Company Accounting 11th edition Leo Test Bank

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Testbank

to accompany

Company accounting

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by
Leo et al.

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Chapter 2: Financing company operations

Multiple-choice questions

1. In respect to the issue of shares by companies, which of the following statements is incorrect?

    a. Companies can convert ordinary shares into preference shares.
    *b. Companies can only issue ordinary shares.
    c. Companies can issue any specified number of shares at any price.
    d. Companies can issue both ordinary and preference shares.

Correct answer: b
Learning objective 2.1

2. According to the Corporations Act, when a company issues shares to the public, the issue price, terms and rights of the shares are determined by:

    a. the Australian Securities Exchange.
    *b. the company's directors.
    c. the Australian Investments and Securities Commission.
    d. the company's auditors.

Correct answer: b
Learning objective 2.1

3. Before a company issues shares to the public, the company must:

    a. register the prospectus with the Australian Accounting Standards Board.
    b. first offer the shares to the existing shareholders.
    c. register the prospectus with the Australian Securities Exchange.
    *d. provide a disclosure document with an application form attached.

Correct answer: d
Learning objective 2.1

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4. ABC Limited issued a prospectus offering 100 000 ordinary shares at an issue price of $2.50 each, payable $1.50 per share on application. The company received applications for 110 000 shares. Which of the following entries correctly records the application money?

a.	DR	Application	$165 000	
		CR Cash trust		$165 000
b.	DR	Cash trust	$250 000	
		CR Application		$250 000
*c.	DR	Cash trust	$165 000	
		CR Application		$165 000
d.	DR	Cash trust	$275 000	
		CR Application		$275 000

Correct answer: c
Learning objective 2.1

5. When a company requests a further payment from shareholders of the unpaid amounts on their shares, it:

*a. makes a call on the shares.
b. makes a further allotment of those shares.
c. converts the shares into debentures.
d. forfeits the shares.

Correct answer: a
Learning objective 2.1

6. Which of the following is the appropriate journal entry to record the cash collected from applicants for shares before the shares are actually issued?

a. Increase *cash trust* account: increase *share capital* account
b. Increase *application* account: decrease *share capital* account
c. Increase *share capital* account: decrease *cash trust* account
*d. Increase *cash trust* account: increase *application* account

Correct answer: d
Learning objective 2.1

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7. When shares are issued fully payable on application, the journal entries to record the issue (assuming the minimum subscription is reached) are

a.	Cash trust	Dr	X	
	Application	Cr		X
	Allotment	Dr	X	
	Share capital	Cr		X
b.	Cash trust	Dr	X	
	Application	Cr		X
	Cash	Dr	X	
	Cash trust	Cr		X
c.	Cash	Dr	X	
	Call	Cr		X
	Call	Dr	X	
	Share capital	Cr		X
*d.	Cash trust	Dr	X	
	Application	Cr		X
	Application	Dr	X	
	Share capital	Cr		X
	Cash	Dr	X	
	Cash trust	Cr		X

Correct answer: d
Learning objective 2.1

8. The journal entry to record further receipts of cash due on the allotment of shares will include which of the following line items?

a. DR Allotment
b. DR Share capital
*c. CR Allotment
d. CR Cash

Correct answer: c
Learning objective 2.1

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9. The journal entry to record the amount receivable when a call is made by the company is:

   *a. DR Call
   CR Share capital
   b. DR Allotment
   CR Share capital
   c. DR Share capital
   CR Call
   d. DR Cash trust
   CR Call

Correct answer: a
Learning objective 2.1

10. After the completion of all steps in the issue of shares, the company's statement of financial position will show which of the following changes?

   a. Assets increased, liabilities increased
   b. Assets decreased, equity increased
   c. Assets decreased, liabilities decreased
   *d. Assets increased; equity increased

Correct answer: d
Learning objective 2.1

11. XYZ Ltd was registered as a company on 1 July 2017. On 4 July 2017, ABC Ltd issued a prospectus offering 200 000 ordinary shares at an issue price of $5.00 each, payable $3.00 on application and $2.00 on allotment. Applications closed on 1 August 2017 with the company having received applications for 220 000 shares. After application but prior to allotment, the balance in the application account would be:

   a. $600 000 credit.
   b. $1 000 000 credit.
   c. $660 000 debit.
   *d. $660 000 credit.

