



Continuing Professional Development Programme

A Refresher Course on Current Financial Reporting Standards (Programme Code: CFW160620)

Programme Dates: 20, 24, 27, 29 June and 1 July 2016
Facilitator: Ms Winnie Chan, Ms Grace Lau
Examination Date: 3 July 2016
Examination Time: 3:30 p.m. – 4:30 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 taken out of the examination hall.

Candidate Name: _____

Membership No.: _____

Question 1

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 1 **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 2

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 2 **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 3

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 proper classifications. 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?

- (1) 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
 - (2) 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
 - (3) Depreciation of \$100M would be disclosed as financing activities
 - (4) 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
- A. (1) and (2) only
- B. (2) and (3) only
- C. (2) and (4) only
- D. (1), (2) and (3) only
- E. (2), (3) and (4) only

Answer 3

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 4

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, the only factor is to consider whether it is currently exercisable.
- D An investor with decision-making rights shall determine whether it is a principal or an agent. An investor that is an agent does not control an investee when it exercises decision-making rights delegated to it.
- E Statement A is CORRECT.

Answer 4 **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 HKFRS 10 paragraph B23 and B24: factors to consider in determining whether rights are substantive include but are not limited to:
 - (a) Whether there are any barriers (economic or otherwise) that prevent the holder (or holders) from exercising the rights;
 - (b) When the exercise of rights requires the agreement of more than one party, or when the rights are held by more than one party, whether a mechanism is in place that provides those parties with the practical ability to exercise their rights collectively if they choose to do so;
 - (c) Whether the party or parties that hold the rights would benefit from the exercise of those rights;
 - (d) 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 paragraph B58.

Question 5

Under HKAS 27 (2011) *Separate Financial Statements*, which one of the following independent statements about preparation of separate financial statements of an entity for the financial year ended 31 December 2016 is CORRECT?

- A When an entity prepares separate financial statements, it shall account for investments in subsidiaries, joint ventures and associates at cost, using equity accounting or in accordance with HKFRS 9 / HKAS 39.
- B Dividend received from subsidiaries, joint ventures and associates are recognized in profit or loss when its right to receive the dividend is established.
- C When a parent prepares separate financial statements, those separate financial statements shall disclose the fact that the statements are separate financial statements.
- D All of the above statements A, B and C are correct.
- E None of the above statement A, B and C is correct.

Answer 5 **D**

- A is CORRECT. Under the Amendments of *HKAS 27 Equity Method in Separate Financial Statements* effective for annual periods beginning on or after 1 January 2016, when an entity prepares separate financial statements, it shall account for investments in subsidiaries, joint ventures and associates either: (a) at cost; or (b) in accordance with HKFRS 9 / HKAS 39; or (b) using equity method as described in HKAS 28 in separate financial statements.
- B is CORRECT because of paragraph 12 of HKAS 27 (2011)
- C is CORRECT because of paragraph 16(a) of HKAS 27 (2011)

Question 6

Entity Z purchased a piece of land on 31 December 20X1 but there was no plan on what the land would be used for. On 10 March 20X2, management approved the plan to develop a 20-storey building which will then be leased out under operating leases to generate rental income. The construction was completed in April 20X3 and was then leased out to third parties.

On 10 June 20X6, 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 20X7, after all the tenants had moved out, Entity Z and its subsidiaries occupied the building and used it as office. Entity Z occupied the first six floors as head office while the remaining floors were leased out to its subsidiaries.

Entity Z 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 Z should account for the land under HKAS 16 Property, plant and equipment as at 31 December 20X1.
2. Entity Z should state the property under construction at its fair value on 31 December 20X2 unless the fair value cannot be determined reliably.
3. The building is accounted for as property, plant and equipment under HKAS 16 in entity Z's separate financial statements as at 31 December 20X6.
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 Z should account for the whole building as property, plant and equipment under HKAS 16 in its consolidated financial statements as at 31 December 20X7.

- A (1), (2) & (3)
B (2), (3) & (4)
C (2) & (3)
D (2) & (4)
E (2), (4) & (5)

Answer 6

E

1. is NOT CORRECT because of paragraph 8(b) of HKAS 40. Land held for undetermined future use is under the scope of HKAS 40.
2. is CORRECT because of paragraph 8(e) 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 7

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 25 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 30 June 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 Assuming that on 30 June 20X1, all criteria of classifying the outlet to be disposed of as non-current assets held for sale were met, Entity X should present the post-tax profit or loss of the outlet to be disposed of in the statement of comprehensive income for the period ended 30 June 20X1.
- B Impairment loss recognised 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 7 **C**

- A is NOT CORRECT. HKFRS 5 paragraph 38 states that "An entity shall present a non-current asset classified as held for sale and the assets of a disposal group classified as held for sale separately from other assets in the statement of financial position. The liabilities of a disposal group classified as held for sale shall be presented separately from other liabilities in the statement of financial position." The requirement to present post-tax profit or loss in the statement of comprehensive income relates to discontinued operations (HKFRS 5 para 33(a)).
- 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 8

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 CORRECT?

