Exam

Name___________________________________

MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.

1) The official recognition of shares for trading on a securities exchange is known as: 1) _______

A) redemption B) incorporation C) listing D) registration

Answer: C
Explanation: A)
B)
C)
D)

2) Holly Ltd decide to issue 100 000 ordinary shares at $2 each and require applicants to pay 50 cents for each share applied for on application. Applications are received for 120 000 shares. The journal entry to record the receipt of the application money is: 2) _______

A) Bank trust 200 000
Application 200 000

B) Bank trust 60 000
Application 60 000

C) Application 60 000
Bank trust 60 000

D) Bank trust 50 000
Application 50 000

Answer: B
Explanation: A)
B)
C)
D)

3) A request to make a further payment on the outstanding balance of a partly-paid share is referred to as a/an: 3) _______

A) dividend B) call C) allotment D) application

Answer: B
Explanation: A)
B)
C)
D)

4) A typical feature of debt financing is: 4) _______

A) the right to receive payments at agreed dates
B) the absence of an entitlement to return of capital, except on liquidation
C) the right to vote at the annual general meeting
D) the right to receive dividends

Answer: A
Explanation: A)
B)
C)
D)

5) Any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities is referred to as a/an: 5) ________

A) debt instrument
B) equity instrument
C) mortgage
D) none of the above

Answer: B
Explanation:
A)
B)
C)
D)

6) If a company grants options to its employees to acquire shares in the future, the journal entry to record the granting of the options is: 6) ________

A) Debit Cash
Credit Options
B) Debit Wages Expense
Credit Options
C) Debit Cash
Credit Share Capital
D) Debit Options
Credit Share Capital

Answer: B
Explanation:
A)
B)
C)
D)

7) Which of the following is <u>not</u> one of the criteria for a large proprietary company under the Corporations Act? 7) ________

A) consolidated revenue of at least $25 million
B) 50 or more full-time employees
C) total liabilities of greater than $5 million
D) end of financial year consolidated gross assets of at least $12.5 million

Answer: C
Explanation:
A)
B)
C)
D)

8) Company prospectuses must be lodged with: 8) ________

A) ASX
B) FRC
C) AASB
D) ASIC

Answer: D
Explanation:
A)
B)
C)
D)

9) When a company sells the right to buy a certain number of shares in the company at a pre-determined price at or up to some fixed time in the future, that right is known as a: 9) ________

A) bonus issue
B) redeemable preference share
C) call option
D) private issue

Answer: C
Explanation:
A)
B)
C)
D)

10) Which of the following are an example of a share issue cost? 10) _______

A) stamp duty
B) legal fees
C) registration fees
D) all of the above

Answer: D

Explanation: A)
B)
C)
D)

11) Calls in advance are classified in the company's financial statements as: 11) _______

A) revenue
B) assets
C) equity
D) liabilities

Answer: D

Explanation: A)
B)
C)
D)

12) When a shareholder is permitted to sell his or her right to participate in the purchase of shares in a new issue, it is known as a: 12) _______

A) private issue
B) renounceable right
C) call option
D) non-renounceable right

Answer: B

Explanation: A)
B)
C)
D)

13) White Ltd decides to forfeit 50 000 shares on which a call of 50 cents per share had not been paid. The amounts previously paid on the shares were $1 on application and 50 cents on allotment. The journal entry to record the forfeiture of the shares is: 13) _______

A)

Share capital	100 000	
Call		25 000
Forfeited shares		75 000

B)

Share Capital	100 000	
Call		75 000
Forfeited Shares		25 000

C)

Forfeited shares	100 000	
Call		25 000
Share capital		75 000

D)

Forfeited shares	100 000	
Call		25 000
Bank		75 000

Answer: A

Explanation: A)
B)
C)
D)

14) The buying back of a financial liability or equity instrument is referred to as: 14) _______

A) call
B) allotment
C) application
D) redemption

Answer: D
Explanation:
A)
B)
C)
D)

15) When there are applications for more shares than are available for purchase, it is referred as a/an: 15) _______

A) undersubscription
B) underwritten issue
C) oversubscription
D) forfeiture

Answer: C
Explanation:
A)
B)
C)
D)