Correct answer: d
Learning objective 2.1

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12. If the minimum number of applications specified in the disclosure document is not received, all application money must be refunded to applicants. The minimum number of applications must be received within:

    *a. 4 months after the date of the disclosure document.
    b. 1 month after the receipt of the first application money by the company.
    c. 13 months after the date of the disclosure document.
    d. 75 days from the date that ASIC gives its approval of the disclosure document.

Correct answer: a
Learning objective 2.2

13. Interest paid to shareholders on calls in advance is:

    a. credited to retained earnings.
    b. recorded as an expense.
    *c. debited to retained earnings.
    d. recorded as revenue.

Correct answer: c
Learning objective 2.2

14. ABC Ltd was registered as a company on 1 July 2017. On 4 July 2017, ABC Ltd issued a prospectus offering 250 000 ordinary shares at an issue price of $3.50 each, payable $2.50 on application and $1.00 on allotment. Applications closed on 1 August 2017 with the company having received applications for 300 000 shares. The shares were allotted on 15 August 2017, with the over-subscription amount being refunded to unsuccessful applicants. All allotment money was received by 31 August 2017. Following the allotment, the balance in the share capital account would be:

    a. $750 000 credit.
    *b. $875 000 credit.
    c. $625 000 credit.
    d. $1 050 000 credit.

Correct answer: b
Learning objective 2.2

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15. Smith Ltd was registered as a company on 1 July 2017. On 4 July 2017, Smith Ltd issued a prospectus offering 300 000 ordinary shares at an issue price of $4.00 each, payable $2.00 on application and $2.00 on allotment. Applications closed on 1 August 2017 with the company having received applications for 330 000 shares. The shares were allotted on 15 August 2017, with the over-subscription amount being refunded to unsuccessful applicants. All allotment money was received by 31 August 2017. Following the allotment, the amount transferred from the cash trust account to the cash account would be:

    *a. $600 000.
    b. $1 320 000.
    c. $1 200 000.
    d. $660 000.

Correct answer: a
Learning objective 2.2

16. The appropriate account to record any excess application money received and retained by a company to reduce allotment money due and in payment of future calls, is the:

    a. calls in arrears account.
    b. forfeited shares account.
    c. share capital account.
    *d. calls in advance account.

Correct answer: d
Learning objective 2.2

17. If a company's constitution does not contain rules governing the forfeiture of shares, then the company:

    a. may forfeit shares but not reissue them.
    *b. cannot forfeit shares.
    c. may forfeit shares and reissue them at a later date.
    d. can register the shares in the name of another shareholder, but cannot receive payment from that shareholder.

Correct answer: b
Learning objective 2.3

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18. A company's share capital consists of 50 000 ordinary shares issued at $2 and paid to $1 per share. On 1 September, a first call of 50c was made on the ordinary shares. By 30 September, call money was received on 45 000 shares. On 31 October, the shares on which calls were outstanding were forfeited. The company's constitution provided for any surplus on resale to be returned to the shareholders whose shares were forfeited. The entry to record the forfeiture of shares is:

*a.	Share capital	Dr	7 500	
	First call — ordinary shares	Cr		2 500
	Forfeited shares	Cr		5 000
b.	Share capital	Dr	7 500	
	First call — ordinary shares	Cr		5 000
	Forfeited shares	Cr		2 500
c.	Share capital	Dr	5 000	
	Forfeited shares	Cr		5 000
d.	Forfeited shares	Dr	2 500	
	Share capital	Cr		2 500

Correct answer: a
Learning objective 2.3

19. A company's share capital consists of 100 000 ordinary shares issued at $4 and paid to $2 per share. On 1 February, a first call of $1 was made on the ordinary shares. By 28 February, call money was received on 90 000 shares. On 31 March, the shares on which calls were outstanding were forfeited. The company's constitution provided for any surplus on resale to be returned to the shareholders whose shares were forfeited. On 15 April, the forfeited shares were reissued as paid to $4.00 for a payment of $3.50 per share. The entry to record the reissue of the forfeited shares is:

*a.	Cash	Dr	35 000	
	Forfeited shares	Dr	5 000	
	Share capital — ordinary	Cr		40 000
b.	Cash	Dr	5 000	
	Forfeited shares	Dr	35 000	
	Share capital — ordinary	Cr		40 000
c.	Cash	Dr	35 000	
	Share capital — ordinary	Cr		35 000
d.	Share capital	Dr	35 000	
	Forfeited shares	Cr		35 000

Correct answer: a
Learning objective 2.3

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20. A company forfeited 10 000 shares that had been paid to $2 but on which a $1 call was outstanding. The company's constitution provided for any surplus on reissue to be returned to the forfeiting shareholders. The forfeited shares were reissued as paid to $4.00 for a payment of $3.50 per share. Costs of reissue amounted to $2000. The amount of the surplus repaid to the shareholders whose shares were forfeited is:

    a. $15 000.
    *b. $13 000.
    c. $10 000.
    d. $38 000.

