Testbank

to accompany

Company Accounting 9e

by

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Chapter 2: Financing company operations

True/False Questions (20 in total)

1. It is only possible for a company to issue different types of preference shares if the rights of each type are specified in it's constitution.

The statement is True. This is a requirement of s 245A(2) of the Corporations Act.

Feedback: Section 2.1 Accounting for share issues

2. Prior to the allotment 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.

Feedback: Section 2.1 Accounting for share issues

3. If a company has not reached a minimum subscription within 90 days of the date of release of a disclosure document inviting applications for shares, the money paid in by applicants must be refunded by the company with in one month in accordance with the requirements of s 724(1) 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.

Feedback: Section 2.1 Accounting for share issues

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

The statement is False. Calls in arrears are accounted for as a reduction in share capital in a company's financial statements.

Feedback: Section 2.1 Accounting for share issues

5. In the case of a share issue being oversubscribed, and amount kept by the company for future calls is credited to a Calls in Advance account, which is reported as an addition to share capital in the financial statements.

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

Feedback: Section 2.1 Accounting for share issues

6. If a company forfeits shares and the company's constitution is silent in relation to reissue, 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 are typically retained in a reserve account.

Feedback: Section 2.3 Forfeiture and reissue of shares

7. Underwriting commission fees paid to underwriters 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 provides that such costs are to be accounted for as a reduction in the share capital being raised.

Feedback: Section 2.4 Share issue costs and formation costs

8. Professional adviser's fees and brokerage fees incurred in relation to an issue of shares are accounted for as an expense.

The statement is False. As these share issue costs are considered to be an integral part of the equity issue transaction, such costs are accounted for as a reduction in equity.

Feedback: Section 2.4 Share issue costs and formation costs

9. In accordance with AASB 138 Intangible Assets professional legal and accounting advice prior to the registration of a company qualifies for recognition as an asset.

The statement is False. There are no future economic benefits to be obtained from formation costs. As such, paragraph 69 of AASB 138 requires that they be expensed.

Feedback: Section 2.4 Share issue costs and formation costs

10. A rights issue gives existing shareholders a right to an additional number of new shares in proportion to the number of shares they currently own.

The statement is True. Rights issues are entitlements to new shares. If all shareholders choose to exercise their rights the percentage ownership interest of the shareholders will not change relative to each other.

Feedback: Section 2.5 Subsequent issues of equity shares

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

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

Feedback: Section 2.5 Subsequent issues of equity shares

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

The statement is False. The 15% restriction is not one set out in the Corporations Act, rather in ASX Listing Rules, therefore applying to listed entities only.

Feedback: Section 2.5 Subsequent issues of equity shares

13. Share options issued at no cost to the recipient are accounted for in the same way as rights issues.

The statement is True. The accounting rules differ for share options depending on whether they are issued for consideration or no consideration.

Feedback: Section 2.6 Share options

14. Where share options are issued and subsequently lapse, the cost of the lapsed options are transferred to a reserve account.

The statement is True. As the options were issued with the intention of the holders becoming equity holders, amounts are excluded from the definition of income in the *Framework*.

Feedback: Section 2.6 Share options

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

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

Feedback: Section 2.7 Redeemable preference shares

16. 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.

Feedback: Section 2.7 Redeemable preference shares

17. 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 allows such conversions to be undertaken provided a resolution is passed by a company's shareholders at a general meeting.

Feedback: Section 2.8 Conversion of shares

18. If a 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 effectively the shares capital of the company is reduced.

Feedback: Section 2.9 Share buy-backs

19. Debentures may be issued at a premium or discount.

The statement is True. This is different to shares, which are issued at nominal value.

Feedback: Section 2.10 Debentures

20. Convertible notes which will be converted to shares in the future are classified as equity.

The statement is False. The accounting treatment and classification of convertible notes depends on the requirements of AASB 139 *Financial Instruments: Recognition and Measurement*. Some convertible notes are classified as equity, others as liabilities and others as compound financial instruments.

Feedback: Section 2.10 Debentures

Multiple Choice (20 in total)

21. In respect to the issue of shares by a company, what is an IPO?

    a. Investment in Preference and Ordinary shares
    b. Initial Public Offering of shares
    c. Investment Prospectus for an issue of Options
    d. Instruments Providing Options to ordinary shareholders.

The correct answer is b.
Feedback: Section 2.1 Accounting for share issues

22. When a public share issue is made, the offer comes from:

    a. the company issuing the shares
    b. the Australian Securities and Investments Commission once it has reviewed the prospectus documentation
    c. the broker handing the share issue for the company
    d. the applicant.