16) The journal entry used to record money due on the allotment of shares is 16) _______

A) Debit Allotment
Credit Share Capital
B) Debit Bank
Credit Share Capital
C) Debit Share Capital
Credit Allotment
D) Debit Allotment
Credit Application

Answer: A
Explanation:
A)
B)
C)
D)

17) A form of debt which can be converted to shares after a set period of time is referred to as a: 17) _______

A) unsecured note
B) lease
C) mortgage
D) convertible note

Answer: D
Explanation:
A)
B)
C)
D)

18) The acronym ACN stands for: 18) _______

A) Annual Classification Number
B) Australian Classification Number
C) Australian Committee Number
D) Australian Company Number

Answer: D
Explanation:
A)
B)
C)
D)

19) Which of the following is a major advantage of public companies? 19) _______

A) being able to invite the public to invest in them through the subscription to share or debt capital
B) being subject to more government regulation than proprietary companies
C) being subject to less government regulation than proprietary companies
D) none of the above

Answer: A
Explanation: A)
B)
C)
D)

20) Which of the following is a characteristic of preference shares? 20) _______

A) they may have restricted voting rights
B) they have an entitlement to assets remaining after all obligations have been satisfied
C) they may be preferential as to return of capital
D) both A and C

Answer: D
Explanation: A)
B)
C)
D)

TRUE/FALSE. Write 'T' if the statement is true and 'F' if the statement is false.

21) According to AASB 132, the costs of issuing shares are expensed as incurred. 21) _______

Answer: True ✔ False
Explanation:

22) When a shareholder is permitted to sell his or her right to participate in the purchase of shares in a new issue it is known as a non-renounceable rights issue. 22) _______

Answer: True ✔ False
Explanation:

23) A *debt instrument* is any contract that evidences a residual interest in the assets of an entity after deducting all of its equities. 23) _______

Answer: True ✔ False
Explanation:

24) A request by a company to its shareholders to make a further payment on the outstanding balance of a partly paid share is known as a call. 24) _______

Answer: ✔ True False
Explanation:

25) Proprietary companies have the advantage of being able to invite the public to invest in them through the subscription to share or debt capital. 25) _______

Answer: True ✔ False
Explanation:

26) When an investor does not pay the calls by the due dates the company, if its constitution so authorises, may forfeit the shares. 26) _______

Answer: ✓ True False
Explanation:

27) An invitation to the public by a company to subscribe to its shares is called a constitution. 27) _______

Answer: True ✓ False
Explanation:

28) A company may, in its constitution, limit the number of shares the directors can issue. 28) _______

Answer: ✓ True False
Explanation:

29) When debentures are redeemed, the general journal entry includes a credit to the debenture liability account. 29) _______

Answer: True ✓ False
Explanation:

30) Allotment is an offer by a company to potential investors to apply for shares in the company. 30) _______

Answer: True ✓ False
Explanation:

31) The statement of financial position is also known as the profit and loss statement. 31) _______

Answer: True ✓ False
Explanation:

32) Providers of debt capital form part of the owners of a company. 32) _______

Answer: True ✓ False
Explanation:

33) The right to receive payments at agreed dates is a typical feature of debt. 33) _______

Answer: ✓ True False
Explanation:

34) A charge over specific property of the company which restricts the disposal of that property except with the consent of the lender is referred to as a floating charge. 34) _______

Answer: True ✓ False
Explanation:

35) The term "securities" covers shares, debt and accounts receivable. 35) _______

Answer: True ✓ False
Explanation:

36) The administration of the Corporations Act is the responsibility of the ASX. 36) _______

Answer: True ✓ False
Explanation:

37) A bonus issue represents to right to buy a certain number of shares in the company at some fixed time in the future. 37) _______

Answer: True ✔ False
Explanation:

38) An undersubscription is the situation that occurs when there are applications for more shares than are available for purchase. 38) _______

Answer: True ✔ False
Explanation:

39) A lease is an agreement whereby the lessor provides the lessee with the right to use an asset for an agreed period of time in return for a series of payments. 39) _______

Answer: ✔ True False
Explanation:

40) Limited liability refers to the liability of each member of a company with share capital to contribute up to the amount, if any, unpaid on the shares if called upon to do so. 40) _______