Correct answer: b
Learning objective 2.3

21. If the balance in a forfeited shares account is refundable to the owners of those shares, then the account is classified as a component of:

    a. revenue.
    *b. liabilities.
    c. equity.
    d. expense.

Correct answer: b
Learning objective 2.3

22. The costs of issuing shares effectively:

    *a. reduce the proceeds from the share issue.
    b. increase the proceeds from the share issue.
    c. are borne by the underwriters of the share issue.
    d. are recognised as a deferred asset on the statement of financial position.

Correct answer: a
Learning objective 2.4

23. Which of the following journal entries shows the correct accounting treatment for share issue costs?

    a. Dr Deferred asset: Cr Cash
    b. Dr Cash: Cr Deferred asset
    *c. Dr Share capital: Cr: Cash
    d. Dr Cash: Cr Share capital

Correct answer: c
Learning objective 2.4

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24. Underwriting and other share issue costs paid to a stockbroker or financial institution should be reported in the statement of financial position as a/an:

    a. liability.
    b. asset.
    c. increase in share capital.
    *d. decrease in share capital.

Correct answer: d
Learning objective 2.4

25. Brown Limited was incorporated on 1 July 2017. A prospectus offering 200 000 shares at $3.00 each was released and closed fully subscribed. The share issue was underwritten by a broker for $25 000 and other costs of the share issue amounted to $13 000. The net share capital on the statement of financial position is:

    a. $575 000.
    b. $162 000.
    c. $587 000.
    *d. $562 000.

Correct answer: d
Learning objective 2.4

26. According to ASX Listing Rule 7.1, the proportion of existing capital that a listed company can issue in any one year without the prior approval of the ordinary shareholders is:

    a. 5%.
    b. 10%.
    *c. 15%.
    d. 20%.

Correct answer: c
Learning objective 2.5

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27. A bonus issue of shares to existing shareholders has which of the following impacts on the equity of a company?

    a. Total equity increases.
    b. Total equity decreases.
    *c. No overall change in total equity.
    d. Only the amount of issued share capital changes.

Correct answer: c
Learning objective 2.5

28. A share option is an instrument that gives the holder the right but not the obligation to:

    *a. buy a certain number of shares in the company by a specified date at a stipulated price.
    b. sell a variable number of shares in the company by a specified date at a stipulated price.
    c. receive a certain dividend declared by the company by a specified date.
    d. receive a bonus issue of shares in a proportion as notified by the company.

Correct answer: a
Learning objective 2.6

29. Bellvista Limited issued 20 000 share options to subscribe for ordinary shares. The exercise price on the options was $5 per share. If all options were exercised by the due date, the following journal entry would be recorded for the issue of the shares.

a.	Share capital — ordinary	Dr	100 000	
	Cash	Cr		100 000
b.	Share options — ordinary	Dr	100 000	
	Share capital — ordinary	Cr		100 000
c.	Share options reserve	Dr	100 000	
	Cash	Cr		100 000
*d.	Cash	Dr	100 000	
	Share capital — ordinary	Cr		100 000

Correct answer: d
Learning objective 2.6

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30. On 1 July 2017, a company redeemed its $200 000 debenture liability using its available cash on hand. The terms of the debenture issue provided that a premium of 5% was to be paid on redemption of the debentures. Which of the following is the entry to record the redemption?

a.	Debentures	Dr	210 000	
	Redemption revenue	Cr		10 000
	Cash	Cr		200 000
b.	Debentures	Dr	210 000	
	Cash	Cr		210 000
*c.	Expense on redemption of debentures	Dr	10 000	
	Debentures	Dr	200 000	
	Cash	Cr		210 000
d.	Debentures	Dr	200 000	
	Premium on redemption	Cr		10 000
	Cash	Cr		190 000

Correct answer: c
Learning objective 2.10

31. Which of the following statements is correct in relation to the payment of dividends?

a. Dividends can only be paid if a company has generated a profit in the current period.
*b. The payment of dividends is regulated by the *Corporations Act*.
c. A company can only pay an interim dividend if its constitution allows it.
d. Preference dividends must be paid on a cumulative basis.

