Financial Reporting – Module 3 Quiz

Here are some easy questions just to test you have understood the main points within this module.

Questions

Question 1

Which of the following about provisions is **not** correct?

A Provisions are a liability.

B Provisions are a contingent liability.

C Provisions are often an estimate.

D Provisions are an uncertain liability.

Question 2

Which of the following about contingent liabilities is correct?

A Contingent liabilities have the same accounting treatment as provisions.

B Contingent liabilities must be recognised in the statement of financial position.

C Contingent liabilities are a possible obligation where the outflow of resources in the future is certain.

D Contingent liabilities are a present obligation where the outflow of resources in the future is not probable.

Question 3

Which of the following about contingent assets is **not** correct?

A Contingent assets are possible assets as their present existence is unclear.

B Contingent assets are based on the definition of an asset according to the Conceptual Framework.

C Contingent assets are recognised in the statement of financial position and in the notes to the accounts.

D Contingent assets are disclosed in the notes to the accounts where the flow of economic benefits is probable.

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Question 4

Which of the following describes elements of when a provision is recognised in the statement of financial position?

Item I A present obligation as a result of a future event.

Item II The provision amount must be measured accurately.

Item III An outflow of economic benefits to settle the obligation is probable.

Item IV The provision amount can be measured reliably, even if it has to be estimated.

A I and III only.

B III and IV only.

C I, II and IV only.

D II, III and IV only.

Question 5

RRR Ltd (RRR) operates in the recycling industry. Three weeks ago, it inadvertently released poisonous gases into the air which caused a number of local residents to become ill.

A law firm representing the affected residents has submitted a compensation claim to the entity for pain and suffering of between $10 000 to $50 000 per affected resident. There was a total of 15 residents affected.

The court hearing is scheduled to occur sometime over the next three months. RRR does not believe that they will be required to make any payments to claimants, as this was an accident and no-one has been seriously harmed as a result.

Which of the following is the **most** correct approach for accounting for this event?

A As a liability as it is a present obligation arising as a result of a past event that will result in a probable outflow of economic benefits which can be reliably measured.

B As a contingent liability as it is a possible obligation arising as a result of a past event that may result in a probable outflow of economic benefits which can be reliably measured.

C No recognition or disclosure is required as there is no present obligation arising as a result of a past event that will result in a probable outflow of economic benefits which can be reliably measured.

D As a provision as it is a present obligation arising as a result of a past event that will result in a probable outflow of economic benefits which can be reliably measured however the timing of this occurring is uncertain.

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Question 6

Which of the following is **not** a key disclosure requirement for provisions according to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*?

A Amount charged against the provision during the period.

B Increases made to the provisions during the reporting period.

C The opening balance of provisions from the previous reporting period.

D Amount of unused provisions reversed during the reporting period.

Question 7

Which of the following about the disclosure of contingent assets and liabilities is **not** correct?

A An estimate of the financial effect of a contingent asset should be disclosed.

B Contingent liabilities require recognition in the statement of financial position and disclosure in the notes.

C Disclosure of contingent liabilities is required unless the possibility of an outflow of resources is remote.

D A description of the nature of the contingent asset at the end of the reporting period should be disclosed.

Question 8

Library Laser Ltd (LL) is restructuring one of its major production facilities. LL is in the process of developing a detailed formal plan for the restructuring provision.

Which of the following is **not** likely to be an element identified in the formal plan?

A The business unit concerned.

B Date that the plan will be implemented.

C The roles and approximate numbers of affected staff.

D The number of years' service provided by each affected employee.

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Question 9

Farnot Ltd (Farnot) has acquired 100 per cent ownership and control of Closeso Ltd (Closeso). As part of the due diligence process, Farnot developed a detailed formal plan to discontinue the homewares division of Closeso, due to underperforming sales. Farnot estimated the restructure costs to be $60 000. Management formally announced the homewares division closure and mentioned that it is unsure when the restructure will take place, but that it will definitely finalise the process within six months of acquisition.