The correct answer is d.
Feedback: Section 2.1 Accounting for share issues

23. The appropriate journal entry to record the cash collected from applicants for shares before the shares are issued is:

    a. Increase *Cash* account: Increase *Issued Share Capital* account
    b. Increase *Application* account: Decrease *Issued Share Capital* account
    c. Increase *Issued Share Capital* account: Decrease *Cash Trust* account
    d. Increase *Cash Trust* account: Increase *Application* account.

The correct answer is d.
Feedback: Section 2.1 Accounting for share issues

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

a.

Cash	Dr	X	
Application	Cr		X
Application	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	
Allotment	Cr		X
Allotment	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

The correct answer is d.
Feedback: Section 2.1 Accounting for share issues

Use the following information to answer questions 5–7.

ABC Ltd was registered as a corporation on 1 July 2012. On 4 July 2012, ABC Ltd issued a prospectus offering 100 000 ordinary shares at an issue price of $2.50 each, payable $1.50 on application and $1.00 on allotment.

Application closed on 1 August 2012 with the company having received applications for 110 000 shares. The shares were allotted on 15 August 2012, with the over-subscription amount being refunded to unsuccessful applicants. All allotment monies were received by 31 August 2012.

25. After application, and prior to allotment, the balance in the Application account would be:

a. $150 000 Debit
b. $150 000 Credit
c. $165 000 Debit
d. $165 000 Credit.

The correct answer is d.
Feedback: Section 2.1 Accounting for share issues

26. Following the allotment the balance in the Share Capital account would be:

    a. $100 000 Credit
    b. $250 000 Credit
    c. $100 000 Debit
    d. $250 000 Debit.

The correct answer is b.
Feedback: Section 2.2 Undersubscription and oversubscription

27. Following the allotment, the amount transferred from the Cash Trust account to the Cash account would be:

    a. $150 000
    b. $110 000
    c. $100 000
    d. $15 000.

The correct answer is a.
Feedback: Section 2.2 Undersubscription and oversubscription

28. The appropriate account to record any excess proceeds received and retained (not refunded) by a company from an oversubscription to a share offer application, is the:

    a. Share issue costs account
    b. Forfeited Shares account
    c. Share capital account
    d. Calls in advance account.

The correct answer is d.
Feedback: Section 2.

Use the following information to answer questions 9 to 11.

A company's capital consists 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, the call money received amounted to $22 500. No further payments were received, and on 31 October, the shares on which calls were outstanding were forfeited. On 15 November, the forfeited shares were reissued as paid to $1.50 for a payment of $1.00 per share. The appropriate cash amount from the reissue was received on 19 November. Costs of reissue amounted to $2 000. The company's constitution provided for any surplus on resale, after satisfaction of unpaid calls, accrued interest and costs, to be returned to the shareholders whose shares were forfeited.

29. 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

The correct answer is a.
Feedback: Section 2.3 Forfeiture and reissue of shares

30. The entry to record the reissue of forfeited shares is:

a.	Cash	Dr	5 000	
	Forfeited shares	Dr	2 500	
	Share capital – Ordinary	Cr		7 500
b.	Cash	Dr	2 500	
	Forfeited shares	Dr	2 500	
	Share capital – Ordinary	Cr		5 000
c.	Cash	Dr	5 000	
	Share capital – Ordinary	Cr		5 000
d.	Share capital	Dr	7 500	
	Forfeited shares	Cr		7 500

The correct answer is a.
Feedback: Section 2.3 Forfeiture and reissue of shares

31. The amount of the surplus payable to the shareholders whose shares were forfeited is:

a. $5 000
b. $500
c. $2 500
d. $3 000.

The correct answer is b.
Feedback: Section 2.3 Forfeiture and reissue of shares

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

    a. income
    b. liabilities
    c. equity
    d. expense.

The correct answer is b.
Feedback: Section 2.3 Forfeiture and reissue of shares

33. The costs of issuing equity effectively:

    a. reduce the proceeds from the equity issue
    b. increase the proceeds from the equity issue
    c. are borne by the underwriters of the equity issue
    d. are recognised as a deferred asset and carried forward in the balance sheet.

The correct answer is a.
Feedback: Section 2.4 Share issue costs and formation costs

34. Which of the following journal entries demonstrates the appropriate 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.

The correct answer is c.
Feedback: Section 2.4 Share issue costs and formation costs

35. Underwriting and other share issue costs paid to a broker or a financial institution should be reported in a balance sheet as:

    a. a liability
    b. an asset
    c. an increase in retained earnings
    d. a reduction of share capital.