Correct answer: b
Learning objective 2.11

32. According to the *Corporations Act*, dividends may:

a. only be paid to shareholders once a year.
b. only be paid out of the current year's profits of a company.
c. be declared and paid to shareholders irrespective of whether a company has accumulated losses.
*d. be paid if the company has an excess of assets over liabilities.

Correct answer: d
Learning objective 2.11

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33. The appropriate accounting entry to record the declaration of a bonus share issue out of the Revaluation Surplus account is which of the following?

a. DR Bonus dividend
CR Revaluation surplus
b. DR Revaluation surplus
CR Cash
*c. DR Revaluation surplus
CR Share capital
d. DR Cash
CR Share capital

Correct answer: c
Learning objective 2.11

34. Dividends declared after the reporting period:

a. meet the criteria for recognition as a liability.
b. satisfy the criteria for recognition as an expense.
c. are recognised in the statement of financial position as they meet the definition of equity.
*d. do not meet the AASB 132/IAS 32 recognition criteria for liabilities.

Correct answer: d
Learning objective 2.11

35. Which of the following statements is not correct in relation to cumulative preference shares?

*a. Holders of cumulative preference shares are guaranteed a dividend every year.
b. Undeclared cumulative preference share dividends accumulate, or carry forward, to future periods.
c. The accumulated amount of any cumulative preference share dividend plus the current year's preference dividend must be paid before any dividend can be paid to ordinary shareholders.
d. Cumulative preference share dividends that are not declared in the year they are due are called dividends in arrears.

Correct answer: a
Learning objective 2.11

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36. In relation to a revaluation surplus, an entity:

a. cannot use this surplus for the payment of future dividends.
*b. can transfer this surplus to retained earnings when the asset is derecognised or used.
c. cannot transfer this surplus to any other reserve account.
d. can transfer the surplus to the current period profit or loss when the asset is disposed of.

Correct answer: b
Learning objective 2.12

37. Reserves that are not required by accounting standards are known as:

a. specific reserves.
*b. general reserves.
c. current reserves.
d. retained reserves.

Correct answer: b
Learning objective 2.12

38. When making a transfer from a general reserve to retained earnings, which of the following journals could be used?

*a. DR General reserve
CR Retained earnings
a. DR General reserve
CR Share capital
b. DR Retained earnings
CR General reserve
c. DR Share capital
CR General reserve

Correct answer: a
Learning objective 2.12

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39. For a company, retained earnings represent:

    a. contributed capital from shareholders.
    b. profits retained by the company before tax is paid to the government.
    c. net cash retained by the company before any payment of dividends to shareholders.
    *d. profits retained by the company after payment of dividends, and after any transfer to and from reserves.

Correct answer: d
Learning objective 2.12

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True/false questions

40. It is possible for a company to issue different types of preference shares provided that the rights of each type are specified in its constitution.

The statement is true. This is a requirement of s 254A(2) of the *Corporations Act*.
Learning objective 2.1

41. Prior to the allotment/issue of shares, the balance in the application account represents a liability of the company to the applicants.

The statement is true. If the shares are not issued, the money must be returned to the shareholders as soon as practicable.
Learning objective 2.1

42. If a company has not reached a minimum subscription level within 90 days of the date of the disclosure document, the money paid in by applicants must be refunded by the company within 1 month in accordance with the requirements of ss 724(1) and (2) of the *Corporations Act*.

The statement is false. Section 724 (1) of the *Corporation Act* allows 4 months from the date of issuing the prospectus for the refund of money to the applicants.
Learning objective 2.1

43. Any unpaid calls are accounted for as a receivable in a company's financial statements.

The statement is false. Unpaid calls/calls in arrears are accounted for as a reduction in share capital in a company's financial statements even though they are similar in nature to a receivable.
Learning objective 2.1

44. In the case of a share issue being oversubscribed, any amount kept by the company for future calls is credited to a Calls in Advance account, which is reported in the equity section of the statement of financial position.

The statement is true. Even though calls paid in advance are not legally part of share capital, they are not like normal unsecured liabilities, in that on liquidation, unsecured debts have priority over calls paid in advance, as per s 563A of the *Corporations Act*.
Learning objective 2.2

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45. If a company forfeits shares and the company's constitution is silent in relation to reissue of the shares, the company is entitled to keep any balance in the account after reissue, payment of unpaid calls and interest and administrative costs.

The statement is true. Such amounts from forfeited shares are typically retained in a forfeited shares reserve account.
Learning objective 2.3

46. Underwriting commission fees are treated as expenses as they are not considered to be an integral part of the equity issue transaction.