Which of the following statements about the need for Farnot to recognise a provision for restructuring is correct?

A Farnot should recognise a provision of $60 000 in its post-acquisition financial statements.

B Farnot should recognise a provision of $60 000 at acquisition date as part of the acquisition process.

C Farnot cannot recognise the provision because it should be recognised in the financial statements of Closeso.

D Farnot cannot recognise a provision for restructuring as has not confirmed when the restructure will take place.

Question 10

The accountant for RYK Ltd (RYK) is preparing the financial report for the period ended 31 December 20X6. The accountant notes that an electricity invoice for the last six months' usage has not been received.

Which of the following is **most** correct for recognising the liability?

A A present obligation exists and RYK should recognise a liability based on a reliable estimate.

B As the invoice has not yet been received, no present obligation exists so RYK cannot recognise a liability.

C A possible obligation exists, however it is not certain when the invoice will be received so the accountant should recognise a provision.

D A present obligation exists, however as the amount of usage cannot be reliably measured, the estimated costs can only be disclosed as a contingent liability.

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Solutions

Question 1: Correct answer is B

Explanation

Option A	This is incorrect because provisions are a subset of liabilities.
Option B	This is correct because where there is a significant level of certainty (e.g. where the existence will be confirmed by an uncertain future event), or where it doesn't meet the recognition criteria, the amount is not recognised as a provision but is a contingent liability (IAS 37 para. 12).
Option C	This is incorrect because provisions are defined in IAS 37 as liabilities of uncertain timing or amount (IAS 37 para. 10).
Option D	This is incorrect because the definition of a provision requires that uncertainty exists.

Question 2: Correct answer is D

Explanation

Option A	This is incorrect because contingent liabilities are distinguished from provisions in that they are not recognised as liabilities. The IASB has adopted a view that it is useful to treat provisions that fail one or both of the recognition criteria as contingent liabilities.
Option B	This is incorrect because contingent liabilities are not recognised in the statement of financial position. IAS 37 requires the disclosure of contingent liabilities in the notes unless the possibility of an outflow of resources is remote (IAS 37 para. 28).
Option C	This is incorrect because as a possible obligation, it is yet to be confirmed whether the entity has a present obligation and so the outflow of resources in the future is not certain (i.e. still uncertain).
Option D	This is correct because while it may be a present obligation that arises from past events, a contingent liability may not recognised because 'it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation' (IAS 37 para. 10(b)(i)).

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Question 3: Correct answer is C

Explanation

Option A	This is incorrect because a possible asset is identified and disclosed per IAS 37. It is a contingent asset if, after taking into account all available information, the existence of an asset remains unclear and cannot be clarified until an uncertain future event occurs or fails to occur.
Option B	This is incorrect because the definition of contingent assets in IAS 37 is aligned to the definition of assets provided in the Conceptual Framework.
Option C	This is correct because contingent assets are not recognised in the statement of financial position but are disclosed in the notes to the financial statements.
Option D	This is incorrect because IAS 37 requires disclosure where the inflow of economic benefits is probable. This disclosure requirement is consistent with the asset recognition criteria in the Conceptual Framework.

Question 4: Correct answer is B

Explanation

Option A	This is incorrect because a provision can be recognised in the statement of financial position when an entity has a present obligation as a result of a past event.
Option B	This is correct because these two elements are part of the recognition criteria per IAS 37 para. 14. An additional element is that the entity has a present obligation as a result of a past event.
Option C	This is incorrect because a provision can be recognised in the statement of financial position when an entity has a present obligation as a result of a past event. Also, it is not necessary for the provision to be measured accurately - only that there be a reliable estimate.
Option D	This is incorrect because a provision does not need to be measured accurately - only that there be a reliable estimate.