Answer: ✔ True False
Explanation:

41) When a company receives cash on application, it decreases the application account's credit balance. 41) _______

Answer: True ✔ False
Explanation:

42) The Corporations Act no longer requires companies to have an authorised capital or shares to have a par value. 42) _______

Answer: ✔ True False
Explanation:

43) Debt capital is a term used for long-term debt (borrowing) incurred by the company. 43) _______

Answer: ✔ True False
Explanation:

44) Under the Corporations Act 2001, proprietary companies can be classified as either public or private . 44) _______

Answer: True ✔ False
Explanation:

45) The acronym ASX stands for the Association of Safety Examiners. 45) _______

Answer: True ✔ False
Explanation:

ESSAY. Write your answer in the space provided or on a separate sheet of paper.

46) What is a rights issue?

Answer: It is usual for the constitution to contain a provision that any additional shares be first offered to the existing shareholders before being offered to the public. The existing shareholders have first right of purchase, so such issues are called rights issues. The shareholders would be entitled to a number of shares in proportion to their existing shareholdings; for example, a one-for-six rights issue means that the existing shareholders have rights to purchase an additional share for each six held. The new issue may be at the original price but would more likely be at a greater price in order to take advantage of any increased market price. The price would likely be a little less than the market price of the shares so as to encourage subscription. The new shares are in effect "allotted" to the existing shareholders, so the accounting entries are slightly simpler than the initial issue. The rights issue may be by payment in full or by instalments.

47) What are convertible notes and explain their accounting treatment?

Answer: Convertible notes are a form of debt which can be converted to shares after a set period of time. As discussed in the section on preference shares, some types of securities may have economic characteristics that combine features of debt and equity. AASB 132 requires that in certain circumstances financial instruments be decomposed into liability and equity components. Paragraph 29 illustrates how convertible debt may be decomposed into a financial liability and an equity instrument; the equity component represents a call option to convert the instrument into a fixed number of ordinary shares of the entity. The economic effect is similar to issuing a debt instrument simultaneously with an early settlement provision and rights to purchase ordinary shares, or issuing a debt instrument with detachable share purchase rights. However, once classified, these components remain unchanged for the remainder of the life of the compound instrument. This approach is justified by arguing that the conversion option is a complex combination of tax and other considerations and the likelihood of conversion will also change over time.

48) Describe the purpose and benefits of companies listing on a stock exchange.

Answer: For public companies the shares are transferable; that is, the owner may sell them to a third party. When the shares are transferred it is the owner of the shares who receives the proceeds. The transfer is usually (although not always) done through the medium of the Australian Securities Exchange (ASX). However, companies tend to want to have their shares listed on a stock exchange; listing is the official recognition of shares for trading on a securities exchange. In order for companies to have this privilege they must comply with various regulations and rules imposed by the stock exchange; these are referred to as the listing rules. The benefits to the company arise from the fact that listing provides a "market incentive" in the finance market. Investors are aware of the company and will be prepared to invest in any future issues of securities by the company, reducing the cost of any additional finance.

49) What is the difference between a company's constitution and the replaceable rules?

Answer: Another legal document that can be prepared and attached to the application is the company's constitution. This contains the rules for managing the internal affairs of the company, the responsibilities of the directors (the members of the governing body of the company, that is, the board) and their relationship to the shareholders. A company need not include a constitution, in which case the replaceable rules in the Corporations Act will apply. Section 141 provides a table of replaceable rules, which summarises sections of the Act relating to officers and employees, inspection of books, directors' meetings, meetings of members, shares and transfers of shares. However, a company can replace or discard any of the replaceable rules by passing a special resolution at a general meeting of the company. The replaceable rules will not apply to a small proprietary company with one member who is the sole director.

50) What are debentures and explain their accounting treatment?