The statement is false. AASB 132/IAS 32 *Financial Instruments: Presentation* provides that such costs are to be accounted for as a reduction in the share capital being raised.
Learning objective 2.4

47. Share issue costs such as professional adviser's fees and brokerage fees must be reported as an expense in the income statement.

The statement is false. As these share issue costs are considered to be an integral part of the equity issue transaction, they are accounted for as a reduction in equity on the statement of financial position.
Learning objective 2.4

48. In accordance with AASB 138/IAS 38 *Intangible Assets*, company formation costs such as professional legal and accounting advice qualifies for recognition as an asset.

The statement is false. It is doubtful whether any future economic benefits will be obtained from such formation costs. As such, paragraph 69 of *AASB 138/IAS 38* does not permit them to be treated as an asset so they must be expensed.
Learning objective 2.4

49. A rights issue gives all existing shareholders the right to an additional number of shares in proportion to their current shareholding.

The statement is true. Rights issues are entitlements for existing shareholders to purchase new shares. If all shareholders choose to exercise their rights, the percentage ownership interest of the shareholders will not change relative to each other.
Learning objective 2.5

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50. If a company makes a renounceable rights issue, the shareholders are not allowed to sell their rights, but must either accept or reject the offer to purchase additional shares in the company.

The statement is false. The scenario described is that of a non-renounceable issue. Under the terms of a renounceable rights issue, shareholders may sell their rights to acquire the company's shares to other investors.
Learning objective 2.5

51. Section 124 of the *Corporations Act* places a restriction on the private placement of shares, limiting to 15% of existing capital the amount of capital that a company can issue in any one year without prior shareholder approval.

The statement is false. The 15% restriction on private placements of shares is set out in ASX Listing Rule 7.1, rather than in the *Corporations Act.* Therefore, the restriction applies only to listed entities.
Learning objective 2.5

52. Share options issued at no cost to the recipient are accounted for in the same way as a rights issue.

The statement is true. On exercise of the options, the company records a debit to Cash and a credit to share capital.
Learning objective 2.6

53. Where share options are issued and subsequently lapse, the cost of the lapsed options is transferred to a Lapsed Options Reserve account.

The statement is true. This is because the cost of the lapsed options does not qualify as 'income' or 'revenue' under the *Conceptual Framework*/Framework because options represent the issue of an equity instrument.
Learning objective 2.6

54. Redeemable preference shares are always considered to be compound financial instruments that contain both equity and liability components.

The statement is false. Redeemable preference shares may be classified as liabilities, equity or compound financial instruments. The classification depends on the rights of the preference shareholders as set out in the company's constitution.
Learning objective 2.7

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55. Only fully paid-up preference shares can be redeemed by a company.

The statement is true. This is a requirement of s 254K of the *Corporations Act*.
Learning objective 2.7

56. Share splits and share consolidations are only allowed if a company's constitution contains specific provisions relating to such transactions.

The statement is false. Section 254H of the *Corporations Act* permits such conversions to be undertaken provided a resolution is passed at a general meeting of the company's shareholders.
Learning objective 2.8

57. If a company uses its surplus cash reserves to buy-back its own shares, the total equity of the company will increase by the equivalent amount of cash spent.

The statement is false. If a company buys-back its own shares, the company's share capital is effectively reduced.
Learning objective 2.9

58. Debentures may be issued at a nominal value, a premium or a discount.

The statement is true. The issue price of the debentures depends on the current market rates for investments of similar risks.
Learning objective 2.10

59. Many investors may wish to purchase debentures or notes offering the ability to be converted into fully paid shares at the maturity date, in lieu of a cash payment.

The statement is true. These are known as convertible notes and their accounting treatment depends on the requirements of AASB 9/IFRS 9.
Learning objective 2.10

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60. According to the *Corporations Act,* dividends can only be paid out of the profits earned by a company.

The statement is false. Dividends can be paid providing the company has an excess of assets over liabilities immediately before the dividend is declared and the excess is sufficient for the payment of the dividend.
Learning objective 2.11

61. The Reserves accounts of a company are disclosed in the statement of financial position as liabilities.

The statement is false. Reserves are a component of the equity of a company.
Learning objective 2.12

62. The statement of changes in equity shows the movement between the beginning and ending balance for the period for each equity account.

The statement is true. The statement of changes in equity shows movements in share capital (if any) and movements in every reserve account.
Learning objective 2.12

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