obligations required of the company has been substantially accomplished.

(4) CEF Ltd. is a household appliances manufacturer that sells its products with a standard guarantee of two years. Sales returns can be reliably measured. The shipping terms are FOB Shipping Point. CEF Ltd. recognized the revenue from the sale of its appliance at the date the goods arrive at the buyer's destination.

Which of the above revenue recognition is in accordance with the recognition criteria under HKAS 18 and hence, revenue was appropriately recognised?

A. (1) and (2) only

B. (2) and (3) only

C. (1), (3) and (4) only

D. (2) and (4) only

E. (1), (2) and (3) only

Answer 14 **E**

Paragraph 20 of HKAS 18 states that "when the outcome of a transaction involving the rendering of services can be estimated reliably, revenue associated with the transaction shall be recognised by reference to the stage of completion of the transaction at the end of the reporting period." The outcome of a transaction can be estimated reliably when the criteria listed in paragraphs 20(a), (b), (c) and (d) are met. Therefore, it is appropriate for JAP to recognise revenue over the period of instruction under scenario (1).

Paragraph 14 of HKAS 18 states that revenue from the sale of goods shall be recognised when all of criteria in accordance with paragraphs 14(a), (b), (c), (d) and (e) are met. For scenario (2), since the repurchase price is based on the market value as at the date of exercise of the option, Y acquires both the opportunity to benefit from any increase in the value of the asset and the risk of loss due to an adverse change in its value. In that case, X has transferred the risks and rewards of ownership to the buyer, and a sale has taken place which justifies the recognition of revenue.

Paragraph 22 of HKAS 18 states that "revenue is recognised only when it is probable that the economic benefits associated with the transaction will flow to the entity…." Franchise fees may cover the supply of initial and subsequent services, equipment and other tangible assets, and know-how. Accordingly, franchise fees are recognised as revenue on a basis that reflects the purpose for which the fees were charged and fees for the provision of continuing services are recognised as revenue as the services are rendered. Under scenario 3, the company should determine whether the separate fee of 3% of gross sales would be sufficient to cover the cost of continuing services of $1,000,000 and result in a reasonable profit. If the company considers that the separate fee of 3% of gross sale is sufficient to cover the cost of continuing services together with a reasonable profit, the company should recognize the whole amount of $5M as revenue when performance of all the initial services and other obligations required of the company has been substantially accomplished. Otherwise, a part of the $5M initial fee should be deferred and recognised as revenue as the services are rendered, such that the total amount of fee recognised would be sufficient to cover the costs of continuing services and to provide a reasonable profit on those services.

Under the shipping terms of FOB Shipping Point, risk and rewards are considered to be passed from the seller to the buyer when the products are loaded on board and hence, revenue can be recognised provided that that all the other recognition criteria for sales of goods in accordance with HKAS 18 are met. Under scenario (4), revenue was only recognised by the seller at the date the goods arrived at the buyer's destination and considered inappropriate.

Question 15

The following are different independent scenarios for the accounting of financial instruments under HKAS 39:

(1) Hedge effectiveness is the degree to which changes in the fair value or cash flows of the hedged item that are attributable to a hedge risk are offset by changes in the fair value or cash flow of the hedging instrument

(2) A floating rate debt instrument would qualify for classification in the held-to-maturity financial asset category provided the entity has the intent and ability to hold them until maturity in accordance with the requirements of HKAS 39

(3) The risk exposure of a variable-rate loan asset for interest risk and a forecast purchase of wheat can be hedged using a cash flow hedge.

(4) Asset Management Company (AMC) classifies its investments in equity securities in the available-for-sale financial asset category. Earlier this year, AMC purchased an interest in SC Ltd, a private company. SC Ltd., a relative new comer in the hi-tech industry sector, has gained a multinational contract in the new field of wireless DVD players. HKAS 39 permits AMC to measure its investment in SC Ltd at cost less any provision for impairment, even if the investment's fair value is reliably determinable, as its investment in SC Ltd is in an unquoted equity instrument.

Which of the above statements regarding accounting for financial instruments are CORRECT under HKAS 39?

A. (1) and (2) only

B. (2) and (3) only

C (1), (2) and (3) only

D. (2), (3) and (4) only

E. All of the above are correct

Answer 15 **C**

(1) is CORRECT because hedge effectiveness is the degree to which changes in the fair value or cash flows of the hedged item that are attributable to a hedge risk are offset by changes in the fair value or cash flow of the hedging instrument. A hedge is regarded as highly effective only if both of the following conditions are met: (i) at the inception of the hedge and in subsequent periods, the hedge is expected to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated and (ii) the actual results of the hedge are within a range of 80-125% (i.e, not based on past history of effectiveness as indicated).

(2) is CORRECT because HTM investments are financial instruments with fixed or determinable payments and fixed maturity, which means that the contractual arrangement defines the amounts and dates of payments to the holder. A debt instrument with a variable interest rate can satisfy the criteria for a HTM investment.

(3) is CORRECT because HKAS 39(86)(b) states that a cash flow hedge is hedge of the exposure to variability in cash flows that is attributable to a particular risk associated with a recognised asset or liability (such as some future interest

payments on variable rate debt) or a highly probable forecast transaction; and could affect profit or loss.

(4) is INCORRECT because if a market for a financial instrument is not active, an entity establishes fair value by using an acceptable valuation technique that makes maximum use of market inputs. AMC must measure its investment in SC Ltd at fair value if the variability in the range of reasonable fair value estimates is not significant. If fair value is not reliably determinable, AMC is precluded from measuring the investment at fair value. The presumption that fair value can be determined can be overcome only in very limited circumstances. Where there is no active market for an unquoted equity instrument, or derivatives that are linked to it, the range of reasonable fair value estimates is significant and these estimates cannot be made reliably, an entity then must measure the equity instrument at its cost less any impairment.

Question 16

Mr. Benson is the CEO of Tasty Inc., a large restaurant chain in the USA. He also holds 95% of the shares in the company. His wife, Doris, owns 52% of a joint venture, Supply Chain, who supplies Tasty Inc with many of the sweets served in the restaurants. The remaining 48% is owned by a third party, Holdings Group.

Which of the following is/are CORRECT statements about the related parties of Tasty Inc?

(1) Mr. Benson is related because he controls Tasty Inc.

(2) Mr. Benson is related because he is part of the key management of Tasty Inc.

(3) Supply Chain is related because Doris Benson owns 52% of it

(4) Holdings Group is related because it owns 48% of Supply Chain

A. (1) only

B. (2) only

C. (1) and (2) only

D. (1), (2) and (3) only

E. All of the above are correct

Answer 16 **D**

Paragraph 9(a) of HKAS 24(Revised) defines that a person or a close member of that person's family related to a reporting entity if that person (i) has control or joint control over the reporting entity; (ii) has significant influence over the reporting entity; or (iii) is a member of the key management personnel of the reporting entity or of a parent of the reporting entity. Paragraph 9(b) of HKAS 24 (Revised) defines that an entity is related to a reporting entity if the entity is controlled or jointly controlled by a person identified in paragraph 9(a) above.