Answer: A debenture is merely an acknowledgment of a debt. It is a legally binding agreement to repay money lent to the company. Debentures may be issued in units similar to shares (but frequently larger). By doing this the company is able to borrow funds from a number of investors (in a manner similar to a new share issue). Debentures may be listed or unlisted. Those who invest in the debentures issued by a company (debenture holders) are lending the company money; the company is the borrower. This "loan" will be for a period of time and will attract a rate of interest. The debenture holders will have their investment protected in at least two ways. First, the debenture will be secured by a charge over some of the company's assets. This charge will be fixed, relating to specific assets, or floating relating to the assets generally. A fixed charge over specific property of the company restricts the disposal of that property except with the consent of the lender. In contrast, a floating charge covering a class of assets permits disposal in the ordinary course of business (in the absence of specified events, such as default, which cause the charge to "crystallise" into a fixed charge over the assets). Secondly, there will be (unless exempted by law) an entity that serves as the trustee for the debenture holders, a person or an institution appointed to act on behalf of the debenture holders to protect their interests.

The accounting for a debenture issue is similar to that for a share issue: a prospectus is issued inviting offers (applications), which are then accepted (or not) by the company, at which stage a binding contract exists requiring the company to provide security over the debentures, pay interest, and repay them at the stated date.

51) Discuss the differences between ordinary and preference shares.

Answer: The most common types of shares are called ordinary shares. (They are called common stock in the United States.) Many companies, especially proprietary companies, will only have this class of share. The ordinary shareholders have an entitlement to assets remaining after all obligations have been satisfied. This is referred to as a residual interest and it relates to the net (that is, assets less liabilities) assets of the company. Ordinary shares form the basic "ownership" units for which members subscribe.

The preference shares will have some preferential right. For example, they could be entitled to a fixed amount of return (dividend) each year irrespective of whether or not a profit has been earned. If the company does not have the cash to pay these amounts, then it assumes a liability for the amounts due. Or they could be preferential as to return of capital in preference to (that is, before) the ordinary shareholders in the event that the company ceases to operate (is wound up). Or they could be both preferential as to income and capital return. They may be participating, which means that they are entitled to a fixed income return and they share with the ordinary shares in any remaining distributable profit. Sometimes preference shares are issued for a set period and on the expiration of this period the shareholders are paid back their capital or are able to convert their shares into ordinary shares. These shares are called redeemable preference shares. Because of their preferential rights, preference shares may have restricted voting rights.

52) Explain the characteristics of a company limited by guarantee.

Answer: The liability of the members is limited to a prearranged amount similar to any type of guarantee, although the amount is often nominal. Standards Australia Limited is an example of a company limited by guarantee. Its constitution states that members undertake to contribute up to a maximum amount of $100 towards obligations outstanding in the event of the company being wound up. Trading companies usually do not adopt this form and such companies are often encountered as clubs, non-profit charitable organisations or schools. It used to be possible for a company to be limited by shares and guarantee, but these too are rare and no new such companies can be formed.

53) Explain the concepts of oversubscription and undersubscription in relation to share issues.

Answer: The success of a share issue will depend on the economic conditions of the time. In a buoyant, confident economic climate it is likely that there would be applications for more shares than were available (being issued). In such a case, there is an oversubscription, in which case the shares would be allotted on some basis the directors had decided on. In accounting terms, the cash received would be in excess of that due so some would have to be returned or, if the terms of the issue permit (indicated in the prospectus), be used to pay the amounts that became due on allotment and/or calls. The share issue will normally be cancelled should the subscription fail to meet the minimum threshold as stipulated in the company's IPO prospectus.

Where the directors have misread the economic climate and there are too few applicants, there has been an undersubscription. Often this situation is avoided by the use of an underwriter (for example, a broking firm or a financial institution). The underwriter undertakes to take up any undersubscribed shares in return for an underwriting commission. In such situations there are no complications in respect of the accounting for the share issue. Where the underwriter takes up part of the issue, the share issue will be accounted for as a full issue (as above). Where there is an undersubscription the amount received (bank trust) will simply be a lower figure.

54) What are options and explain their accounting treatment?

Answer: A company may sell the right to buy a certain number of shares in the company at a pre-determined price at or up to some fixed time in the future. This right is called a company-issued call option. Where the company issues options for some valuable consideration, the amount received will increase the shareholders' equity. An option provides the recipient with the right, but not the obligation, to acquire a specified number of shares at a pre-determined price in the company. An option will usually be granted close to the prevailing market price and the recipient will exercise the option *only* if the market price exceeds the exercise price. If the option is exercised, share capital will increase. If the option is allowed to lapse, however, there will be no change in share capital. In the example above, the options account is an equity account. If the option holder exercises the option to acquire all the shares it will record an increase in equity arising from that transaction.