1. B's loan receivable from C is considered as a net investment in foreign operation (C) and hence, in Yellow's consolidated financial statements, the related exchange differences recognised will also be recognised in the consolidated profit or loss.
2. For each subsequent reporting period, the goodwill arising on the acquisition of D is translated using the exchange rate at the date of the transaction.
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 foreign currency translation 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 8 **E**

1. is NOT CORRECT because of paragraph 15, 15A and 32 of HKAS 21.
2. is NOT CORRECT 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 9

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 9 **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 of 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)(vi) 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.

(4) is NOT CORRECT. Paragraph 11(b) of HKAS 24 (Revised) states that two joint venturers simply because they share joint control of a joint venture are not related parties.

Question 10

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 10 **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 11

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

- A Cash payment to owners to redeem the entity's shares is classified under investing activities
- B Cash receipts from repayment of loans made to parties 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 11 **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 12

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 Goodwill of \$100,000 arising from this transaction is included in the carrying amount of the investment.
- D Entity M's interest in entity N at the end of 20X1 under the equity method is \$271,300.
- E Statement A is CORRECT.

Answer 12 **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 ($\$100,000 \times 30\%$)
- B is NOT CORRECT because of paragraph 32(a) of HKAS 28. Goodwill relating to an associate is included in the carrying amount of the investment.
- C is CORRECT because of paragraph 32(a) of HKAS 28. Goodwill relating to an associate is included in the carrying amount of the investment.
- D is CORRECT because interest in entity N under the equity method is $\$250,000 + 30\% \times (\$100,000 - 9,000 - 20,000)$.

Question 13

The following are different independent scenarios for the accounting of financial instruments under HKFRS 9:

- (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 HKFRS 9
- (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) purchased a 2% interest in SC Ltd, a private company, in view of its potential growth. SC Ltd. is a relative new comer in the hi-tech industry sector; dividends distribution to investors is at the discretion of SC Ltd.. HKFRS 9 permits AMC to measure its investment in SC Ltd at cost less any provision for impairment.

Which of the above statements regarding accounting for financial instruments are CORRECT under HKFRS 9?

- A. (1) and (3) 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 13 **A**

- (1) is CORRECT because of HKFRS 9 (2011) B6.4.1.
- (2) is NOT CORRECT . HKFRS 9 removes the category of "held-to-maturity" investment existed under HKAS 32. HKFRS 9 requires all financial assets to be classified on the basis of the entity's business model for managing the financial assets and the contractual cash flow characteristics of the financial asset.
- (3) is CORRECT because HKFRS 9 para 6.5.2 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 all, or a component of, a recognised asset or liability (such as all or some future interest payments on variable-rate debt) or a highly probable forecast transaction, and could affect profit or loss.
- (4) is NOT CORRECT because HKFRS 9 para 4.12 states that a financial asset shall be measured at amortised cost if both of the following conditions are met: (a) the financial asset is held within a business model whose objective is to hold financial assets in order to collect contractual cash flows and (b) the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding. AMC's investment in SC Ltd. should not be measured at amortised cost as the conditions specified in HKFRS 9 para 4.12 are not met.

Question 14

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) When funds are borrowed specifically for the purpose of acquiring or constructing a qualifying asset, any investment income earned on the temporary investment of the funds, pending their expenditure on the qualifying asset, should be deducted from the actual borrowing costs incurred to arrive at the borrowing costs eligible for capitalisation
 - (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) and (4) only
- D. (1), (2) and (3) only
- E. (1), (2) and (4) only

Answer 14 **D**

- (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 of paragraph 12 of HKAS 23.
- (3) is 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 15

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

- (1) An entity contracts with a customer to sell a piece of equipment and installation services. The equipment is operational without any customisation or modification. The installation required is not complex and is capable of being performed by several alternative service providers. In accordance with HKFRS 15, the entity identifies two performance obligations in the contract for the following goods or services: (i) the equipment; and (ii) installation services.
- (2) An entity enters into a contract to provide monthly payroll processing services to a customer for one year. The customer would not need to re-perform payroll processing services. The entity recognises revenue from the one-year contract of monthly payroll processing services over time.
- (3) An entity enters into a contract with a customer to provide a consulting service that results in the entity providing a professional opinion to the customer. The professional opinion relates to facts and circumstances that are specific to the customer. If the customer were to terminate the consulting contract for reasons other than the entity's failure to perform as promised, the contract requires the customer to compensate the entity for its costs incurred plus a 15 per cent margin. The 15 per cent margin approximates the profit margin that the entity earns from similar contracts. The entity recognises revenue only upon completion of professional opinion to the customer
- (4) An entity promises to sell 120 products to a customer for CU12,000 (CU100 per product). The products are transferred to the customer over a six-month period. The entity transfers control of each product at a point in time. After the entity has transferred control of 60 products to the customer, the contract is modified to require the delivery of an additional 30 products (a total of 150 identical products) to the customer. The additional 30 products were not included in the initial contract. The price of the contract modification for the additional 30 products is an additional CU2,850 or CU95 per product. The pricing for the additional products reflects the stand-alone selling price of the products at the time of the contract modification. Consequently, the amount recognised as revenue for each of the remaining products is a blended price of CU98.33 $\{[(CU100 \times 60 \text{ products not yet transferred under the original contract}) + (CU95 \times 30 \text{ products to be transferred under the contract modification})] \div 90 \text{ remaining products}\}$.