The correct answer is d.
Feedback: Section 2.4 Share issue costs and formation costs

36. Without the prior approval of shareholders a company is restricted to private placements of shares, in any one year, of no more than:

    a. 5% of existing capital
    b. 10% of existing capital
    c. 15% of existing capital
    d. 20% of existing capital.

The correct answer is c.
Feedback: Section 2.5 Subsequent issues of equity shares

37. The bonus issue of shares has the following impact on the equity of a company

    a. total equity increases
    b. total equity decreases
    c. one equity account increases and another equity account decreases by an equal amount
    d. only the amount of issued share capital changes.

The correct answer is c.
Feedback: Section 2.5 Subsequent issues of equity shares

38.

    a. buy a certain number of shares in the company by a specified date at a stated price
    b. sell a certain number of shares in the company by a specified date at a stated 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.

The correct answer is a.
Feedback: Section 2.6 Share options

39. Bonacurso Limited issued 10 000 share options to subscribe for ordinary shares. The exercise price on the options was $3 per share. If all options were exercised on due date the following journal entry would be recorded:

a.	Share capital – Ordinary	Dr	30 000	
	Cash	Cr		30 000
b.	Share options – Ordinary	Dr	30 000	
	Share capital – Ordinary	Cr		30 000
c.	Share options reserve	Dr	30 000	
	Cash	Cr		30 000
d.	Cash	Dr	30 000	
	Share capital – Ordinary	Cr		30 000

The correct answer is d.
Feedback: Section 2.6 Share options

40. On 1 July 2012, a company redeemed its debenture liability of $100 000 using available cash on hand. The terms of the debenture issue provided that a premium of 10% was to be paid on redemption of the debentures. The entry to record the redemption is:

a.	Debentures	Dr	110 000	
	Redemption revenue	Cr		10 000
	Cash	Cr		100 000
b.	Debentures	Dr	110 000	
	Cash	Cr		110 000
c.	Debenture redemption expense	Dr	10 000	
	Debentures	Dr	100 000	
	Cash	Cr		110 000
d.	Debentures	Dr	100 000	
	Premium on redemption	Cr		10 000
	Cash	Cr		90 000

The correct answer is c.
Feedback: Section 2.10 Debentures

OTHER ASSESSMENT QUESTIONS (5 IN TOTAL)

41. *Easy*

Identify 5 common differences between ordinary and preference shares.

Some of the common areas in which there are differences between ordinary and preference shares are as follows:

> voting rights

> right to participate in surplus assets and profits

> right to receive cumulative or non-cumulative dividends

> right to receive payment of capital or dividends before other shares

> right to be redeemed at a certain time at the company's or the shareholder's option.

42. *Medium*

Summarise the steps involved in the issue of securities to the public.

When a company decides to issue securities to the public in order to raise funds it must proceed as follows.

(1) It must prepare a disclosure document, referred to as a prospectus, that contains all the information as required under the Corporations Act, and must obtain the consent of the directors to the document.
(2) It must then lodge the document with the Australian Securities and Investments Commission.
(3) The securities are then offered to the public.
(4) If necessary the prospectus must be amended.
(5) The company must hold all application money in trust until the securities are issued or the money refunded.
(6) Finally the company issues the securities if a minimum subscription has been achieved.

43. *Medium*

Outline 3 advantages to a company of a private placement. Also discuss a key disadvantage.

Three main advantages, as outlined by Bruce et al. (1991, pp. 131–2) are:

1. Speed – placements can be effected in a matter of days
2. Price – New shares can be priced close the market price
3. Direction – shares may be placed with friendly institutions.

The key disadvantage of a private placement is from the perspective of existing shareholders, in terms of a dilution of their ownership.

44. *Hard*

Explain why a company may hold excess money from an applicant for securities.

An investor may have applied for more shares than were allotted to that investor. In such case the company will be holding an excess of money received from the applicant. Also, an applicant for partly paid shares may pay the future calls in advance in the hope that the application will receive favourable treatment in the allotment process.

45. *Hard*

Discuss the effect that a bonus issue of shares may have on the share price of a company.

A bonus issue of shares is funded through a transfer from one equity account to another equity account and so does not increase or decrease total equity. However, the total number of shares on issue increases. Empirical research shows that share prices tend to increase as a result of a bonus issue. Explanations offered for this effect include that: it serves as an indicator of potential increases in dividends the increase in shares on issue acts as a defence against a hostile takeover bid it provides a tradeable non-cash return to shareholders.