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Question 5: Correct answer is B

Explanation

Option A & Option D	These are incorrect because a present obligation to the affected residents does not exist.
Option B	This is correct because this is a possible obligation that may result in a flow of funds to claimants depending upon the outcome of the case. Per IAS 37 para. 10 either part (a) or part (b) needs to be satisfied to meet the definition of a contingent liability. Based on the facts that the court case has not been heard as yet, there is no present obligation. While an estimate of the claim can be made: best case = $0 payment or worst case = 15 x $50 000 = $750 000, the probability of a flow of economic benefits cannot be determined with certainty.
Option C	This is incorrect because a present obligation to the affected residents does not exist but the details of the case should be disclosed as a possible obligation in the notes to the accounts.

Question 6: Correct answer is C

Explanation

Option A	This is incorrect because for each class of provision, an entity shall disclose: amounts used (i.e. incurred and charged against the provision) during the period (IAS 37 para. 84(c)).
Option B	This is incorrect because for each class of provision, an entity shall disclose: additional provisions made in the period, including increases to existing provisions (IAS 37 para. 84(b)).
Option C	This is correct because while the carrying amount at the beginning and end of the period is required (IAS 37 para. 84(a), comparative information is not required (IAS 37 para. 84).
Option D	This is incorrect because for each class of provision, an entity shall disclose: unused amounts reversed during the period (IAS 37 para. 84(d)).

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Question 7: Correct answer is B

Explanation

Option A This is incorrect because IAS 37 requires disclosure of the description of the nature of the contingent assets at the end of the reporting period. Where practicable this should also include an estimate of their financial effect.

Option B This is correct because contingent liabilities are not recognised in the statement of financial position. IAS 37 requires the disclosure of contingent liabilities in the notes accompanying the statements unless the possibility of an outflow of resources is remote (IAS 37 para. 28).

Option C This is incorrect because IAS 37 para. 28 requires the disclosure of contingent liabilities in the notes accompanying the statements unless the possibility of an outflow of resources is remote.

Option D This is incorrect because IAS 37 requires the disclosure of the description of the nature of the contingent assets at the end of the reporting period and an estimate of their financial effect, measured using the principles set out for provisions in paragraph 36–52 of IAS 37 (para. 89).

Question 8: Correct answer is D

Explanation

Option A This is incorrect because for an entity to recognise a provision other than as part of an acquisition, IAS 37 para. 72 requires that the entity: (a) has developed a detailed formal plan for the restructuring identifying at least: (i) the business or part of a business concerned.

Option B This is incorrect because for an entity to recognise a provision other than as part of an acquisition, IAS 37 para. 72 requires that the entity: (a) has developed a detailed formal plan for the restructuring identifying at least: v) when the plan will be implemented.

Option C This is incorrect because for an entity to recognise a provision other than as part of an acquisition, IAS 37 para. 72 requires that the entity: (a) has developed a detailed formal plan for the restructuring identifying at least: (iii) the location, function, and approximate number of employees who will be compensated for terminating their services.

Option D This is correct because while the expenditures that will be undertaken need to be calculated (IAS 70 para. 72(a)(iv)), but the number of years' service by each affected employee is not a requirement of the formal plan.

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Question 9: Correct answer is A

Explanation
With regard to the first and second option, Farnot does not recognise those costs as part of applying the acquisition method. Farnot recognises those costs in its post-combination financial statements in accordance with other IFRSs (per IFRS 3 para. 11).

The third option is incorrect because Closeso cannot recognise those costs. Farnot recognises those costs in its post-combination financial statements in accordance with other IFRSs (per IFRS 3 para. 11).

The fourth option is incorrect because Farnot has met the requirements for the recognition of restructuring provisions (See Figure 3.1).

Question 10: Correct answer is A

Explanation
The entity does not need to have received an invoice for a present obligation to exist. RYK has used electricity so legally, they are liable for the costs.

Therefore present obligation exists based on a past event (usage of electricity). As the actual costs are unknown, RYK would need to recognise a provision based on a reliable estimate. This gives rise to a provision which is a subset of a liability.