55) Describe the concepts of par value, premium and discount in relation to share issues.

Answer: Until the recent changes to the Corporations Act, when formed, a company was required to state its amount of capital and how it was comprised in respect of types of shares. This was referred to as the company's authorised capital, and the company could not issue capital in excess of that. In addition, each share had to be of a stated amount. This was the par value or nominal value of a share and was the value stated on the shares at the date of incorporation (most commonly $1 or 50 cents). The only funds a company receives from a share issue are those from the initial issue. It is the owners of the shares who receive any benefit from a subsequent increase in the value of those shares. Where the market value of shares is above the par value the company will want to take advantage of this and issue the shares for a price in excess of the par. This was referred to as issuing shares at a premium. If a company issued shares for less than the par value, then it was said to have issued shares at a discount.

1) C
2) B
3) B
4) A
5) B
6) B
7) C
8) D
9) C
10) D
11) D
12) B
13) A
14) D
15) C
16) A
17) D
18) D
19) A
20) D
21) FALSE
22) FALSE
23) FALSE
24) TRUE
25) FALSE
26) TRUE
27) FALSE
28) TRUE
29) FALSE
30) FALSE
31) FALSE
32) FALSE
33) TRUE
34) FALSE
35) FALSE
36) FALSE
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38) FALSE
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40) TRUE
41) FALSE
42) TRUE
43) TRUE
44) FALSE
45) FALSE

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The preference shares will have some preferential right. For example, they could be entitled to a fixed amount of return (dividend) each year irrespective of whether or not a profit has been earned. If the company does not have the cash to pay these amounts, then it assumes a liability for the amounts due. Or they could be preferential as to return of capital in preference to (that is, before) the ordinary shareholders in the event that the company ceases to operate (is wound up). Or they could be both preferential as to income and capital return. They may be participating, which means that they are entitled to a fixed income return and they share with the ordinary shares in any remaining distributable profit. Sometimes preference shares are issued for a set period and on the expiration of this period the shareholders are paid back their capital or are able to convert their shares into ordinary shares. These shares are called redeemable preference shares. Because of their preferential rights, preference shares may have restricted voting rights.

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Where the directors have misread the economic climate and there are too few applicants, there has been an undersubscription. Often this situation is avoided by the use of an underwriter (for example, a broking firm or a financial institution). The underwriter undertakes to take up any undersubscribed shares in return for an underwriting commission. In such situations there are no complications in respect of the accounting for the share issue. Where the underwriter takes up part of the issue, the share issue will be accounted for as a full issue (as above). Where there is an undersubscription the amount received (bank trust) will simply be a lower figure.

54) A company may sell the right to buy a certain number of shares in the company at a pre-determined price at or up to some fixed time in the future. This right is called a company-issued call option. Where the company issues options for some valuable consideration, the amount received will increase the shareholders' equity. An option provides the recipient with the right, but not the obligation, to acquire a specified number of shares at a pre-determined price in the company. An option will usually be granted close to the prevailing market price and the recipient will exercise the option *only* if the market price exceeds the exercise price. If the option is exercised, share capital will increase. If the option is allowed to lapse, however, there will be no change in share capital. In the example above, the options account is an equity account. If the option holder exercises the option to acquire all the shares it will record an increase in equity arising from that transaction.

55) Until the recent changes to the Corporations Act, when formed, a company was required to state its amount of capital and how it was comprised in respect of types of shares. This was referred to as the company's authorised capital, and the company could not issue capital in excess of that. In addition, each share had to be of a stated amount. This was the par value or nominal value of a share and was the value stated on the shares at the date of incorporation (most commonly $1 or 50 cents). The only funds a company receives from a share issue are those from the initial issue. It is the owners of the shares who receive any benefit from a subsequent increase in the value of those shares. Where the market value of shares is above the par value the company will want to take advantage of this and issue the shares for a price in excess of the par. This was referred to as issuing shares at a premium. If a company issued shares for less than the par value, then it was said to have issued shares at a discount.