Which of the above revenue recognition is in accordance with the recognition criteria under HKFRS 15?

- 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 15 **A**

- (1) is CORRECT. The entity assesses the criteria in paragraph 27 of HKFRS 15 to determine whether each promised good or service is distinct. The entity determines that the equipment and the installation each meet the criterion in paragraph 27(a) of HKFRS 15. The customer can benefit from the equipment on its own, by using it or reselling it for an amount greater than scrap value, or together with other readily available resources (for example, installation services available from alternative providers). The customer also can benefit from the installation services together with other resources that the customer will already have obtained from the entity (ie the equipment). The entity further determines that its promises to transfer the equipment and to provide the installation services are each separately identifiable (in accordance with paragraph 27(b) of HKFRS 15). The entity considers the principle and the factors in paragraph 29 of HKFRS 15 in determining that the equipment and the installation services are not inputs to a combined item in this contract. In this case, each of the factors in paragraph 29 of HKFRS 15 contributes to, but is not individually determinative of, the conclusion that the equipment and the installation services are separately identifiable (HKFRS 15 illustrative example 11 Case C).
- (2) is CORRECT. The promised payroll processing services are accounted for as a single performance obligation in accordance with paragraph 22(b) of HKFRS 15. The performance obligation is satisfied over time in accordance with paragraph 35(a) of HKFRS 15 because the customer simultaneously receives and consumes the benefits of the entity's performance in processing each payroll transaction as and when each transaction is processed. The fact that another entity would not need to re-perform payroll processing services for the service that the entity has provided to date also demonstrates that the customer simultaneously receives and consumes the benefits of the entity's performance as the entity performs. The entity recognises revenue over time by measuring its progress towards complete satisfaction of that performance obligation in accordance with paragraphs 39–45 and B14–B19 of HKFRS 15 (HKFRS 15 illustrative example 13)
- (3) is NOT CORRECT. the entity's performance obligation meets the criterion in paragraph 35(c) of HKFRS 15 and is a performance obligation satisfied over time because of both of the following factors: (a) in accordance with paragraphs 36 and B6–B8 of HKFRS 15, the development of the professional opinion does not create an asset with alternative use to the entity because the professional opinion relates to facts and circumstances that are specific to the customer. Therefore, there is a practical limitation on the entity's ability to readily direct the asset to another customer; (b) in accordance with paragraphs 37 and B9–B13 of HKFRS 15, the entity has an enforceable right to payment for its performance completed to date for its costs plus a reasonable margin, which approximates the profit margin in other contracts. Consequently, the entity recognises revenue over time by measuring the progress towards complete satisfaction of the performance obligation in accordance with paragraphs 39–45 and B14–B19 of HKFRS 15 (HKFRS 15 illustrative example 14).
- (4) is NOT CORRECT. The additional products are distinct (in accordance with paragraph 27 of HKFRS 15) from the original products. In accordance with paragraph 20 of HKFRS 15, the contract modification for the additional 30 products is, in effect, a new and separate contract for future products that does not affect the accounting for the existing contract. The entity recognises revenue of CU100 per product for the 120 products in the original contract and CU95 per product for the 30 products in the new contract (HKFRS 15 illustrative example 5 Case A).

Question 16

During the year, CEF Ltd incurred general borrowings on 1 January 2014 for a general loan of \$50,000 at 4% per annum. It also issued a debenture of \$200,000 on 1 April 2014 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 2014. Expenses incurred as from 1 May 2014 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.
- E None of the above statement A, B and C is correct.

Answer 16 **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 asset A was \$45,000. Interest capitalized at the capitalization rate of 4.75% (Total weighted average of borrowing outstanding during the period: $\$50,000 \times 12/12 + \$200,000 \times 9/12 = \$200,000$; Capitalization rate: $4\% \times 50,000/200,000 + 5\% \times 200,000 \times 9/12 / 200,000 = 4.75\%$) should be \$1,425 ($\$45,000 \times 4.75\% \times 8/12$). Total interest incurred was \$9,500 ($\$50,000 \times 4\% + \$200,000 \times 5\% \times 9/12$). The company has already capitalized \$9,000 of the borrowing costs on other qualifying assets. Therefore, only \$500 can be capitalized to qualifying asset A.
- 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....."